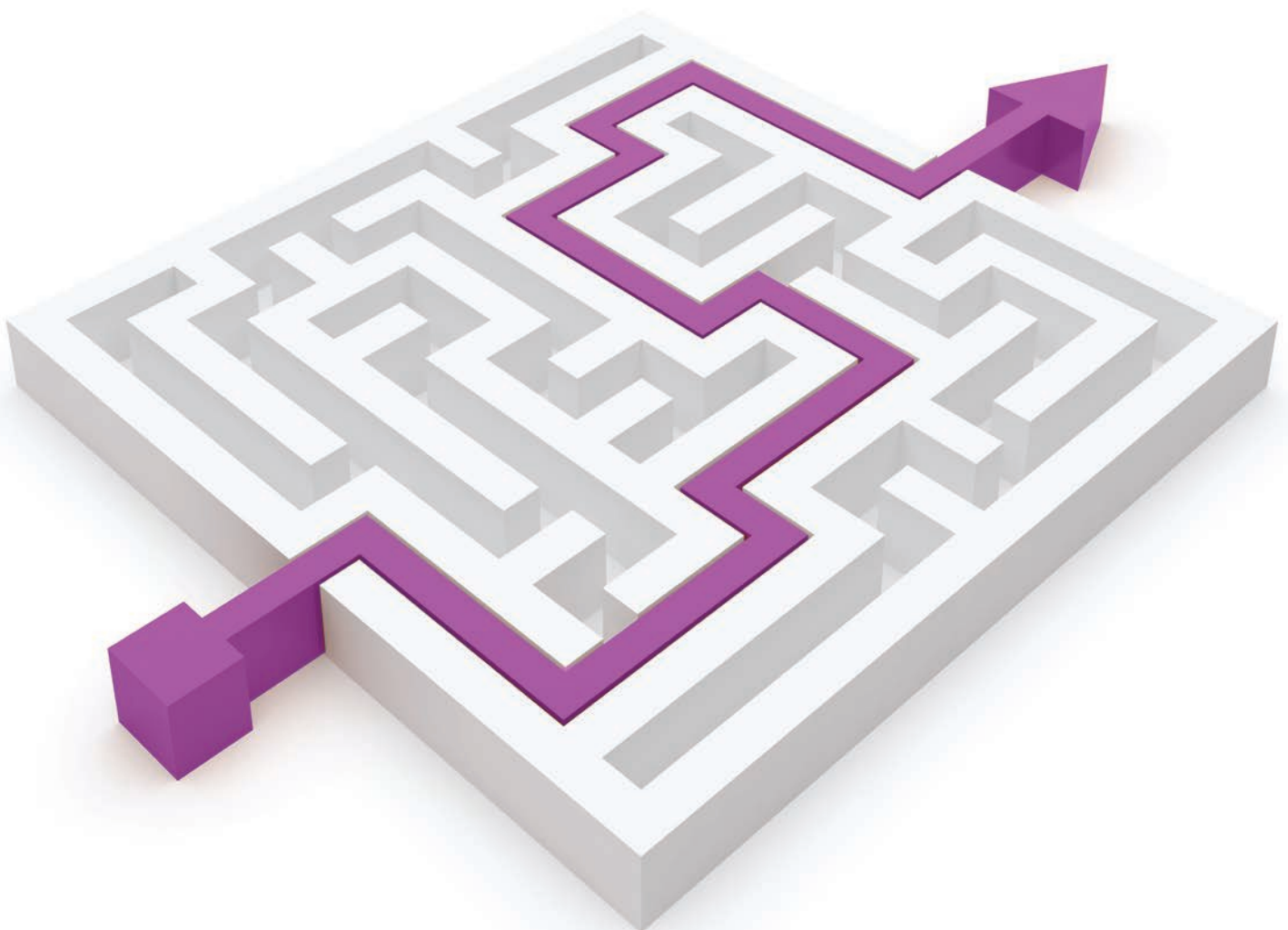




Plain English guide to independence



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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. 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.

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, issuers, and broker-dealers—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.

For the purposes of this guide, a **broker-dealer** is an entity that is defined in Sections 3(a)(4) and 3(a)(5) of the Exchange act and is required to file a balance sheet, income statement, or financial statement under Section 17(1)(A) of the Exchange Act and where these statements are required to be certified by a registered public accounting firm.

Note: The auditors of all registered broker-dealers and certain other entities must be registered with the PCAOB and these auditors need to apply the SEC PCAOB independence rules.

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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?

According to the “[Application of the Conceptual Framework for Independence and Ethical Conflicts](#)” interpretation (ET sec. 1.200.005) of the “Independence Rule” (ET sec. 1.200.001), in the absence of an [interpretation](#) of the “Independence Rule” that addresses a particular relationship or circumstance, a member should apply the “[Conceptual Framework for Independence](#)” interpretation (ET sec. 1.210.010).¹

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

¹ You can find all ET sections in *AICPA Professional Standards*.

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](#)” (ET sec. 1.310.001) rather than the “Independence Rule” if the member can demonstrate that safeguards, although not documented, 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*.²

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 for 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:

² You can find all AR-C sections in *AICPA Professional Standards*.

- [Rule 102](#), *Integrity and Objectivity*
- [Rule 101](#), *Independence*
- [Interpretations 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 May 2006, Rule 3520 became effective, which states "A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period." The firm and its associated persons are still required to comply with both PCAOB and SEC rules.

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 the auditor's 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 (e.g. banking and insurance regulators)
- International Ethics Standards Board for Accountants (IESBA)

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 for 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. 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](#).

If the engaging entity is not also the attest client, the member needs to determine if the engaging entity is an *affiliate* for which the member needs to remain independent. If the engaging entity does not meet the definition of an *affiliate*, the member needs to determine if there are [threats](#) to the *member's* compliance with regards to the “[Integrity and Objectivity Rule](#)” (ET sec. 1.100.001) and the “[Conflicts of Interest for Members in Public Practice](#)” interpretation (ET 1.110.010) with respect to the engaging entity. If threats exist, then the member needs to comply with this rule and interpretation.

What entities are considered affiliates of my financial statement attest client?

The “[Client Affiliates](#)” interpretation (ET sec. 1.224.010) of the “Independence Rule” (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*. This interpretation does not apply to affiliates of state and local government clients. See “[State and Local Government Affiliates](#)” below.

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 several 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, the member 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 (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)–(l) above.

The second 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)–(l). 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 [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)–(l) 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 fourth exception involves [immediate family](#) members and [close relatives](#) who are employed at those entities described as an *affiliate* under (c)–(l). 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).

The final exception involves a covered member that is part of the attest engagement team or is an individual in a position to influence the attest engagement, or the firm itself, having a lease with an entity described as an *affiliate* under (c)–(l) that does not meet the requirements of the “Leases” interpretation (1.260.010) during the period of professional engagement. The covered

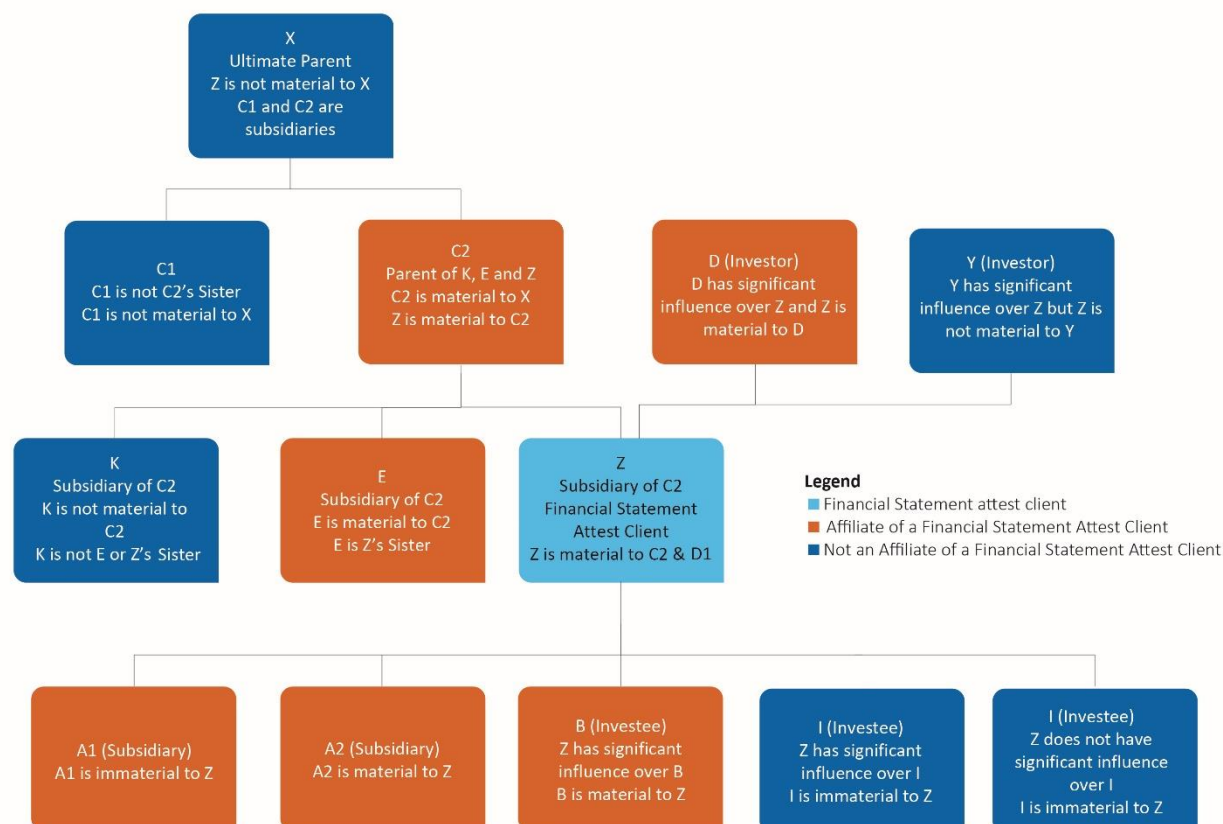
member should use the “Conceptual Framework for Independence” to evaluate threats to the member’s independence and apply safeguards to mitigate threats that are not at an acceptable level.

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?

We created a visual aid 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.



Is there an executive summary of the interpretation?

Type of relationship	Affiliate A	Affiliate B	Affiliate C	Affiliate D	Affiliate E	Affiliate F	Affiliate G	Affiliate H	Affiliate I	Affiliate J
Financial interest in	P	P	P	P	P	P	P	P	N/A	P
Loan to or from	PS	PS	PS	PS	PS	PS	PS	PS	PS	PS
Nonattest services provided to	P	P	NSA	NSA	NSA	NSA	NSA	NSA	NSA	NSA
Member's employ or association with	P	P	A	A	A	A	A	A	A	A
Former employment or association with	P	P	P	P	P	P	P	P	P	P
Immediate family employment or interest in	P	P	R	R	R	R	R	R	R	R
Close relative employment or interest in	P	P	R	R	R	R	R	R	R	R

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 (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 (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.

Is independence different for state and local government affiliates?

In the AICPA code the entity's basic financial statements include the government-wide financial statements, the fund financial statements, and other entities disclosed in the notes to the basic financial statements. Some of the entities that should be included are related organizations, joint ventures, jointly governed organizations, and component units of another governments with characteristics of a joint venture or jointly governed organization.

When a member audits the basic financial statements, the member must be independent of all of the organizations whose financial statements are included in the basic financial statements as described previously unless the member explicitly states reliance on another auditors' reports. If the member has an immediate family member that holds a key position in an entity included in the basic financial statements during the period of professional engagement or during the period covered by the financial statements, then the member would not be independent.

If the member is not the auditor of the basic financial statements, but instead audits one of the entities included in the basic financial statements, the member does not have to be independent of the entities that the member does not audit. If the member has an immediate family member that holds a key position in in the primary government during the period of professional engagement or during the period covered by the financial statements, then the member would not be independent.

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 [attest engagement team](#) for the client
- 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 person³ 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 substantially equivalent.

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.

³ 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 threats exist when a member is on the attest engagement team for an extended period of time?

The familiarity threat exists when senior personnel are on the attest engagement team for an extended period of time. Nonauthoritative questions and answers regarding senior personnel's long association on an attest engagement is available in the Frequently Asked Questions: General ethics questions at

www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf

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 significance, 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 (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*). Additionally, if comparative financial statements are being issued that include the 2015 fiscal year, you could not participate in the engagement.
- 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*.⁴

⁴ See the section "[When do my \(or my family's\) financial interests impair independence?](#)" in chapter 6, "Financial relationships," of this guide.

- ii. Collect and repay all [loans](#) to or from the *attest client* (except those specifically permitted or have transition provisions⁵).
- 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 influence the attest engagement*, the member 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 penalty⁶ 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](#).⁷

See the "[Former Employment or Association With an Attest Client](#)" interpretation (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 and employment with the client is no longer a possibility.

See the "[Considering Employment or Association With an Attest Client](#)" interpretation (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*, the firm's *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

⁵ Also, see the "[Loans and Leases With Lending Institutions](#)" interpretation (ET sec. 1.260.020).

⁶ 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.

⁷ See the section "[What should I do if no specific guidance exists on my particular independence issue?](#)" in chapter 1, "Introduction," of this guide.

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

- 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.⁸

See the “[Subsequent Employment or Association With an Attest Client](#)” interpretation (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, the former partner 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

⁸ 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.

The SEC uses the terms *accounting role* and *financial reporting oversight role*⁹ 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 for the client) would be excluded from the audit engagement team for purposes of this rule.

This rule applies to an issuer and its consolidated entities.

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 policies for the educational institution.

⁹ 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.

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 sharing, 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
- The sharing of a significant part of professional resources, for example personnel, supplies, or information systems
- 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 (ET sec. 1.220.010) under the "Independence Rule" (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 [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 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 the 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 (ET sec. 1.220.040) under the "Independence Rule" (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 conditions are met. The first condition 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*. This condition should be met prior to the closing date of the acquisition. The second condition is that any individual that participated in the prohibited nonattest services engagement not be on the attest engagement or in a position to influence the attest engagement. The last condition 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. This discussion should occur as soon as practicable under the circumstances but before issuing the attest report.

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 the spouse's 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 the family member 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 requires 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 the 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, the family member 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 the employee's 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 are considered covered members only because they provided more than 10 hours of nonattest services to the attest clients.

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 owned¹ by you through an investment vehicle, an estate, a trust, or another intermediary if you can either
 - o control the intermediary or
 - o 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.

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) 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 ($\$50,000 \times 0.10$).

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.

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.

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 eligible for a transition provision (that is, you may be allowed to keep it). For your *loan* to be eligible for a transition provision, you must have obtained it under [normal lending procedures, terms, and requirements](#). The following *loans* may be eligible for a transition provision:

- Home mortgages
- Other secured *loans*
- Unsecured *loans* that are immaterial to your net worth

Generally speaking, a *loan* may be eligible for a transition provision 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* eligibility for a transition provision 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).

There are no transition provisions. The SEC rules only provide exceptions for the following loans obtained from a lending institution under its normal lending procedure, terms, and requirements:

- automobile loans and leases collateralized by the automobile
- loans fully collateralized by the cash surrender value of an insurance policy
- loans fully collateralized by cash deposits at the same financial institution
- mortgage loan collateralized by the borrower's primary residence provided the loan was not obtained while the covered person in the firm was a covered person

The prior test for loans to or from record or beneficial owners of an audit client's equity securities (1) has been replaced with a test for beneficial owners known through reasonable inquiry, of an audit client's equity securities, and (2) no longer references a more than 10 percent ownership test, but rather is based on significant influence over the audit client.

Reasonable inquiry is an inquiry by the auditor and the audit client in conjunction with the consideration of the audit client's governance structure, governing documents, Commission filings, or other information prepared by the audit client which may relate to the identification of a beneficial owner. An accountant would not be independent when the accounting firm, any covered person in the firm, or any of his or her immediate family members has any loan (including any margin loan) to or from an audit client, or an audit client's officers, directors, or beneficial owners (known through reasonable inquiry) of the audit client's equity securities where such beneficial owner has significant influence over the audit client. Significant influence refers to the principles in ASC 323.

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

May I have an insurance policy with an attest client?

The AICPA rules⁵ 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:

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

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\(c\)\(1\)\(ii\)\(B\)](#).

⁵ The guidance is found in the "[Insurance Products](#)" subtopic (ET sec. 1.257) of the "Independence Rule" (ET sec. 1.200.001).

May I give gifts or entertainment to, or accept gifts or entertainment from, an attest client?

The “[Offering or Accepting Gifts or Entertainment](#)” interpretation (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 (ET sec. 1.120.010) under the “[Integrity and Objectivity Rule](#)” (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.)⁷

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.

⁷ See www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts_Basis_Document.pdf.

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 (See Chapter 3, above.).
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](#)" (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
- Hosting Services
- Information systems design, implementation, or integration services
- Internal audit services
- Investment advisory or management services
- Tax services

In addition to considering the general standard and four guiding principles (mutual or conflicting interest with the audit client, position to audit their own work, acting as management or an employee of the audit client, and position of being an advocate for the audit client), 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, service opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services
- Management functions
- Human resources
- Broker-dealer, investment adviser, or investment banking services
- 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).

The SEC staff frequently asked questions (FAQ) document Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence—Frequently Asked Questions, updated in June 2019, includes 11 questions related to non audit services provisions of the rule. FAQ No. 4 under section E addresses the question of whether a successor auditor who performed one of the prohibited services (bookkeeping, internal audit outsourcing, valuation services, actuarial services, financial information system design and implementation) during the prior audit period would be independent of the SEC audit client during the current audit period. 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. However, independence would be impaired if the successor auditor is engaged to help design a client's financial system in the prior audit period, and the system was not implemented until the current period

FAQ No. 11 under section E addresses the question of whether an auditor, prior to being dismissed, is precluded from proposing on prohibited non-audit services to be provided after the audit has been completed and the professional engagement period has ended. The FAQ states that proposing on prohibited non-audit services while the firm is still the auditor heightens the threat, both in fact and appearance, of audit team members acquiescing to management in order to increase the firm's chance of winning the prohibited non-audit services engagement. As such, independence could 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 (ET sec. 1.295) under the "Independence Rule" (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 (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 (ET sec. 1.295.030) under the "Independence Rule."

² See [Rule 2-01\(f\)\(4\) and \(6\)](#).

- 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.

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 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 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 (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 report³ 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

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 or provide network maintenance services for an attest client?

Effective January 1, 2021, your *firm* may not design, or develop an *attest client's* financial information system. In addition, the performance of ongoing functions, processes, or activities that involve management functions (e.g. operating an *attest client's* network, supervising client personnel, operating or managing the attest client's information technology helpdesk) is prohibited.

As long as all of the requirements of the "Nonattest Services" subtopic (1.295) are met, your *firm* may install and configure a commercial off-the-shelf financial information system package for an *attest client*, including helping the *attest client* set up a chart of accounts and *financial statement* format. However, your firm may not customize (i.e. modify or enhance the features and functions in ways that go beyond the options provided by the third-party vendor) such software.

Your *firm* may perform network maintenance, such as updating virus protection and applying certain updates and patches not developed by your firm, as long as the firm doesn't have the responsibility to perform ongoing maintenance. Your *firm* also may provide advice, training, or instruction 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, developing, installing, or implementing an information system that is unrelated to the *attest client's* financial information system as long as the requirements of the "Nonattest Services" subtopic (1.295) are met.⁴

Finally, your firm is precluded from performing interface services and data translation services for off-the-shelf financial information systems (unless the firm uses a third-party application for the services and the firm is not developing code for the application to work).

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).

⁴ [Frequently asked questions](#) are available to assist members in understanding and implementing the IT services provisions.

May my firm provide hosting services to an attest client?

Providing hosting services to an *attest client* after June 30, 2019 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 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 time after the conclusion of the engagement.

Another way to think about hosting services is if the client were to end the professional relationship with your firm and engage another firm to provide the same services. Would the former client need to come back to you in order for its books and records to be complete? If the answer is no, then your firm is not providing hosting services. If the answer is yes, then you may be providing hosting services. Additional examples are available in the [Hosting Services](#) interpretation. Also, the staff of the Professional Ethics Division issued nonauthoritative guidance (in the form of an [FAQ](#) document) that includes specific nonattest services questions and answers (including hosting).

For additional information listen to [episode 3](#), [episode 4](#) and [episode 12](#) of the Ethically Speaking podcast.

May my firm provide an attest client with training services?

The Nonattest Services [FAQ](#) document addresses the question of whether a *member's independence* would be *impaired* if the member 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.

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 responsibility 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 the member's areas of knowledge or experience, *independence* would not be *impaired*.

May my firm assist an attest client with implementing a new accounting standard?

New accounting standards may require changes that are difficult for your attest clients to understand and, as such, correspondence and discussions with clients may go outside the routine activities provided when providing attest services. Some examples of routine activities include discussions with the attest client about management's selection and application of accounting standards or policies and financial statement disclosure requirements, the appropriateness of methods used in determining accounting and financial reporting, adjusting entries that the member has prepared or proposed for management's considerations, or the form or content of the financial statements.

When assessing independence and assisting an attest client with implementing a new standard, you would want to consider whether the firm's involvement becomes so extensive that the firm may need to consider a separate service subject to the requirements for nonattest services. Some considerations may include the significance of the new accounting standard, the extent of the difference from the previous standard, or the complexity of the new standard. If your firm currently provides allowable non-attest services, you should also consider the cumulative effect on independence when providing multiple nonattest services. Before agreeing to perform nonattest services, you should evaluate whether the performance of multiple nonattest services by your firm in aggregate would create a significant threat to the firm's independence that cannot be reduced to an acceptable level with the application of safeguards.

Your firm should also be cautious of crossing the line that may lead to providing prohibited nonattest services. Your firm may explain the steps needed to achieve the principles of the new standard, but the attest client must accept responsibility for the work performed to implement the standard. Management participation and self-review threats seem to be the most prevalent threats when assisting clients with implementing new accounting standards, but there could be others. Your firm should apply the safeguards in the "[General Requirements for Performing Nonattest Services](#)" interpretation.

For additional information listen to [episode 9](#) and [episode 10](#) of the Ethically Speaking podcast.

What about cyber security services?

Firms are often asked to assist their clients with cybersecurity services. This type of service is often considered to be an advisory service depending on the specifics of the engagement. Practitioners would need to follow the guidance in the "[Advisory Services](#)" interpretation (ET sec. 1.295.105). The staff of the Professional Ethics Division issued nonauthoritative guidance (in the form of an [FAQ](#) document) that includes specific nonattest services questions and answers (including cybersecurity services).

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 (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 .04 of the "[Commissions and Referral Fees Rule](#)" (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

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

The AICPA rules do not specifically address this issue.

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.

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 (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](#)" (ET sec. 1.100.001) and the "[Objectivity and Independence](#)" principle (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 the member's 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 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:

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.

- 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*³
- The significance of the client to the engagement partner, office, or practice unit of the firm in light of the following:
 - o The amount of time the *partner*, *office*, or practice unit devotes to the engagement
 - o The effect on the *partner's* stature within the *firm* due to the partner's relationships with the *attest client*
 - o The manner in which the *partner*, *office*, or practice unit is compensated
 - o 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)

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 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 (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](#) 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
 - o [Conceptual Framework Toolkit for Independence](#)
 - o [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. In late summer 2020, the Government Audit Quality Center (GAQC) plans to release a Yellow Book independence Documentation Practice Aid updated for the 2018 Yellow Book on the [GAQC Resources](#) page.

SEC resources

- Consult the [SEC's January 2003 Rules Release](#).
- 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

- [DOL Regulation 2509.75-9](#), *Interpretive Bulletin Relating to Guidelines on Independence of Accountant Retained by Employee Benefit Plan*.
- Direct inquiries to 1.866.4.U.S.A.DOL.

Banking regulators' resources

- Review FDIC regulations "Annual Independent Audits and Reporting Requirements" ([Title 12 U.S. Code of Federal Regulations Part 363](#)).
- 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
- The NAIC developed a Model Rule, which is available at 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.



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