AICPA Plain English Guide to Independence
Notice to Readers

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Preface

Purpose of This Guide

The purpose of the AICPA Plain English Guide to Independence is to help you understand 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 use the term rules broadly to mean rules, standards, interpretations, 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 them with greater confidence and ease.

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

Conventions and Key Terms

This guide uses the following conventions to enhance your reading:

- The word “Note” in boldface italics emphasizes important points, highlights applicable government regulations, or indicates a rule change may soon occur.
- The AICPA interpretations to the code are linked the first time they appear in a chapter.
- Terms that are defined in the code appear in italic. The first time a defined term appears in a chapter, it will also be linked.
- Internet addresses (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 section “Where Can I Find Further Assistance with My Independence Questions?” in chapter 11, “Further Assistance,” of this guide.)

We describe the rules of the SEC and the PCAOB—that is, those that apply to audits of SEC registrants and issuers—in boxed text (like this one) and provide citations to specific rules. Generally, we provide these descriptions when the SEC and the PCAOB impose either additional requirements or their rules otherwise differ from the AICPA rules.

For purposes of this guide, a **SEC registrant** is an issuer filing an initial public offering, a registrant filing periodic reports under the securities laws, a sponsor or manager of an investment fund, or a foreign private issuer that is (or is in the process of becoming) an SEC registrant. In this guide, **SEC audit client** means an SEC registrant and its affiliates, as defined in the SEC rules.

For purposes of this guide, an **issuer** is an entity filing an initial public offering, a registrant filing periodic reports under the securities laws, a sponsor or manager of
an investment fund, or a foreign private issuer that is (or is in the process of becoming) an SEC registrant. In this guide, *SEC audit client* means an *SEC registrant* and its *affiliates*, as defined in the SEC rules.

*Note:* The auditors of all registered broker-dealers must be registered with the PCAOB.
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Chapter 1—Introduction

What Is Independence?

Independence is defined as follows:

a. Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

b. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party, who has knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.

This definition should not be interpreted as an absolute. For example, the phrase “without being affected by influences that compromise professional judgment” is not intended to convey that the member must be free of all influences that might compromise objective judgment. Instead, the member should determine whether such influences, if present, create a threat that is not at an acceptable level that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement or would be perceived as not being able to do so by a reasonable and informed third party with knowledge of all relevant information.

This definition reflects the long-standing 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 “Conceptual Framework for Independence” interpretation recognizes that it is impossible for the AICPA Code of Professional Conduct (the code) to identify all circumstances in which the appearance of independence might be questioned.

When threats to independence are not at an acceptable level, the member must apply safeguards to eliminate the threats or reduce them to an acceptable level. If threats to independence are not at an acceptable level and require the application of safeguards, the member must document the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level. Failure to prepare the required documentation would be considered a violation of the “Compliance With Standards Rule” (AICPA, Professional Standards, ET sec. 1.310.001) rather than the “Independence Rule” if the member can demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.
The “Conceptual Framework for Independence” interpretation provides a valuable tool to help you comply with the “Independence Rule” when a specific circumstance or relationship is not addressed in the code. To assist with implementing the interpretation, the Professional Ethics Division developed a toolkit.

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 the “Independence Rule” whenever your firm performs an attest engagement for an attest client.

A compilation is an attest engagement. Although performing a compilation of an attest client’s financial statements does not require independence, if a non-independent firm issues a compilation report, the accountant is required to indicate the accountant’s lack of independence in a final paragraph of the accountant’s compilation report, pursuant to paragraph .22 of AR-C section 80, Compilation Engagements (AICPA, Professional Standards).

You and your firm are not required to be independent to perform services that are not attest services (for example, financial statement preparation, tax preparation or advice or consulting services, such as personal financial planning) if they are the only services your firm provides to a 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 sets independence rules that apply to entities audited under Government Auditing Standards (also referred to as the Yellow Book). For these clients (and others, such as those subject to regulation by the SEC or Department of Labor), you and your firm also must comply with the independence rules established by those agencies.

The SEC regulates SEC registrants and issuers and establishes the qualifications of independent auditors. This guide refers to these independence rules as SEC rules.

The PCAOB, a private standard-setting body whose activities are overseen by the SEC, is authorized to set, among other things, auditing, attestation, quality control, ethics, and independence standards for accounting firms that audit issuers and broker dealers. The PCAOB adopted interim ethics standards based on the following provisions of the code, as in existence on April 16, 2003, to the extent not superseded or amended by the board:

- Rule 102, Integrity and Objectivity
- Rule 101, Independence
- Interpreta tions and rulings under Rules 102 and 101

It also adopted Independence Standards Board (ISB) Independence Standard No. 2, Certain Independence Implications of Audits of Mutual Funds and Related Entities, and No. 3, Employment with Audit Clients, as well as ISB Interpretation 99-1, Impact on Auditor Independence of Assisting Client in the Implementation of FAS 133. 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 function in the role of management, audit his or her own work, serve in an advocacy role for the client, or have a mutual or conflicting role with the client.

Other organizations establish independence requirements that may be applicable to you and your firm. You should contact the following 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.
Chapter 2—Applying the Rules—Attest Client and Affiliates

Do I Need to Remain Independent From Just My Attest Client or From Other Entities As Well?

Although we think of our attest clients as the entity for which we are performing an attest engagement, in some instances, you will need to remain independent from other entities. Specifically, if the engaging party is not the entity you are performing the attest engagement on, the AICPA Code of Professional Conduct (the code) requires that you also remain independent of the engaging party.

In addition, the code requires you to remain independent of affiliates of any financial statement attest client. A financial statement attest client is considered to be any entity whose financial statements are audited, reviewed, or compiled when the member's compilation report does not disclose a lack of independence.

What Entities Are Considered Affiliates of My Financial Statement Attest Client?

The “Client Affiliates” interpretation (AICPA, Professional Standards, ET sec. 1.224.010) of the “Independence Rule” (AICPA, Professional Standards, ET sec. 1.200.001) requires that when a client is a financial statement attest client, members should apply the “Independence Rule” and related interpretations applicable to the financial statement attest client to their affiliates.

The following entities will need to be considered affiliates of your financial statement attest client:

a. An entity (for example, subsidiary, partnership, or LLC) that a financial statement attest client can control.

b. An entity in which a financial statement attest client or an entity controlled by the financial statement attest client has a direct financial interest that gives the financial statement attest client significant influence over such entity and is material to the financial statement attest client.

c. An entity (for example, parent, partnership, or LLC) that controls a financial statement attest client when the financial statement attest client is material to such entity.

d. An entity with a direct financial interest in the financial statement attest client when that entity has significant influence over the financial statement attest client, and the interest in the financial statement attest client is material to such entity.

e. A sister entity of a financial statement attest client if the financial statement attest client and sister entity are each material to the entity that controls both.

f. A trustee that is deemed to control a trust financial statement attest client that is not an investment company.

g. The sponsor of a single employer employee benefit plan financial statement attest client.

h. Any entity, such as a union, participating employer, or a group association of employers, that has significant influence over a multiemployer employee benefit plan financial statement attest client and the plan is material to such entity.
i. The participating employer that is the plan administrator of a multiple employer employee benefit plan financial statement attest client.

j. A single or multiple employer employee benefit plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client. All participating employers of a multiple employer employee benefit plan are considered sponsors of the plan.

k. A multiemployer employee benefit plan when a financial statement attest client or entity controlled by the financial statement attest client has significant influence over the plan and the plan is material to the financial statement attest client.

l. An investment adviser, a general partner, or a trustee of an investment company financial statement attest client (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

What Do I Do If a Financial Statement Attest Client’s Affiliates Can’t Be Identified?

If after expending your best efforts to obtain the information to identify the affiliates of a financial statement attest client, you are unable to do so, all the following steps must be taken:

- Discuss the matter, including the potential effect on independence, with those charged with governance.
- Document the results of the discussion with those charged with governance.
- Document the efforts taken to obtain the information to identify the affiliates of the financial statement attest client.
- Obtain written assurance from the financial statement attest client that it is unable to provide the member with the information necessary to identify its affiliates.

What If My Financial Statement Attest Client Is Acquired After I Begin the Engagement?

Although the interpretation requires members to apply the independence provisions applicable to their financial statement attest clients to any affiliates, it was determined that an exception was necessary when a financial statement attest client is acquired while you are performing an attest engagement. The exception would only be applicable if the attest engagement covers periods prior to the acquisition and provided you will not continue to perform financial statement attest services to the acquirer.

Are There Any Other Exceptions to the Affiliate Rules?

It was also deemed appropriate that members need not apply the independence provisions applicable to their financial statement attest clients to any affiliates in four other situations.

The first situation involves loans and applies to all affiliates. The code currently prohibits a covered member from making a loan to, or having a loan from, an individual who is an officer, a director, or a 10 percent or more owner of an attest client. If this provision were applied to affiliates any time a member had a loan to or from an individual, especially one that is only an investor and not in a position of governance, he or she would need to take steps to ensure the individual was not in one of these positions at an affiliate. Accordingly, the exception concludes that only when the covered member has knowledge that the individual is in such a position with an affiliate of a financial statement attest client,
the covered member should be required to consult the “Conceptual Framework for Independence” interpretation (AICPA, Professional Standards, ET sec. 1.210.010), because without knowledge, the familiarity, undue influence, and financial self-interest threats would be at an acceptable level.

The second, third, and fourth exceptions may not be applied by those described as an affiliate under (a) or (b); rather, they may only be applied to those described as an affiliate under (c)–(j).

The next exception involves the provision of prohibited nonattest services (that is, nonattest services that would impair a member’s independence). Specifically, when it is reasonable to conclude that the prohibited nonattest services do not create a self-review threat because the results of the nonattest services will not be subject to financial statements attest procedures, and any other threats that are created by the provision of the nonattest service (for example, management participation threats) that are not at an acceptable level are eliminated or reduced to an acceptable level by the application of safeguards, members should not be prohibited from providing these services to entities described as an affiliate under (c)–(j). This exception does not apply to those entities described as an affiliate under (a) or (b).

The third exception involves subsequent employment at an affiliate. The code (that is, the “Subsequent Employment or Association With an Attest Client” interpretation [AICPA, Professional Standards, ET sec. 1.279.020]) requires the application of specific safeguards when a former partner or employee becomes employed at an attest client in a key position. Under the interpretation, if no exception were provided, these safeguards would need to be applied when a former partner or employee becomes employed or associated with an affiliate in a key position. It was determined that it is not necessary to apply these safeguards to entities described as an affiliate under (c)–(j) if the individual’s position does not allow the individual to be in a key position with respect to the financial statement attest client. Again, this exception does not apply to those entities described as an affiliate under (a) or (b).

The final exception involves immediate family members and close relatives who are employed at those entities described as an affiliate under (c)–(j). Similar to the third exception previously described, covered members need only be concerned with employment positions their immediate family members and close relatives have with such affiliates when these positions put them in a key position with respect to the financial statement attest client at those defined as an affiliate under (a) and (b).

Is There Any Additional Guidance to Help Me Understand How to Apply the Affiliate Definition and Related Interpretation?

The Ethics Division issued a nonauthoritative frequently asked questions (FAQ) document, “Application of the Independence Rules to Affiliates of Employee Benefit Plans.” The FAQ document is designed to help you better understand how the definitions and guidance provided in the “Client Affiliates” interpretation apply to affiliates of employee benefit plans subject to the Employee Retirement Income Security Act.
Is There a Visual Aid to Help Me Understand the Affiliate Definitions?

A visual aid was created to help explain how the first five entities, (a)–(e) identified in the affiliate definition, could be related to Entity Z, the financial statement attest client. The letters used in the visual aid correspond with the letters used in the affiliate definition.

![Visual Aid Diagram]

**Legend:**
- Financial Statement attest client
- Affiliate of a Financial Statement Attest Client
- Not an affiliate of a Financial Statement Attest Client

**First Five Entities**

- **A** (Subsidiary)
  - A2 is material to Z

- **B** (Investee)
  - Z has significant influence over B and Z is material to B

- **C**
  - C1 is not C2’s sister
  - C2 is not material to X

- **D** (Investor)
  - D has significant influence over Z and Z is material to D

- **E**
  - E is material to C2

- **F**
  - F is Z’s sister

- **G**
  - G is material to E

- **H**
  - H is material to G

- **I** (Investor)
  - I has significant influence over Z and I is material to Z

- **J**
  - J is not a financial statement attest client

- **K**
  - K is material to C2

- **L**
  - L is a financial statement attest client

- **M**
  - M is material to L

- **N**
  - N is not a financial statement attest client

- **O**
  - O is material to N

- **P**
  - P is not a financial statement attest client

- **Q**
  - Q is material to P

- **R**
  - R is not a financial statement attest client

- **S**
  - S is material to R

- **T**
  - T is not a financial statement attest client

- **U**
  - U is material to T

- **V**
  - V is not a financial statement attest client

- **W**
  - W is material to V

- **X**
  - X is not material to W

- **Y** (Investor)
  - Y has significant influence over Z but Z is not material to Y

- **Z**
  - Z is material to K and I

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Is There an Executive Summary of the Interpretation?

<table>
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<th>Type of relationship</th>
<th>Affiliate A</th>
<th>Affiliate B</th>
<th>Affiliate C</th>
<th>Affiliate D</th>
<th>Affiliate E</th>
<th>Affiliate F</th>
<th>Affiliate G</th>
<th>Affiliate H</th>
<th>Affiliate I</th>
<th>Affiliate J</th>
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</tr>
</tbody>
</table>

**Tick Mark Key**

**P:** The independence provisions contained in the AICPA Code of Professional Conduct should be applied to this affiliate.

**PS:** A member may have a loan to or from an individual who is an officer, a director, or a 10 percent owner of an affiliate; however, if the covered member has knowledge of the individual’s relationship with the affiliate, he or she should consult the "Conceptual Framework for Independence" interpretation (AICPA, Professional Standards, ET sec. 1.210.010).

**A:** The firm will have to apply safeguards outlined in paragraph .02 of the “Subsequent Employment or Association With an Attest Client” interpretation (AICPA, Professional Standards, ET sec. 1.279.020), if the former employee is in a key position at the affiliate. Even if position is a non-key position, when considering employment, the individual must report the consideration to the appropriate person in the firm and be removed from the engagement.

**R:** Immediate family members and close relatives of a covered member may be employed at an affiliate, as long as their position does not put them in a key position with respect to the financial statement attest client.

**NSA:** Services are permitted if not subject to audit; see the second exception for details.

**N/A:** The relationship is not applicable.

**Affiliate Definitions**

**Affiliate A:** Entity that a financial statement attest client can control.

**Affiliate B:** An entity in which a financial statement attest client or an entity controlled by the financial statement attest client has a direct financial interest that gives the financial statement attest client significant influence over such entity and is material to the financial statement attest client.

**Affiliate C:** An entity that controls a financial statement attest client when the financial statement attest client is material to entity.

**Affiliate D:** An entity with a direct financial interest in the financial statement attest client when that entity has significant influence over the financial statement attest client, and the interest in the financial statement attest client is material to such entity.

**Affiliate E:** Sister entity of a financial statement attest client if the financial statement attest client and sister are material to the entity that controls both.

**Affiliate F:** Trustee that is deemed to control a trust financial statement attest client that is not an investment company.

**Affiliate G:** Sponsor of a single employer employee benefit plan financial statement attest client.

**Affiliate H:** Union or participating employer having significant influence over a multiple or multiemployer employee benefit plan financial statement attest client.

**Affiliate I:** Employee benefit plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client.

**Affiliate J:** Investment adviser, general partner, and trustee of an investment company financial statement attest client (the fund) if the fund is material to the investment adviser, general partner, or trustee, and they are deemed to have either control or significant influence over the fund.
Chapter 3—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 attest client. You are a covered member if you are any of the following:

a. An individual on the client’s attest engagement team
b. An individual in a position to influence the attest engagement
c. A partner, partner equivalent, or manager who provides more than 10 hours of nonattest services to the attest client
d. A partner or partner equivalent in the office in which the lead attest engagement partner primarily practices in connection with the client’s attest engagement
e. The firm, including the firm’s employee benefit plans
f. An entity whose operating, financial, or accounting policies can be controlled by any of the individuals or entities described in items (a)–(e) or by two or more such individuals or entities if they act together.

The SEC uses the term covered person 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 (the 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.

1 See Rule 2-01(f)(11). Also, see the definition of covered persons in the firm in Section IV(H)(9) of the SEC’s Final Rule Release, Revision of the Commission’s Auditor Independence Requirements.
Do Any of the Rules Apply to Me If I Am Not a Covered Member?

Yes, these rules apply in certain circumstances, even if you are not a covered member. Due to their magnitude, two categories of relationships 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 5 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. The 5 percent prohibition also extends to immediate family members. See paragraph .03 of the “Overview of Financial Interests” interpretation (AICPA, Professional Standards, ET sec. 1.240.010) for further details.

What If I Was Formerly Employed by an Attest Client or I Was a Member of the Attest Client’s Board of Directors?

You must be aware of a number of things, including the following:

a. 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 you were associated with the attest client. So, for example, if you worked for the attest client during its 2015 fiscal year, you would be prohibited from serving on the attest client’s audit engagement for the fiscal year 2015 financial statements. You also could not serve in a position that would allow you to influence the fiscal year 2015 engagement (for example, you could not directly or indirectly supervise the audit engagement partner).

b. Before becoming a covered member, you must do the following:
   
i. Dispose of any direct financial interests or material indirect financial interests in the attest client.²

   ii. Collect and repay all loans to or from the attest client (except those specifically permitted or grandfathered³).

   iii. Cease active participation in the attest client’s employee health and welfare plans (except for benefits under the Consolidated Omnibus Budget Reconciliation Act of 1985).

   iv. Cease to participate in all other employee benefit plans by liquidating or transferring all vested benefits in the attest client’s defined benefit plans, defined contribution plans, share-based compensation arrangements, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. When the covered member does not participate on the attest engagement team or is not an individual in a position to

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² See the section “When Do My (or My Family’s) Financial Interests Impair Independence?” in chapter 6, “Financial Relationships,” of this guide.

³ Also, see the “Loans and Leases With Lending Institutions” interpretation (AICPA, Professional Standards, ET sec. 1.260.020).
influence the attest engagement, he or she is not required to liquidate or transfer any vested benefits if such an action is not permitted under the terms of the plan or if a penalty significant to the benefits is imposed upon such liquidation or transfer.

v. Assess if you have any other relationships with the attest client to determine if such relationships create threats to independence that would require the application of safeguards to reduce the threats to an acceptable level. See the “Former Employment or Association With an Attest Client” interpretation (AICPA, Professional Standards, ET sec. 1.277.010) for further details.

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 attest client to the appropriate person in your firm. You cannot participate in the engagement until your negotiations with the attest client end. See the “Considering Employment or Association With an Attest Client” interpretation (AICPA, Professional Standards, ET sec. 1.279.010) for further details.

What If I Accept Employment or a Board Position With an Attest Client?

Being employed by an attest client or member of the attest client’s board of directors impairs independence. However, even if you leave your firm to take a position with an attest client, independence still may be affected. This would be the case if you accept a key position with the attest client, which means you prepare financial statements or accounting records or are otherwise able to influence the attest client’s statements or records. A few examples of key positions are controller, CFO, or treasurer. Remember that the substance, not only the position title, determines whether a position is considered “key.”

If you meet the following conditions, having a key position with an attest 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 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 attest client has not compromised the firm’s independence and that independence will be maintained going forward. The firm should consider

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4 A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed, or market losses that may be incurred, as a result of the liquidation or transfer.

5 See the section “What Should I Do If No Specific Guidance Exists on My Particular Independence Issue?” in chapter 1, “Introduction,” of this guide.
• 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 attest client.
• 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 that it has sufficient stature and experience to deal effectively with you in your new position.
• 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.\(^6\)

See the “Subsequent Employment or Association With an Attest Client” interpretation (AICPA, Professional Standards, ET sec. 1.279.020) for further details.

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 the following:

• A capital balance with the firm
• A financial arrangement with the firm (for example, retirement benefits) that is not fully funded by the firm
• Influence over the firm’s operations or financial policies

The SEC uses the terms accounting role and financial reporting oversight role\(^7\) 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 of an issuer who assume a financial reporting oversight role with the 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 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

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\(^6\) 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.

\(^7\) Accounting role or financial reporting oversight role means a role in which a person is in a position to or does exercise more than minimal influence over the contents of the accounting records or anyone who prepares them or 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, CEO, president, CFO, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, vice president of marketing, or any equivalent position.
What If I Am Employed as an Adjunct Faculty Member at an Educational Institution That Is an Attest Client?

This is the one and only exception to the prohibition of being employed at an attest client. Although being employed by an attest client as an adjunct faculty member still raises threats to independence, when certain specified safeguards are in place, threats can be reduced to an acceptable level, and independence can be maintained. The specific safeguards are that a partner or professional employee must not

- be in a key position at the educational institution.
- participate on the attest engagement team.
- be an individual in a position to influence the attest engagement.
- participate in any employee benefit plans sponsored by the educational institution, unless participation is required.
- assume any management responsibilities or set polices for the educational institution.
Chapter 4—Applying the Rules—Network Firms and Firm Mergers and Acquisitions

What Is a Network Firm?

CPA firms frequently form associations with other firms and entities and cooperate with them to enhance their capabilities to provide professional services. On occasion, such cooperation creates the appearance that firms are closely aligned or connected. Such appearance exists when one or more of the following characteristics are present:

- The use of a common brand name (including common initials) as part of the firm name
- Common control among the firms through ownership, management, or other means
- Profits or costs, excluding costs of operating the association; costs of developing audit methodologies, manuals, and training courses; and other costs that are immaterial to the firm
- Common business strategy that involves ongoing collaboration among the firms whereby the firms are responsible for implementing the association’s strategy and are held accountable for performance pursuant to that strategy
- Significant part of professional resources
- Common quality control policies and procedures that firms are required to implement and that are monitored by the association

When a firm participates in such an association, and one or more of the preceding characteristics are present, the firm is considered a network firm. Any entity the firm controls by itself or through one or more of its owners is also considered a network firm. In addition, any entity that can control the firm or that the firm is under common control with would also be considered a network firm.

It is possible that not all firms in the association will meet one of the preceding characteristics. In such situations, only the subset of firms that meet one or more of the characteristics would be considered network firms.

How Do I Apply the Network Firm Rules?

The “Networks and Network Firms” interpretation (AICPA, Professional Standards, ET sec. 1.220.010) under the "Independence Rule” (AICPA, Professional Standards, ET sec. 1.200.001) explains that when your firm is considered a network firm, your firm is required to remain independent of other network firms' audit and review clients and vice versa. Thus, a network firm may provide audit or review services for a client only insofar as other network firms are independent of the client. For example, other network firms could not provide prohibited nonattest services (that is, services that would impair independence under the “Nonattest Services” subtopic [AICPA, Professional Standards, ET sec. 1.295] of the “Independence Rule”) for that client or have any prohibited relationships, such as investments by the firm in the client, or loans to or from that client. For all other attest clients, members of network firms should consider any threats the firm knows or has reason to believe may be created by network firm interests and relationships. If those threats are not at an acceptable level, the member should apply safeguards to eliminate the threats or reduce them to an acceptable level.
However, when a foreign network firm (a firm or entity that is part of the network that is located outside of the United States) departs from the "Independence Rule," the domestic network firm’s independence is not impaired provided the foreign network firm has at a minimum, complied with the independence requirements set forth in the International Ethics Standards Board for Accountants’s Code of Ethics for Professional Accountants.

When determining if a network exists, the SEC would look at all the facts and circumstances, especially how the firms treat one another when referring audit work (that is, do they place reliance on the work received by another firm, or do they treat the work the same as if an unaffiliated firm performed the work). At the SEC-PCAOB conference on December 10, 2007, it was noted that the SEC staff continue to follow the guidance issued in the SEC’s January 2001 independence rulemaking regarding its definitions of firm and affiliate, meaning the staff will consider specific facts and circumstances, including the following:

- Does the primary auditor refer to another network firm in his or her audit opinion?
- Do the firms have common ownership, profit-sharing, or cost-sharing agreements?
- Do the firms share management, have a common brand name, or use shared professional resources?
- Do the firms have common quality control policies and procedures?

How Do I Apply the Rules in a Merger or Acquisition?

The "Firm Mergers and Acquisitions" interpretation (AICPA, Professional Standards, ET sec. 1.220.040) under the "Independence Rule" (AICPA, Professional Standards, ET sec. 1.200.001) provides guidance in situations where independence with respect to an attest client may become impaired as a result of a firm merger or acquisition. The guidance would apply when either (1) a member’s firm merges with or acquires another firm or entity or all or part of the business thereof or (2) a member’s firm, or all or part of the business thereof, is merged with or acquired by another firm. The interpretation focuses on two types of relationships that could impair independence: employment or association with an attest client and the provision of nonattest services that would impair independence (prohibited nonattest services).

Employment or Association With an Attest Client

The interpretation requires certain safeguards to be in place in order for independence to be maintained when a partner or professional employee of one firm is employed by or associated with an attest client of the other firm. Such safeguards require that the partner or professional employee terminate the relationship prior to the closing date of the merger or acquisition and be prohibited from participating on the attest engagement team or being an individual in a position to influence the attest engagement if the engagement covers any period in which the partner or employee was employed or associated with the attest client. The partner or employee must also comply with any applicable safeguards under the provisions of the “Former Employment or Association With an Attest Client”
interpretation regarding disassociation from an *attest client*, such as the *safeguard* that requires any *covered member* to cease participation in the *attest client’s* employee benefit plans.

The interpretation also requires that a responsible individual within the *firm* (for example, an individual with responsibility for the policies and procedures relating to *independence*) should assess the prior relationship that the *partner* or professional employee had with the *attest client* as well as the position that the individual will hold at the *firm* to determine if *threats* are at an *acceptable level*. If *threats* are determined not to be at an *acceptable level*, the responsible individual will need to be satisfied that *safeguards* are applied that will eliminate or reduce *threats* to an *acceptable level*.

The interpretation further requires that in situations where the *partner* or professional employee will have interaction with the *attest engagement team* or where the *attest engagement team* will evaluate work performed by the *partner* or professional employee while he or she was employed or associated with the *attest client*, an individual within the *firm* with the appropriate stature, expertise, and objectivity must review the subsequent *attest engagement*, prior to issuing the attest report, to determine whether the *attest engagement team* maintained integrity, objectivity, and as appropriate, professional skepticism.

Finally, the interpretation requires that the nature of the relationship and any *safeguards* that were applied be discussed with *those charged with governance* and that such discussion take place as soon as practicable under the circumstances but before issuing the attest report and encourages the substance of the discussions be documented.

**Nonattest Services**

The interpretation also provides *independence* guidance in situations where one *firm* provided prohibited nonattest services to an *attest client* of the other *firm*. The interpretation acknowledges that the significance of the *threats* differ depending upon whether the prohibited nonattest services were provided by the “acquiring firm” with respect to an *attest client* of the acquired firm or by the “acquired firm” with respect to an *attest client* of the acquiring firm.

In situations where the acquiring firm provided prohibited nonattest services to an *attest client* of the acquired firm during the *period of the professional engagement* or the period covered by the *financial statements*, *threats* would be so significant that they could not be reduced to an *acceptable level*. For example, in the situation where the acquired firm’s *attest client* would become an *attest client* of the acquiring firm (that is, the surviving firm) upon the merger or acquisition and any prohibited nonattest services performed by the acquiring firm for such an *attest client* would *impair independence* if the *attest engagement* were to continue.

Alternatively, when the acquired firm provided the prohibited nonattest services to an *attest client* of the acquiring firm during the *period of the professional engagement* or the period covered by the *financial statements*, the acquiring firm’s *independence* will not be *impaired* provided certain steps are taken. One step is for the acquired firm to either terminate the prohibited nonattest services or modify the nonattest services such that the services will no longer be considered to *impair independence*. Another step is for the *firm* to perform an evaluation to determine if *threats* are either at an *acceptable level* or can be reduced to an *acceptable level* by the application of *safeguards*. The extent of the evaluation performed would be based on whether or not the prohibited nonattest services will be attributable to the acquiring firm. The nonattest services will be considered attributable to the acquiring firm if the acquiring firm will assume responsibility (that is, be held liable or accountable, or both) for the results of the prohibited nonattest services performed by the acquired firm.
In evaluating the significance of any threats, the interpretation provides various factors that should be considered and where threats are determined not to be at an acceptable level, the interpretation provides examples of possible safeguards to be applied. In cases where no safeguards exist that can eliminate or reduce threats to an acceptable level, independence would be impaired.

The interpretation also requires a responsible individual within the firm discuss with those charged with governance the nature of any prohibited services performed that are subject to the evaluation, along with any safeguards applied, and encourages documentation of such discussion.
Chapter 5—Applying the Rules—Family Members

When Is My Family Subject to the Rules?

If you are a covered member with respect to an attest client, members of your immediate family (your spouse or equivalent and dependents) generally must follow the same rules you follow. For example, your spouse’s investments must be investments 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. In addition, when materiality is a factor, the covered member’s and immediate family member’s financial interests are combined.

This general rule has exceptions for certain employment situations and employee benefit plans:

a. Your immediate family member’s employment with an attest client would not impair your firm’s independence, provided he or she is not in a key position.

b. Immediate family members in permitted employment positions may participate in certain employee benefit plans (other than certain share-based arrangements or nonqualified deferred compensation plans) that are attest clients or sponsored by an attest client, provided the plan is offered to all employees in comparable positions, and the immediate family member does not serve in a position of governance for the plan or have the ability to supervise or participate in the plan’s investment decisions or selection of investment options.

c. Immediate family members of certain covered members may invest in an attest client through employee benefit plans that aren’t considered share-based compensation arrangements or nonqualified deferred compensation arrangements (for example, retirement or savings accounts), provided the immediate family member has no other investment options available for selection, and when such option becomes available, the immediate family member selects the option and disposes of any financial interest in the attest client.

d. Immediate family members in permitted employment positions of certain covered members may participate in share-based compensation arrangements and nonqualified deferred compensation plans, provided certain safeguards are implemented.

e. The covered members whose families may invest or participate in the plans described in items (c)–(d) are

i. partners and managers who provide only nonattest services to the attest client.

ii. partners or partner equivalents who are covered members only because they practice in the same office where the attest client’s lead attest partner practices in connection with the engagement.

At no time may any direct or material indirect financial interests in an attest client permitted by the preceding exceptions exceed 5 percent of the attest client’s outstanding equity securities or other ownership interests.

If you are not a covered member, see the section “Do any of the Rules Apply to Me If I Am Not a Covered Member?” in chapter 3, “Applying the Rules-Covered Members and Other Firm Professionals,” of this guide.
The SEC rules concerning holding unexercised stock options require the immediate family member to exercise or forfeit vested stock options as soon as the closing market price of the underlying stock equals or exceeds the exercise price. The AICPA rule recognizes that a privately held entity may not have a ready market for its shares or that thinly traded securities may have volatile markets. Therefore, the triggering event requiring an immediate family member to exercise his or her vested stock options occurs when the market price of the underlying stock equals or exceeds the exercise price for 10 consecutive days.

Alternatively, the SEC’s rules concerning employee stock ownership plans (ESOPs) are more restrictive than the AICPA’s rules in that the immediate family member must dispose of the publicly traded shares received as soon as possible. Because the AICPA rules deal exclusively with private-sector securities, it is possible that when the immediate family member receives shares from an ESOP, he or she may not be able to dispose of the shares because there is not a ready market for the shares. Accordingly, the AICPA’s rules allow the immediate family member to require the employee to exercise his or her put option for the employer to repurchase the shares as soon as permitted by the ESOP terms. If the employer does not pay for the repurchase shares within 30 days, the repurchase obligation must be immaterial to the covered member during the payout period.

What About My Other 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 an attest client in a key position impairs independence, except for covered members who provide only nonattest services to an attest 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 attest client that either
  o was material to your relative’s net worth or
  o enables the relative to exercise significant influence over the attest client.

- If you are a covered member because you are able to influence the attest engagement or are a partner or partner equivalent 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 attest client that
  o is material to your relative’s net worth and
  o enables your relative to exercise significant influence over the attest 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 SEC audit client (for example, the family member is a treasurer, CFO, accounting supervisor, or controller) or
- owns more than 5 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 an SEC audit client.
Chapter 6—Financial Relationships

When Do My (or My Family’s) Financial Interests Impair Independence?

This chapter discusses various types of financial relationships and how they affect independence. Although this chapter focuses on how these rules apply to you and your family, keep in mind that your firm also is subject to the financial relationship rules (because the AICPA Code of Professional Conduct [the code] includes firms in its definition of covered member).

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

- **direct financial interest** in an attest client, regardless of how immaterial it would be to your net worth.
- material **indirect financial interest** in the attest 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 an attest client, your independence would be impaired. For example, if you sign a stock subscription agreement with the attest 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 an attest client; or rights of participation, such as puts, calls, or straddles.

The following types of financial interests are direct financial interests:

- Owned by you directly
- Under your control
- Beneficially owned\(^1\) by you through an investment vehicle, an estate, a trust, or another intermediary if you can either
  - control the intermediary or
  - 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 in the investments held in your account.

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\(^1\) 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 disposition of the interest or to receive the economic benefits of the ownership of the interest.
You also have a **direct financial interest** in an **attest client** if you have a **financial interest** in an **attest 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. that 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, an estate, a trust, or another 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:** The “Financial Interests” subtopic (ET sec. 1.240), the “Trusts and Estates” subtopic (ET sec. 1.245), and the “Insurance Products” subtopic (ET sec. 1.257) of the “Independence Rule” (ET sec. 1.200.001) (AICPA, Professional Standards) provide 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 an SEC audit 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 preceding applies, your investment in an SEC audit client through another entity would normally be considered to be an indirect financial interest in that client.
What If My Immediate Family or I Receive a Financial Interest as a Result of an Inheritance or a Gift?

If, due to an unexpected event, you or members of your immediate family receive a financial interest in an attest client that would impair your independence, you may qualify under an exemption in the rules if you meet the following criteria:

- The financial interest was unsolicited.
- You dispose of the interest as soon as practicable but no later than 30 days after you become aware of it and have the right to dispose.
- If the interest is material, but you do not have the right to dispose of the interest (for example, as in the case of stock options or restricted stock), you do not participate in the attest engagement.

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 SEC 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 attest clients through a mutual fund are considered to be indirect financial interests in those attest clients unless the fund is a diversified mutual fund.

If a mutual fund is diversified, and you or your immediate family, or both, own 5 percent or less of its outstanding shares, the fund’s holdings in attest clients for which you are a covered member will not be considered material indirect financial interests in those attest clients. Thus, you would be relieved of the burden of having to monitor whether, and to what degree, the fund invests in attest clients for which you are a covered member.

If the fund is not diversified or if you or your family, or both, own more than 5 percent of the fund’s equity, you should treat the fund’s holdings as indirect financial interests.

For example, suppose ABC Mutual Fund, a diversified mutual fund, owns shares in attest client XYZ, and

- ABC Mutual Fund’s net assets are $10 million.
- your shares in ABC Mutual Fund are worth $50,000.
- ABC Mutual Fund has 10 percent of its assets invested in XYZ.
- your indirect financial interest in XYZ is $5,000 ($50,000 × 0.10).
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 an Attest Client?**

As a *covered member*, if you or the *attest 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 *attest client* includes certain persons associated with the *attest client*, such as officers, directors, or owners, who are able to exercise *significant influence* over the *attest client*.

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The SEC rules prohibit you and your immediate family from having a joint business venture with an SEC audit client or 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, regardless of whether they are material, cause the client and audit firm to have mutuality of interests, which impairs independence.

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**May My Family or I Borrow Money From, or Lend Money to, an Attest 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 attest client.
- an officer or a director of the attest client.
- an individual holding 10 percent or more of the attest client’s outstanding equity securities (or other ownership interests).

Certain exceptions affect this rule. First, specific *loans* exist that *covered members* are permitted to have from *lending institution* attest clients, including

- 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.
- *loans* fully collateralized by an insurance policy.

In addition, if you have a *loan from a lending institution that is an attest client* (for example, a bank) 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 **attest client**.

• the lending institution became an attest client.

• the **attest client** acquired the **loan**.

To maintain your loan’s grandfathered status, you must keep the loan current (that is, make timely payments according to the loan agreement). In addition, 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 an Attest Client?**

The AICPA rules indicate that for **independence** to be maintained, a **covered member** whose assets are held by a broker-dealer **attest 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 preceding loan rules.²

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

**May I Have a Bank Account With an Attest Client?**

As a **covered member**, you may have a **bank account with a client bank or similar depository 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.³

> The SEC prohibits covered persons and their immediate families from having bank account balances with an SEC audit client in excess of FDIC insurance limits. That is, deposits in excess of FDIC limits are considered to impair independence, even if the amounts are immaterial to you and your family.⁴

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² See the following section, “May My Family or I Borrow Money From, or Lend Money to, an Attest Client?”

³ 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.

⁴ The SEC treats money market funds (as opposed to money market accounts) as mutual funds for purposes of its rules. Also see [Rule 2-01(c)(1)(ii)(B)](https://www.sec.gov/rules/final/2001-205.pdf).
May I Have an Insurance Policy With an Attest 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 an attest 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 an SEC audit 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, an Attest Client?

The “Offering or Accepting Gifts or Entertainment” interpretation (AICPA, Professional Standards, ET sec. 1.285.010) under the “Independence Rule” addresses the exchange of gifts and entertainment among covered members, the attest client, and certain persons associated with the attest client (for example, persons in key positions and persons owning 10 percent or more of the attest client’s outstanding equity securities or other ownership interests).

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 attest client and not impair independence if the gift is reasonable in the circumstances. In addition, covered members may give or receive entertainment, provided it too is reasonable in the circumstances.

The “Offering or Accepting Gifts or Entertainment” interpretation (AICPA, Professional Standards, ET sec. 1.120.010) under the “Integrity and Objectivity Rule” (AICPA, Professional Standards, ET sec. 1.100.001) covers a broader issue when partners, professionals, or their firms exchange gifts or entertainment with clients (not just attest 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.)

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.

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5 The guidance is found in the “Insurance Products” subtopic (AICPA, Professional Standards, ET sec. 1.257) of the “Independence Rule” (AICPA, Professional Standards, ET sec. 1.200.001).

Chapter 7—Business Relationships

Which Business Relationships With an Attest 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 an attest client as any of the following:

- Employee, director, officer, or in any management capacity
- Promoter, underwriter, or voting trustee
- Stock transfer or escrow agent
- General counsel (or equivalent)
- Trustee for an attest client’s pension or profit sharing trust

In essence, any time you are able to assume management responsibilities for an attest client or exercise authority over an attest 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 attest client’s governing body and, therefore, would be able to participate in managing of the entity.

Three possible exceptions apply to this rule:

1. You may serve as an adjunct faculty member of an educational institution that is an attest client provided certain safeguards are in place.
2. If you are an honorary director or trustee for an attest 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.
3. In addition, you may serve on a client’s advisory board if all the following criteria are met:
   a. The board’s function is purely advisory.¹
   b. The board does not appear to make decisions for the attest 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.

¹ When evaluating your independence, you should examine the applicable board or committee charter to determine whether it is consistent with the “Independence Rule” (AICPA, Professional Standards, ET sec. 1.200.001).
The SEC prohibits direct or material indirect business relationships with an SEC audit client (or persons associated with client), except when the firm is acting as a 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.
Chapter 8—Nonattest Services

Which Rules Describe the Nonattest Services That My Firm and I May or May Not Provide to Attest Clients?

Nonattest services include accounting, tax, and consulting services that are not part of an attest engagement. Activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the attest engagement and, therefore, constitute a nonattest service. Nonattest services specifically addressed in the rules are the following:

- Advisory services
- Appraisal, valuation, or actuarial services
- Benefit plan administration services
- Bookkeeping, payroll, and other disbursement services
- Business risk consulting services
- Corporate finance consulting services
- Executive or employee recruiting services
- Forensic accounting services
- Information systems design, installation, or integration services
- Internal audit services
- Investment advisory or management services
- Tax services

In addition to considering the general standard and four guiding principles, the SEC rules generally prohibit a CPA from providing the following services to an SEC audit client during the audit and professional engagement period:

- 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
Under PCAOB rules, the following types of services are also subject to significant restrictions if the auditor provides them to an issuer during the audit and professional engagement period:

- Aggressive or confidential tax transactions
- Personal tax services provided to persons in financial reporting oversight roles

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 an attest client's general counsel). These rules apply during the period of the professional engagement and the period covered by the financial statements (to which the attest services relate). However, if the firm provided the entity with prohibited nonattest services prior to the entity becoming an attest client, independence would not be impaired if the prohibited nonattest services related to periods prior to the period covered by the financial statements the firm is engaged to audit, and those prior period financial statements were audited by another firm (or, in the case of a review engagement, reviewed or audited by another firm).

In August 2007, the SEC staff updated its frequently asked questions (FAQ) document Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence—Frequently Asked Questions. FAQ No. 7 under the “Prohibited and Non-audit Services” section addresses the question of whether a successor auditor who performed one of the preceding services during the audit period (period covered by the financial statements) would be independent of the SEC audit client. The FAQ states that if the services (a) relate solely to the prior period audited by the predecessor auditor and (b) were performed before the successor auditor was engaged to audit the current audit period, independence would not be impaired.

This chapter 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 the “Nonattest Services” subtopic (AICPA, Professional Standards, ET sec. 1.295) under the “Independence Rule” (AICPA, Professional Standards, ET sec. 1.200.001) and SEC Rule 2-01(c)(4). You also are encouraged to review Frequently Asked Questions: Performance of Nonattest Services developed by the Professional Ethics Division and the “Prohibited and Non-audit Services” section of Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence—Frequently Asked Questions developed by the SEC’s Office of the Chief Accountant.

The AICPA rules require a member to comply with more restrictive independence provisions, if applicable, of certain regulators, such as state boards of accountancy and the SEC, the Government Accountability Office, and the Department of Labor.
SEC and PCAOB rules require independence of an issuer that is an audit client and various affiliated entities of the client.²

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

PCAOB Rule 3526, Communication with Audit Committees Concerning Independence (AICPA, PCAOB Standards and Related Rules, Select Rules of the Board), superseded the PCAOB’s interim standard Independence Standards Board Independence Standard No. 1, Independence Discussions with Audit Committees, and its interpretations. Before accepting a new audit engagement, and annually thereafter, the auditor must describe in writing to the issuer’s audit committee all relationships between the auditor and client (including affiliates of both) that could reasonably be thought to bear on independence, discuss these matters with the audit committee, and document the substance of that discussion (effective September 30, 2008).

**AICPA General Requirements**

**General Requirement 1**

The “General Requirements for Performing Nonattest Services” interpretation (AICPA, Professional Standards, ET sec. 1.295.040) explains the main safeguards that need to be applied whenever members provide nonattest services to their attest clients.

The first general requirement explains that the attest client must agree to assume certain responsibilities related to the nonattest services engagement in order for independence to be maintained. Therefore, prior to agreeing to perform any nonattest services for the attest client, the member must obtain the attest client’s agreement that the attest client will

a. assume all management responsibilities as described in the “Management Responsibilities” interpretation (AICPA, Professional Standards, ET sec. 1.295.030) under the “Independence Rule.”

b. oversee the service by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them but is not required to possess the expertise to perform or re-perform the services.

c. evaluate the adequacy and results of the services performed.

d. accept responsibility for the results of the services.

² See Rule 2-01(f)(4) and (6).
With regard to the preceding list, the member should be satisfied that the attest client designee will be able to meet this criteria, make an informed judgment on the results of the nonattest services, and be responsible for making all significant judgments and decisions that are the proper responsibility of management. The attest client also must be willing to commit the time and resources needed for the designee to fulfill these duties.

General Requirement 2

One of the key principles underlying the AICPA rules on nonattest services is that you may not assume management responsibilities or even appear to assume management responsibilities. Management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources. Examples of management responsibilities can be found in the “Management Responsibilities” interpretation under the “Independence Rule.”

General Requirement 3

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

- Objectives of the engagement
- Services to be performed
- Attest 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 such as providing advice and responding to questions as part of the normal client-member relationship are exempt.

Are Preparing Financial Statements, Cash-to-Accrual Conversions, and Reconciliations Considered Nonattest Services?

The AICPA independence rules consider the preparation of financial statements, cash-to-accrual conversions, and reconciliations outside the scope of the attest engagement and, therefore, constitute a nonattest service. Such activities would not impair independence if the requirements of the interpretations of the “Nonattest Services” subtopic are met.

What Are the Rules Concerning Performing Bookkeeping Services for an Attest Client?

The AICPA independence rules prohibit members from assuming management responsibilities in all circumstances. Accordingly, a member may provide bookkeeping services if the attest client oversees the services and, among other things, performs all management responsibilities 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 attest client must

- approve all account classifications.
• provide source documents to the member so that the member can prepare journal entries.

• take responsibility for the results of the member’s services (for example, financial statements).

Note: Proposing adjusting entries to an attest 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 provisions of the “Nonattest Services” subtopic, provided the attest client reviews these entries and understands the effect on its financial statements and records any adjustments identified by the member that the attest client believes appropriate.

Because of self-audit concerns, performing any type of bookkeeping service for an SEC audit 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; therefore, the firm must overcome the presumption to perform the service.

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

May My Firm Provide Internal Audit Services to an Attest Client?

To perform internal audit assistance for an attest client and maintain independence, your firm may not, in effect, manage the internal audit activities of the attest client. For example, you and your firm may not

• perform ongoing evaluations or control activities (for example, reviewing loan originations as part of the attest client’s approval process or reviewing customer credit information as part of the customer’s sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed or accounted for, or both, or perform routine activities in connection with the attest client’s operating or production processes that are equivalent to those of an ongoing compliance or quality control function.

• perform separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the attest client’s business process.

• have attest client management rely on the member’s work as the primary basis for the attest client’s assertions on the design or operating effectiveness of internal controls.

• determine which, if any, recommendations for improving the internal control system should be implemented.

• report to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function.
• approve or be 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.

• be connected with the attest client as an employee or in any capacity equivalent to a member of management (for example, being listed as an employee in the attest client’s directories or other attest client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the attest client’s internal audit function, or using the attest client’s letterhead or internal correspondence forms in communications).

To maintain independence, the attest client must

• designate an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to oversee the internal audit function.

• determine the scope, risk, and frequency of internal audit activities, including those the member will perform in providing the services.

• evaluate the findings and results of internal audit activities, including those the member will perform in providing the services.

• evaluate the adequacy of the audit procedures performed and findings resulting from the performance of those procedures.

Internal audit services provided to an SEC audit client impair independence 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.

May My Firm Manage a Project for an Attest Client?

Responsibility for attest client projects, including deciding whether to proceed with a project, is management’s responsibility. Accordingly, if a member accepts responsibly for management of an attest client’s project, then the member’s independence would be impaired even if the project did not affect the attest client’s financial statements.

However, if the member’s services were limited to providing assistance, advice, suggestions, or recommendations regarding matters that are within his or her areas of knowledge or experience, independence would not be impaired.

May My Firm Provide Valuation, Appraisal, or Actuarial Services to an Attest Client?

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

• the results of the service would be material to the attest client’s financial statements.

• 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 an attest client’s financial statements because that service involves
significant subjectivity (for example, setting the assumptions and selecting and applying the valuation methodology).

Two limited exceptions apply to this rule. First, valuation, appraisal, or actuarial services performed for nonfinancial statement purposes may be provided if safeguards from the “General Requirements for Performing Nonattest Services” interpretation (AICPA, Professional Standards, ET sec. 1.295.040) are met. (For example, the attest client assigns an individual who is in a position to make an informed judgment on, and accept responsibility for, the results of the service to oversee the service.) In addition, your firm may provide an actuarial valuation of an attest 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 to an SEC audit client unless it is reasonable to expect that your firm would not audit the results of those services.

The staff of the Professional Ethics Division issued nonauthoritative guidance (in the form of an frequently asked questions [FAQ] document) on the question of whether members could assist an attest client in applying FASB Accounting Standards Codification (ASC) 805, Business Combinations, or 350, Intangibles—Goodwill and Other, while maintaining independence. Specifically, the FAQ document addresses whether the following services would be considered to impair independence:

- Providing the attest client advice on valuation methodologies and assumptions needed to perform the valuation
- Providing advice on valuation templates, software, or other tools that allow the attest client to determine an appropriate value for acquired assets, goodwill, contingent consideration, and so on

May My Firm Provide Investment Advisory Services to an Attest Client?

Here are examples of what you and your firm may do under the AICPA rules, provided the safeguards from the “General Requirements for Performing Nonattest Services” interpretation are met:

- Make recommendations to an attest 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 do the following:

- Make investment decisions for the attest client
- Execute investment transactions
- Take custody of an attest client’s assets

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3 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.
May My Firm Design or Implement an Information System for an Attest Client?

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

Your firm may install an accounting software package for an attest client, including helping the attest client set up a chart of accounts and financial statement format. Your firm may perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings, as specified by management. Your firm also may provide training to the attest client’s employees on how to use an information system. Your firm may not, however, supervise the attest client’s employees in their day-to-day use of the system because that activity is a management responsibility.

Your firm is not precluded from designing, implementing, integrating, or installing an information system that is unrelated to the attest client’s financial reporting process.4

SEC rules prohibit your firm from providing any service related to an SEC audit 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 do either of the following:

- Evaluate internal controls of a financial information system as it is being designed, implemented, or operated for the client by another service provider
- Make recommendations on internal control matters to management in connection with a system design and implementation project being performed by another service provider
- Note: If your audit client is an issuer, your firm must obtain preapproval for these and other internal control-related services, in accordance with PCAOB Rule 3525, Audit Committee Pre-Approval of Non-audit Services Related to Internal Control Over Financial Reporting (AICPA, PCAOB Standards and Related Rules, Select Rules of the Board).

May My Firm Provide Hosting Services to an Attest Client?

Come September 1, 2018, providing hosting services to an attest client will impair your independence as you would be maintaining internal control over the attest client’s data or records. Hosting services involve (1) acting as the sole host of an attest client’s financial or non-financial information system; (2) taking custody of or storing an attest client’s data or records whereby the attest client’s data or records would be incomplete and they would need to come to you to get that information; or (3) providing the attest client with electronic security or backup services for its data or records. Examples of hosting

4 Frequently asked questions are available to assist members in understanding and implementing the IT services provisions.
services include housing an attest client’s website, keeping your attest client’s general ledger on your servers or servers leased by your firm, or being your attest client’s disaster recovery provider.

Your firm will not be considered to be providing hosting services just because it keeps copies of an attest client’s data or records to support a service you provided, nor would you be providing hosting services if you use general ledger software to facilitate the delivery of bookkeeping services if you and the client maintain separate instances of the software on your respective servers and you just pass updated financial information to the attest client. You would also not be considered to be providing hosting services if the attest client retains a third-party service provider to maintain its general ledger in a cloud-based platform and grants you access to this software to provide bookkeeping services. If you use a portal to electronically exchange data or records, to avoid inadvertently providing hosting services, it is recommended that you terminate access to the data or records in the portal within a reasonable period of after the conclusion of the engagement. Additional examples are available in the Hosting Services interpretation.

**May My Firm Provide an Attest Client With Training Services?**

The staff of the Professional Ethics Division issued nonauthoritative guidance (in the form of an FAQ document) on the question of whether a member’s independence would be impaired if he or she provided training to an attest client that is implementing changes to its financial reporting system or process. The FAQ concludes that a member’s independence would not be impaired if the attest client personnel are provided with a general understanding of the financial reporting system or process. It goes on to explain that if attest client personnel already have a general understanding, the member may provide more specific training to attest client personnel on how the system or process applies to the attest client's specific circumstances. It cautions members that they should ensure that the training does not involve supervising attest client personnel in either the implementation or daily operation of the financial system or process or result in the member performing other management responsibilities, such as making operational decisions or implementing the internal controls necessary for the system or process to run effectively.
Chapter 9—Breach of an Independence Interpretation

What Do I Do If I’m Not in Compliance With an Independence Interpretation?

Before resigning from an attest engagement, you may want to assess the breach under the “Breach of an Independence Interpretation” interpretation (AICPA, Professional Standards, ET sec. 1.298.010). However, if you choose to evaluate the breach using this interpretation and conclude that the consequences of the breach were satisfactorily addressed and do not resign, you should be prepared to justify such conclusion because use of the interpretation will not preclude you from an investigation or enforcement action by the AICPA.

In order to use the interpretation, your firm must be compliant with QC section 10, A Firm’s System of Quality Control (AICPA, Professional Standards), which requires the member’s firm to have established policies and procedures designed to provide it with reasonable assurance that the firm, its personnel, and, when applicable, others subject to independence requirements maintain independence when required. If your firm is not compliant with QC section 10, you would not be able to address the consequences of the breach under this interpretation.

If your firm is compliant with QC section 10, but still a breach occurs that results in the attest engagement team’s integrity, objectivity, and professional skepticism being compromised, the threat to independence would be so significant that you could not take any actions to satisfactorily address the consequences of the breach. In addition, there is a rebuttable presumption that the attest engagement team’s integrity, objectivity, and professional skepticism are compromised and that you cannot take any actions to satisfactorily address the consequence of the breach when the lead attest engagement partner or an individual in a position to influence the attest engagement either (1) committed the breach or (2) knows of a breach and fails to ensure the breach is promptly communicated to or known by an appropriate individual within the firm.

If your firm is compliant with QC section 10 and the attest engagement team’s integrity, objectivity, and professional skepticism are not compromised, then you could evaluate the breach using the interpretation to determine if you can address the breach and perform the attest engagement. If you determine that you can satisfactorily address the breach, the interpretation calls for certain steps to be taken, including communicating with those charged with governance and documenting the breach, the action taken, key decisions made and all the matters discussed with those charged with governance, and any discussions with a professional body, relevant regulator, or oversight authority.
Chapter 10—Fee Issues

What Types of Fee Arrangements Between My Firm and an Attest 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 no fee is charged unless a specified result is attained or 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.
- performs a consulting engagement to decrease a client’s operating costs. The fee is based on a percentage of the cost reduction the client achieves as a result of your service.

The following are exceptions:

- Fees fixed by a court or other public authority
- 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 recommending or referring a third-party’s product or service to a client or recommending or referring a client’s product or service to a third party.

The following are examples of commissions:

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

Commissions or contingent fee arrangements with a client are not allowed if your firm also provides one of the following services to the 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 an 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 non-client 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 in writing that you received a commission for making the referral.
Note: State boards of accountancy and state societies also may have more restrictive regulations regarding fee arrangements, as well as specific disclosure requirements.

PCAOB Rule 3521, Contingent Fees (AICPA, PCAOB Standards and Related Rules, Select Rules of the Board), prohibits you and your firm from providing any service or product to a SEC audit client for a contingent fee or 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 an issuer that is an audit client.

When Are Referral Fees Permitted?

Paragraph .05 of the “Commissions and Referral Fees Rule” (AICPA, Professional Standards, ET sec. 1.520.001) provides an exception for referral fees for recommending or referring a CPA’s services to another person or entity. That is, you may receive a fee for referring a CPA’s services to any person or entity, or if you are a CPA, you may pay a fee to obtain a client. You must inform the client in writing if you receive or pay a referral fee.

Is Independence Affected When an Attest Client Owes the Firm Fees for Professional Services the Firm Has Already Provided?

If an attest 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 attest client has an outstanding debt with the firm. This is the case even if the attest 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 SEC audit client has committed to pay the balance in full before the current year report is issued.¹

¹ The exception generally has been applied only to engagements to audit a client’s financial statements included in its annual report, not in a registration statement.
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 issuers that are 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.\(^2\)

The rule does not prevent an audit partner from sharing in profits of the audit practice or overall firm. It also does not preclude the firm from evaluating a partner based on factors related to the sale of nonaudit services to issuers (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 Attest Client?

Paragraph .16 of the “Conceptual Framework for Independence” interpretation (AICPA, Professional Standards, ET sec. 1.210.010) states that a self-interest threat may exist if a “member or his or her firm relies excessively on revenue from a single attest client.” In addition, the “Integrity and Objectivity Rule” (AICPA, Professional Standards, ET sec. 1.100.001) and the “Objectivity and Independence” principle (AICPA, Professional Standards, ET sec. 0.300.050) 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:

a. Policies and procedures for identifying and monitoring significant client relationships, including the following:
   i. Considering client significance in the planning stage of the engagement.
   ii. Basing the consideration of client significance on firm-specific criteria or factors that are applied on a facts and circumstances basis (see the following section, “Factors to Consider in Identifying Significant Attest Clients”).
   iii. 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

\(^2\) 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.
significant could become significant whenever factors the firm considers relevant for identifying significant clients arise. (For example, additional services are contemplated.)

b. Policies and procedures for helping mitigate possible threats to independence and objectivity, including the following:

i. Assigning a second (or concurring) review partner who is not otherwise associated with the engagement and who practices in an office other than those who perform the attest engagement

ii. Subjecting the assignment of engagement personnel to approval by another partner or manager

iii. Periodically rotating engagement partners

iv. Subjecting significant client attest engagements to internal firm-monitoring procedures

v. Subjecting significant client attest engagements to pre-issuance or post-issuance 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, the firms’ managing partners may engage in frequent and direct communications with the firms’ partners and professional staff on attest 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 client service office or business unit) can choose a second (or concurring) review partner from outside the office to perform the attest engagement. Midsized or regional firms may have aspects of both their smaller and larger counterparts, such as combining the ability to choose second review partners from an office other than the attest client service office while maintaining a relatively close connection to specific attest client relationships.

Factors to Consider in Identifying Significant Attest Clients

The following are both qualitative and quantitative factors that can reveal a significant attest client:

- The size of the attest client, in terms of the percentage of fees or the dollar amount of fees versus total revenue of the engagement partner, office, or practice unit of the firm

- The significance of the client to the engagement partner, office, or practice unit of the firm in light of the following:
  - The amount of time the partner, office, or practice unit devotes to the engagement
  - The effect on the partner’s stature within the firm due to his or her relationships with the attest client
  - The manner in which the partner, office, or practice unit is compensated

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3 Assessing an attest client’s 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 health care or financial services).
• The effect that losing the attest client would have on the partner, office, or practice unit

• The importance of the attest client to the firm’s growth strategies (for example, the firm is trying to gain entry into a particular industry)

• The stature of the attest client, which may enhance the firm’s stature (for example, the firm is trying to gain entry into a particular industry)

• Whether the firm also provides services to related parties (for example, also provides professional services to affiliates or owners of the attest client)

• Whether the engagement is recurring

Judgment is necessary to determine whether an attest 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.

In general, if a firm derives more than 15 percent of its total revenues from one SEC audit 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.
Chapter 11—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 AICPA Code of Professional Conduct (the code).

In addition, readers should refer to the "Conceptual Framework for Independence" interpretation (AICPA, Professional Standards, ET sec. 1.210.010) 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 with those responsible for independence in your firm. If you need further assistance researching your question, contact one of the following organizations for guidance.

AICPA Resources

- Refer to the AICPA's Professional Ethics Division’s standard-setting activities for details regarding current and past projects.
- For questions related to understanding the nonattest service rules, consult the Background and Basis for Conclusions document.
- For questions related to applying the nonattest services rules, consult Frequently Asked Questions: Performance of Nonattest Services.
- For independence inquiries by phone, call 888.777.7077. Send e-mail inquiries to ethics@aicpa.org.
- The AICPA interactive multimedia course on independence, Independence, teaches the AICPA and the SEC independence rules and qualifies for four hours of continuing professional education credits.
- Toolkits to assist members with applying the Conceptual Framework for Independence and Nonattest Services
  - Conceptual Framework Toolkit for Independence
  - Nonattest Services Toolkit
- The 2011 Yellow Book Independence—Nonaudit Services Documentation Practice Aid will assist auditors performing audits in accordance with the 2011 revision to Government Auditing Standards (the 2011 Yellow Book) issued by the Government Accountability Office (GAO) in identifying and evaluating threats to independence for nonaudit services when considering whether to provide a nonaudit service. It will also assist auditors in applying the conceptual framework for independence contained in the 2011 Yellow Book (Yellow Book Conceptual Framework) and in complying with the Yellow Book’s independence documentation requirements.
SEC Resources

- Information for accountants, including independence, may be found online at the Office of the Chief Accountant at www.sec.gov/about/offices/oca/ocaprof.htm.
- Independence reference materials can be found on the SEC website.
- Contact the SEC via U.S. Securities and Exchange Commission, Office of the Chief Accountant, 100 F Street, NE, Washington, D.C. 20549 (mail); 202.551.5300 (phone); or 202.772.9252 (fax).

PCAOB Resources

- The PCAOB website contains its standards.

GAO Resources

- Obtain the GAO Yellow Book requirements at “Resources for the Auditing and Accountability Community.”
- Direct inquiries to 202.512.9535 (phone) or yellowbook@gao.gov (e-mail).

Department of Labor Resources

- Direct inquiries to 1.866.4.USA.DOL.

Banking Regulators’ Resources

- The following organizations comprise the Federal Financial Institutions Examination Council (FFIEC): the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, and the Office of the Comptroller of the Currency. The FFIEC issues financial institution letters (FILs) that are addressed to the CEOs of the financial institutions on the FIL distribution list, generally FDIC-supervised institutions. FILs may announce new regulations and policies, new FDIC publications, and a variety of other matters of principal interest to those responsible for operating a bank or savings association. FILs have addressed auditor conduct (for example, internal audit outsourcing and use of indemnification clauses in engagement letters) in recent years and may apply to both public and nonpublic institutions. Additional information is available.
- International Federation of Accountants Resources
- Information about the International Ethics Standards Board for Accountants (IESBA) can be found on the International Federation of Accountants’ website.
- View the IESBA’s Handbook of the Code of Ethics for Professional Accountants.
National Association of Insurance Commissioners Resources

- The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

- The NAIC website is [www.naic.org](http://www.naic.org)

- The NAIC developed a Model Rule, which is available at [www.naic.org/store/free/MDL-205.pdf](http://www.naic.org/store/free/MDL-205.pdf). Section 7 outlines the model rule's independence requirements. However, the requirements of individual state laws, regulations, and administrative rules take precedence and may differ from the guidance provided by the NAIC. Accordingly, auditors of insurance enterprises should review state laws, regulations, and administrative rules to determine what has been approved in each state.