

Have you impaired your independence by performing nonattest services for your attest clients?

Professional Ethics Quiz

Periodically, the Professional Ethics Division submits questions on varying ethics topics that AICPA members have questioned. This set of questions relates specifically to the revised Interpretation 101-3 *Performance of Nonattest Services*, as described in the Code of Professional Conduct (AICPA Professional Standards).(see **endnote**¹)

In September 2003, the Professional Ethics Executive Committee (PEEC) issued revisions to Interpretation 101-3, updating the independence rules to clarify whether or not a member impairs his or her independence when providing nonattest services to attest clients. The revisions to Interpretation 101-3 clarify existing guidance in the areas of bookkeeping and internal audit services, place further restrictions on valuation, appraisal, and actuarial services and information systems design and implementation, and strengthen the general requirements (**see endnote**¹) of the rule to require that a member document his or her understanding with the client regarding the services to be performed. The revised interpretation takes effect for any new engagements which began after December 31, 2003; however, the documentation requirement included in the revised interpretation has been deferred and will take effect for any nonattest services performed for an attest client after December 31, 2004. Earlier application is always encouraged. You can view the code and any other related information on the Institute's Web site at: www.aicpa.org/members/div/ethics/index.htm

IMPORTANT NOTE:

For the following questions, it is assumed that the member is in compliance with all applicable provisions of Interpretation 101-3 (for example, the general requirements) unless specifically identified otherwise and that the client in question is an attest client that is not required to file with the Security and Exchange Commission.

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

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

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

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

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

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

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

No, because the member would not be considered coding transactions.

5. **A member is engaged to perform an audit, review or compilation of a client's financial statements. During the course of the audit, review or compilation the member proposes audit adjustments to the financial statements. Examples of these entries include the current tax accrual and deferred tax assets or liabilities and the amount of depreciation and amortization necessary for the current year. The client reviews these entries and understands the impact on its financial statements and records the adjustments identified by the member. Would the proposal of such entries constitute a nonattest bookkeeping service subject to Interpretation 101-3?**

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

6. **A member is engaged to perform an audit for a client who records all transactions on a cash basis in its general ledger. During the audit process, the member identifies all appropriate journal entries required to convert the client's general ledger to an accrual basis and prepares the financial statements, including footnotes, on the accrual basis in order to conform with generally accepted accounting principles. The client reviews the entries and financial statements, including all footnote disclosures, and understands the impact these entries have on the financial statements. As part of the management representation letter, the client acknowledges responsibility for the financial statements and footnotes. Would these services be considered nonattest bookkeeping service subject to Interpretation 101-3?**

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

7. **The member performs year end tax planning and prepares the tax returns for an attest client. Would these services be considered nonattest services and therefore subject to the requirements of Interpretation 101-3?**

Yes, tax services are considered nonattest services and are therefore subject to the general requirements of Interpretation 101-3, including the member's understanding with the client with respect to the tax services must be documented in writing.

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

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

9. **General Requirement No. 3 of Interpretation 101-3 requires that the member should establish and document in writing his or her understanding with the client regarding the a) objectives of the engagement; b) services to be performed; c) client's acceptance of its responsibilities; d) member's responsibilities; and e) any limitations of the engagement. Would a member be in compliance with this requirement if such was documented in; an engagement letter; the audit planning memo or in a memo of understanding maintained in the member's billing files.**

Yes, however since the general requirements of Interpretation 101-3 only require a member to document his or her understanding with the client and does not indicate any specific method of documentation the methods indicated are not all inclusive and other methods may be appropriate as well.

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

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

11. **A member performing bookkeeping services records adjusting and reclassification journal entries and compiles preliminary financial statements. The member delivers the financial statements and compilation report to the client and provides the client copies of the general ledger, journals and journal entries, which contain a description of the nature of each entry. The member asks the client to review the journal entries and then asks whether the client has any questions about any of the entries. Would the requirements of Interpretation 101-3 be met?**

Yes. Provided the member is satisfied that client understands the nature and impact of the journal entries, the requirements of Interpretation 101-3 would be met.

12. **Must the member review the proposed journal entries with the client and explain their impact on the financial statements with the client in person or can this review take place by phone, fax, mail or email?**

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

13. Must the member document the client’s review of the journal entries?

Interpretation 101-3 does not require that the member document the client’s review of the journal entries. However, the member may wish to document the name of the client representative who reviewed the journal entries and the date of his or her review to provide evidence that such review took place.

14. Interpretation 101-3 requires that the client designate an individual who possesses suitable skill, knowledge and/or experience, preferably within senior management, to oversee the nonattest services. Which individual(s) at the client can serve in this capacity (e.g., the owner(s), controller, bookkeeper)?

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

15. My client has difficulty understanding deferred tax assets and deferred tax liabilities? What must a client know about these concepts in order to be considered to possess the skill, knowledge, and/or experience necessary to fulfill the requirement(s) under Interpretation 101-3?

The intent of Interpretation 101-3 is not for the client to possess a level of technical expertise commensurate with that of the member. In the case of deferred taxes, the client should understand the basis for the deferred tax assets or liabilities and the impact of the deferred taxes on the financial statements.

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

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

17. Deleted due to revisions made to Interpretation 101-3.

- 18. A member's firm does not require its clients to sign engagement letters for tax return preparation services. How does the documentation requirement under Interpretation 101-3 apply with respect to these clients?**

Tax services are nonattest services subject to the requirements of Interpretation 101-3. Therefore, the documentation requirement applies where the member provides tax services to a client for which the member also provides attest services.

However, the method of documentation is left to the member's discretion and, provided it contains all of the required elements, it could be documented in a tax organizer or disclosure statement provided to the client, in a memo in the tax or attest service working papers, or through other means.

- 19. Does Interpretation 101-3 apply where the member prepares the personal tax returns of the owners and officers of an audit, review or compilation client? Does it matter whether the owners or officers pay for the services themselves or whether the client pays for the services as an executive perk?**

If the personal tax returns are prepared without having to rely on representations of the client, then Interpretation 101-3 would not apply. The mere fact that the client pays for the services would also not cause Interpretation 101-3 to apply.

- 20. A member provides temporary "controllorship services" and various types of other temporary accounting services for clients during client maternity leaves, illness, and sudden departures. Do these activities impair independence under Interpretation 101-3?**

These services would be subject to Interpretation 101-3. If a member performs controller-type activities, independence would be impaired since such activities typically involve the performance of management functions or the supervision of client employees. However, if the member performs temporary accounting and other services in compliance with the requirements of Interpretation 101-3, independence would not be impaired. The member should also consider whether the duration or regularity of the services might appear to impair independence. Having the title of controller would impair independence regardless of the actual services performed.

- 21. As part of performing bookkeeping services, a member records adjusting journal and reclassification entries and prepares the client's preliminary financial statements. The member does not review each and every journal entry with the client but rather, the member describes the nature of the journal entries and their impact on the preliminary financial statements. The client approves the preliminary financial statements and issues them to its bank. Would the requirements of Interpretation 101-3 be met?**

Yes, provided all of the other requirements of Interpretation 101-3 are met.

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

A management function would generally include doing or having the authority to –

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

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

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

23. Would assisting a client in applying [FASB Interpretation \(FIN\) No. 48, Accounting for Uncertainty in Income Taxes](#), such as identifying potential uncertain tax positions, advising the client whether those tax positions meet the more-likely than not (MLTN) threshold, and calculating the related unrecognized tax benefits impair independence?

The provision of such services would not impair independence provided the client can make an informed judgment on the results of the member’s services and the other requirements of Interpretation 101-3 are met. In meeting the requirements of Interpretation 101-3, the member may assist the client in understanding why the tax positions do or do not meet the MLTN threshold and the basis for any unrecognized tax benefit so that the client can accept responsibility for the amounts reported and disclosed in the financial statements. (FAQ added July 2007)

24. Would a member’s independence be considered impaired if a member performed services that would impair independence under Interpretation 101-3 during the period covered by the financial statements but prior to the period of the professional engagement?

Interpretation 101-3 states that in cases where the requirements of the Interpretation have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired. However, independence would not be considered impaired

provided the services (i) do not constitute management functions, (ii) were performed prior to the period of the professional engagement, (iii) relate solely to financial statements of the prior period, and (iv) those financial statements were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm). See frequently asked question number 22 above and the Conceptual Framework for AICPA Independence Standards for further guidance on what would constitute a management function. (FAQ added November 2007)

Endnotes

ⁱ This quiz is based on responses of the AICPA professional ethics division staff to members' inquiries and recent changes to the independence guidance of the professional ethics executive committee. It is not a pronouncement of that committee nor does it purport to set forth an official position of the AICPA. In addition, the questions and answers do not address the requirements of other regulatory bodies, such as the state boards of accountancy, the Securities and Exchange Commission and the General Accounting Office whose positions may differ from those of the AICPA.

ⁱⁱ The General Requirements for Performing Nonattest Services are:

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 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* 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. **

General requirements no. 2 and no. 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.

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- * 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.]

 - ** 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.