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2001

## White Paper: Independence Modernization Project

American Institute of Certified Public Accountants. Professional Ethics Executive Committee

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**WHITE PAPER**

**INDEPENDENCE RULES  
MODERNIZATION PROJECT**

**AICPA PROFESSIONAL ETHICS EXECUTIVE  
COMMITTEE**

**December 2001**

## NOTICE TO READERS

The Professional Ethics Executive Committee has developed this white paper to explain its November 2001 rules release, which revised interpretation 101-1 of Rule 101, *Independence*, and related definitions (ET section 92) of the AICPA Code of Professional Conduct. This paper also provides background and other pertinent information about comments received by the Committee from respondents to the exposure draft of the proposed rules, explains the consideration given to those comments by the Committee, and describes the rationale behind the Committee's adoption of various provisions in the final rules. Although this paper is not authoritative, the Committee believes the guidance it contains, including how various factors were considered during the rulemaking process, will help members, state boards of accountancy, state CPA societies, and other interested parties to gain a better understanding of the rules and how they should be applied.

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## Executive Summary

- ❖ To keep pace with sweeping changes affecting the accounting profession, in 2001 the AICPA Professional Ethics Executive Committee (the Committee) modernized its independence rules on financial, family and certain business relationships, adopting an engagement team-focused approach to independence and making the rules substantially consistent with those of the SEC and global standard setters.
- ❖ In determining the individuals and entities to whom the new independence rules should apply, the Committee evaluated the significance of threats to independence (both in fact and appearance) posed by various relationships between an attest client and individuals in a firm. The Committee concluded that the most significant threats to independence are posed by relationships of persons who are either on or close to that client's attest engagement—such persons are deemed to be *covered members* under the new AICPA rules. Certain relationships between a covered member's family and an attest client may also affect independence.
- ❖ Certain of the new rules extend to all partners and professionals in a firm. Employment and certain business relationships (such as directorships) apply not only to covered members but also to all other partners and professional employees in firms. In addition, no partner or professional employee may have a financial interest in a client that exceeds five percent of that client's outstanding equity.
- ❖ The Committee received broad support for its rule proposal, which was exposed to the membership in April 2001. Several respondents to the Committee's exposure draft suggested that the rules be as simple as practicable and that they be harmonized with rules of other independence standard setters and regulators.

## Background

In 1941, the American Institute of Certified Public Accountants (AICPA) first included independence requirements in its ethics rules governing the professional conduct of its members. The requirements' original purpose was to help ensure that auditors did not have inappropriate financial relationships with clients. Those requirements have been expanded considerably since that time to cover many types of financial, employment, family, and business relationships. The public interest has been well served by those requirements because users of financial information and other interested parties expect public accounting firms and their employees to provide attest services for their clients in an objective and unbiased manner. Nevertheless, major changes in the accounting profession, in firms and their clients, and in society have led many people to conclude that existing independence rules should be updated to ensure they continue to serve the public interest. Those changes include:

- More dual-career families
- More widespread ownership of stock and increased use of stock as compensation
- Globalization of clients
- Increased mobility of professionals and more flexible work arrangements

- Changes in the way accounting firms are structured and do business resulting from globalization, restructuring, affiliations with non-CPA firms and CPA firms, and public offerings

Given these developments, many people felt that the profession's independence requirements were too broad, imposing limitations on relationships with attest clients that posed little threat to independence. Others noted that those requirements unnecessarily restricted investment and employment opportunities available to some individuals in public accounting firms and their relatives. The Securities and Exchange Commission (SEC), Independence Standards Board (ISB),<sup>1</sup> and organizations outside the United States responded to these criticisms by modifying the focus of their rules from an approach that applied virtually firmwide to one that helps to ensure the independence of those individuals and entities that are involved in or can affect the outcome of a specific attest engagement.

The AICPA's modernization initiative is consistent with the approach used by those organizations. Specifically, the new AICPA rules significantly narrow the gap between rules for public (SEC rules) and private entities, as well as further international harmonization. By focusing on the sources of greatest threat of impaired independence for a specific attest engagement, these rules generally reduce the number of individuals in firms and their relatives whose relationships with attest clients are subject to restrictions without lowering audit quality or effectiveness.

Certain advantages may arise from use of this new approach. First, rules that are more reasonable and less onerous should help firms attract and retain qualified personnel more readily, a critical component in firms' ability to perform quality audits, without sacrificing auditor independence. In addition, rules that are generally consistent with SEC requirements may be expected to result in a lower incidence of inadvertent violations among professionals in firms that apply both SEC and AICPA rules.

In 2000, the AICPA began a project to update the independence rules in its Code of Professional Conduct. The Professional Ethics Executive Committee (Committee), which has responsibility for developing AICPA independence interpretations and rulings, formed a task force in February 2000. Based on task force recommendations, the Committee developed and issued an exposure draft (ED) on April 16, 2001, seeking comments from all interested parties. The ED was posted on the AICPA Web site, publicized to state accountancy boards, state CPA societies, and other interested parties, and explained in a Web cast developed by the Committee and the staff of the Professional Ethics Division. In addition, the Division's staff contacted accountancy boards and state CPA societies to encourage their participation in the standard-setting process and met with several of them to discuss the proposed rules and solicit their feedback. The comment period on the ED was extended from

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<sup>1</sup> The Securities and Exchange Commission (SEC) and AICPA jointly created the Independence Standards Board (ISB) in 1997 to initiate research, develop standards, and engage in a public analysis and debate of auditor independence issues. The SEC authorized the ISB to establish and improve independence standards in Financial Reporting Release No. 50 (FRR 50). Much of the ISB's work was incorporated into the SEC's new independence rules adopted in November 2000. Effective July 31, 2001, the SEC amended FRR 50 to state that it would no longer look to the ISB as an independence standard setter and the ISB was disbanded.

the normal 60 days to 90 days to permit all interested parties, including state boards of accountancy (which often meet quarterly), sufficient time to consider the issues.

The comment period ended on July 16, 2001. The Committee and the Division's staff analyzed 32 comment letters from ED respondents and made various changes based on their suggestions. The Committee approved the final version of the rules at its August 9, 2001, meeting. The rules were officially released in the November 2001 *Journal of Accountancy* and are effective on May 31, 2002, with earlier application encouraged.

The new rules include major revisions to Interpretation No. 101-1, "Interpretation of Rule 101," of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.02), and ET section 92, *Definitions* (AICPA, *Professional Standards*, vol. 2), included as Appendixes 1 and 2 of this White Paper. Interpretation No. 101-11 has also been revised to apply the new rules to certain engagements performed under Statements of Standards for Attestation Engagements that are restricted to identified parties. A transition period and grandfathering provisions are included, and the Division's staff has made certain educational tools available, including articles, the AICPA *Plain English Guide to Independence*, a CD-ROM interactive course, and other materials to assist individuals and firms when they adopt the new rules.

The new rules differ in certain, limited respects from current SEC independence requirements. Appendix 3 compares the new AICPA rules to those of the SEC and highlights the differences. State boards of accountancy and other regulators (such as the Department of Labor) may have independence requirements that differ from those of the SEC and AICPA. Firms and individuals should ascertain that they are in compliance with all applicable rules before accepting an attest engagement.

The rest of this White Paper summarizes the new AICPA rules. It also discusses the rationale underlying the Committee's basic approach and major decisions.

### **New AICPA Independence Rules**

Individuals working in firms that provide attest services for clients may have a wide variety of financial, business, and family relationships with their firm's attest clients. For example, an individual may have a checking account at a bank that is audited by that individual's firm, or an attest client may employ an individual's spouse. For many years, the accounting profession's independence rules have prohibited firms, various individuals in those firms, close relatives of those individuals, and entities controlled by those individuals from having certain financial or business relationships with any of the firm's attest clients.

Those old rules generally applied broadly to a group of individuals and entities called *members*:

- Firms engaged in public accounting practice
- All of a firm's partners (or, if applicable, its stockholders or proprietors)
- All individuals in a firm who either participate in an attest engagement or have managerial positions in offices that participate in a significant portion of an engagement
- All entities controlled by a firm or by members acting individually or together

Under those rules, for example, every partner in a firm was proscribed from having specified financial, employment, and certain other business relationships with every one of the firm's attest clients. The rules required this even if the partner had no contact with an attest client or with individuals associated with the attest client or the attest engagement. The rules also proscribed certain relationships between attest clients and members' spouses, dependents, and other close relatives. For example, a member's spouse was prohibited from having a financial interest in an attest client if the member was a partner of the firm. This was so even if the partner was located in an office hundreds of miles from the office performing that client's engagement and he or she had no involvement in, or influence over, the engagement at all.

The project to modernize the AICPA independence rules focused on the two categories of relationships described in Interpretation No. 101-1 of the AICPA Code of Professional Conduct:

1. Investments and other types of financial relationships
2. Employment and other types of business relationships

Independence may be impaired in these circumstances because they involve relationships with attest clients (for example, debtor-creditor, investor-investee, or employer-employee relationships) that are or are perceived to be inconsistent with an individual's responsibility to maintain objectivity—that is, to be “impartial, intellectually honest, and free of conflicts of interest” (Article IV, *Objectivity and Independence*, of the Code of Professional Conduct [AICPA, *Professional Publications*, vol. 2, ET sec. 55.01]).

To determine the individuals and entities to whom the new independence rules should apply, the Committee evaluated the significance of threats to independence posed by those relationships. Its initial conclusion was that the old rules prohibiting relationships between every member and every attest client of the member's firm were too broad because the significance of the threats for different types of individuals and entities that met the rules' definition of member varied greatly. The Committee decided to analyze those threats and develop new rules proscribing those relationships posing an unacceptable risk of impairing independence. In doing so, the Committee considered both independence of mind (that is, an individual's ability to make objective decisions) and independence in appearance (that is, whether a reasonable person aware of all the relevant facts would conclude that independence of mind is not impaired). Initially, the Committee considered the work of the ISB, which originated the engagement team concept; later, the Committee also monitored the SEC's rulemaking activities, which carried forward this concept.

## To Whom Should Independence Rules Apply?

The Committee concluded that the most significant threats to independence are posed by relationships between an attest **client**<sup>2</sup> and individuals in a **firm** who are either on or close to that client's **attest engagement**. This group of individuals includes attest engagement team members and other individuals who are in a position to have a direct or indirect impact on the conduct of the engagement, on its outcome, or on the engagement team members themselves. The consequences of impaired independence for these individuals are greatest because, if their objectivity is compromised, audit decisions could be directly affected and audit effectiveness could be reduced.

Initially, the Committee attempted to identify specific job titles, such as managing partner, that described individuals who are not on engagement teams but who would be in positions to affect attest engagements or engagement team members during the conduct of the engagements. Because AICPA independence rules apply to firms of very different sizes and structures, however, the Committee decided that the rules should describe categories of individuals and entities rather than specific job titles.

Covered Members. The Committee concluded that individuals and entities in any of six categories should be grouped together for purposes of applying independence rules because relationships between attest clients and those individuals and entities generally pose the greatest threat to independence. The new rules refer to an individual or entity in any of the following categories as a **covered member** with respect to a specific attest engagement:

- “An individual on the attest engagement team.” The Committee concluded that the most significant threats to independence are posed by relationships between attest clients and individuals in a firm who are closest to the engagement—those who perform attest services for those clients.
- “An **individual in a position to influence the attest engagement**.” Although these individuals are not on the engagement team, they may be able to influence decisions made during the engagement, the performance of the engagement team members, and therefore, its outcome. For example, a firm's managing partner—the individual who typically oversees all professional services rendered by the firm—makes decisions that directly affect engagement team members and possibly the outcomes of attest engagements. Likewise, a firm's regional audit and attest partner or partners make decisions that may affect attest engagements in their particular region. Individuals who evaluate performance or approve compensation of audit or attest partners and individuals who perform or oversee quality control engagements (for example, as part of a firm's internal monitoring procedures) may also be able to influence those engagements.
- A **partner** or **manager** who provides 10 or more hours of nonattest services to the attest client.<sup>3</sup> Individuals in this category may have significant interaction with engagement team members and attest clients. For example, a partner who provides 40 hours of tax

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<sup>2</sup> Terms defined in Appendix 1 are shown in **boldface print** upon first usage in this section of the White Paper.

<sup>3</sup> The period in which independence is required of a partner or manager in this category begins when the individual completes 10 hours of nonattest services for a client in the client's fiscal year and ends on the later of two dates: the date the firm signs the report on the financial statements for the fiscal year during which those services were provided or when the individual no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis.



services to an attest client may discuss areas of shared concern with individuals on the engagement team<sup>4</sup> and, therefore, may be in a position to affect decisions made on that engagement.

- “A partner in the **office** in which the lead attest engagement partner primarily practices in connection with the attest engagement.” These individuals may appear to affect attest engagements because of their physical proximity to lead engagement partners, which gives them a greater opportunity to have regular professional interaction with those partners.
- “A firm, including the firm’s employee benefit plans.” The Committee concluded that a firm as an entity, as well as a firm’s employee benefit plans, should be subject to the same independence rules as individual owners of the firm. A firm’s name (not an individual owner’s name) appears on attest reports, and the public relies on that name to add credibility to clients’ financial information. Because a firm’s employee benefit plan is typically created by the firm and operates for the benefit of the firm’s owners and employees, the Committee concluded that those plans should adhere to the same independence rules that apply to firms.
- “An entity whose operating, financial, or accounting policies can be controlled...by any of the individuals or entities described above or by two or more of those covered members acting together.” Being controlled by a covered member (or members), the Committee decided that these entities should be subject to the same rules as any other covered member.<sup>5</sup>

Immediate Families and Close Relatives of Covered Members. The Committee also discussed the significance of threats to independence posed by relationships between attest clients and covered members’ relatives. Because covered members’ relatives do not participate in attest engagements or generally have contact with attest clients, the Committee concluded that relationships between covered members’ relatives and attest clients are far less likely to influence decisions made on engagements and, therefore, those relationships pose less risk of impairing independence than if the relationships existed between covered members and attest clients. Nevertheless, the Committee concluded that two groups of covered members’ relatives should be included in the new rules:

- A covered member’s **immediate family** (defined as spouses, spousal equivalents, and dependents). Because of the strength of the family bond between the covered member and his or her immediate family, the Committee concluded that threats from financial or business relationships between a covered member’s immediate family and an attest client generally are as significant as those posed by the same relationships between the covered member and the client. As a result, similar rules should apply to covered members and to their immediate families.
- A covered member’s **close relatives** (defined as parents, siblings, and nondependent children).<sup>6</sup> These relatives may have some contact with the covered member to whom they

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<sup>4</sup> For further information, see Statement on Auditing Standards No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1 (AU sec. 311, “Planning and Supervision”).

<sup>5</sup> This position is consistent with the previous interpretation of “member” as well as Interpretation No. 505-2, “Application of Rules of Conduct to Members Who Own a Separate Business,” of ET section 505, *Form of Organization and Name* (AICPA, *Professional Standards*, vol. 2 (ET sec. 505.03)).

<sup>6</sup> The new rules significantly narrow the definition of close relative.

are related, but such contact is unlikely to be as close or as frequent as the contact between a covered member and his or her immediate family. As a result, less restrictive rules should apply to these individuals—that is, in most cases, a more significant relationship between a covered member’s close relative and an attest client must exist before independence would be considered to be impaired.

Other Individuals in a Firm and Other Relatives of a Covered Member. The Committee concluded that the threat of impaired independence resulting from relationships between an attest client and an individual who is *not* considered to be a covered member with respect to a specific client is substantially less because such individual would typically be unable to affect the outcome of that client’s attest engagement. Nevertheless, the Committee concluded that proscriptions of some particularly significant relationships with an attest client—for example, owning more than 5 percent of a client’s common stock—should be extended to include all partners and other professional employees of the firm, even if those individuals are not considered to be covered members with respect to that client. The Committee also concluded that the threats to independence posed by relationships between an attest client and relatives of covered members who are not defined as immediate family or close relatives are insignificant and, therefore, no specific restrictions on these relationships are included in the new rules.

#### Rules Concerning Investments and Other Financial Relationships

The Committee considered four specific types of financial relationships:

1. Direct or material indirect financial interests in an attest client
2. Serving as a trustee, executor, or administrator of a trust or an estate that has a direct or material indirect financial interest in an attest client
3. Material<sup>7</sup> **joint closely held investments** with an attest client, officers or directors of an attest client, or stockholders of such client who can exercise **significant influence** over the client
4. **Loans** to or from an attest client, officers or directors of an attest client, or individuals who own 10 percent or more of the client’s outstanding equity securities or other ownership interests<sup>8</sup>

Such financial interests or lending relationships with a client may impair an individual’s independence because he or she has an interest in the financial health of the client. Or, the individual may have a material joint closely held investment with a client (or persons associated with the client such as officers or directors). Such relationship may bias the individual in favor of the client, which would be incompatible with the individual’s obligation to maintain objectivity on attest engagements.

The question the Committee needed to resolve was, for which of the groups described previously do these relationships threaten independence? The Committee considered this question by analyzing

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<sup>7</sup> To determine whether an investment is material, the new rules require that the financial interests of covered members and their immediate families be aggregated.

<sup>8</sup> Except as specifically permitted in Interpretation No. 101-5, “Loans From Financial Institutions Clients and Related Terminology,” of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.07).

the significance of the threats to independence when different individuals in firms, relatives of those individuals, and related entities have such relationships with attest clients.

For each of the four types of financial relationships described previously, the Committee concluded that the threat to independence for covered members is unacceptably high. As a result, the rules generally proscribe those relationships for all covered members. In addition, because the Committee considered immediate family members' financial interests generally to be the same as those of the covered member, the rules also prohibit a covered member's immediate family from having those types of financial relationships with the attest client.

The new rules, however, do contain an exception for the immediate family of two types of covered members: partners or managers who provide 10 or more hours of nonattest services to a client and partners in the office in which the lead engagement partner primarily practices in connection with an engagement. The Committee concluded that the immediate family of these types of covered members are sufficiently distant from attest clients and engagement teams, and the rules permit these family members to have one type of financial relationship that is proscribed for other covered members' immediate family. They may participate in retirement, savings, compensation, or similar plans sponsored by, or that invest in, an attest client—as long as those plans are normally offered to all of the employer's personnel in positions similar to those held by the immediate family member. In addition, if the employer is an attest client, the immediate family member should not be in a “**key position**” (discussed below under “Rules Concerning Employment and Certain Other Business Relationships”).

The Committee also felt that there generally is less risk of impaired independence when financial relationships with attest clients involve covered members' close relatives rather than the covered members themselves or their immediate families. As a result, the new rules include only the following proscriptions on such relationships:

- Close relatives of an individual on an attest engagement may not have a financial interest in such client if either (1) the financial interest is material to the close relative and is known to the engagement team member, *or* (2) the financial interest allows the close relative to exercise significant influence over the client.
- Close relatives of individuals in a position to influence an attest engagement or of partners in the office in which the lead partner primarily practices in connection with the client's attest engagement may not have a financial interest in such client that (1) is material to the close relative and is known to the individual in the firm *and* (2) gives the close relative the ability to exercise significant influence over the client.

The Committee identified one type of financial relationship that poses an especially significant threat to independence—when a partner or professional employee in a firm (or his or her immediate family), either acting separately or together, owns more than 5 percent of an attest client's outstanding equity securities or other ownership interests (for example, units in a limited partnership). The new rules extend the proscription on these types of relationships beyond covered members and their immediate families to include all firm partners and professional employees, as well as their immediate family members.

#### Rules Concerning Employment and Certain Other Business Relationships

The Committee discussed threats to independence that may arise when individuals in a firm and their relatives have employment and certain other business relationships with an attest client. The Committee considered the following relationships:

- Working either as a director, officer, or employee of an attest client or in any position in which the individual acts in a capacity equivalent to a member of client management
- Serving as a promoter, underwriter, or voting trustee for an attest client
- Serving as a trustee of an attest client's pension or profit-sharing trust

When an individual in a firm has any of these types of employment or business relationships with an attest client, independence will be considered to be impaired because such relationship puts the firm in a position of reviewing the individual's decisions and other actions. Independence rules have generally precluded individuals and firms from making decisions on behalf of attest clients.

As in the case of financial relationships, the Committee's approach was first to identify individuals in the firm whose employment or business relationships with an attest client would appear to impair independence. The Committee concluded that the threats created by the employment and business relationships described above would be perceived to impair a firm's independence even if the individuals were not covered members. As a result, the new rules proscribing employment and certain other business relationships apply not only to covered members but also to all other partners and professional employees in the firm.

The Committee then considered how the rules should apply to employment and certain other business relationships between an attest client and a covered member's immediate family and close relatives. The Committee considered the threats to independence in those situations generally to be less significant than those posed by similar relationships between an attest client and partners, professional employees, and other covered members. The Committee decided that the new rules should therefore proscribe only certain employment relationships between attest clients and a covered member's relatives, as follows:

- A covered member's immediate family may not have a key position with the attest client. Key positions are those in which the covered member's immediate family either (1) has primary responsibility for the client's significant accounting functions that support material financial statement components, (2) has primary responsibility for preparing the client's financial statements, or (3) can exercise influence over the contents of the client's financial statements. The Committee included examples of positions that meet the third criterion—for example, an attest client's chief executive officer, president, controller, and chief financial officer.
- Close relatives of three categories of covered members also are proscribed from having key positions with an attest client: (1) individuals on the client's attest engagement team, (2) individuals in a position to influence the attest engagement, and (3) other partners in the office in which the lead partner primarily practices in connection with the client's attest engagement.

### Individuals' Prior Associations With Attest Clients

The Committee discussed various situations in which individuals, before their employment with a firm, had worked for or otherwise had been associated with an attest client. The Committee felt that the risk of impaired independence was greatest when an individual held a position with a client in which he or she made decisions or participated in decision-making that is subject to review as part of the client's attest engagement covering a period during which the individual was associated with the client. As a result, the new rules prohibit an individual who previously was an officer, director, or employee of a firm's attest client or was associated with the client as a promoter, underwriter, voting trustee, or trustee of the client's pension or profit-sharing trust from participating on that client's engagement team or from being in a position to influence the client's attest engagement covering those periods.

The Committee also agreed that the firm's independence would be impaired if two other categories of covered member—partners or managers who will provide 10 or more hours of nonattest services to an attest client and partners who will work in the same office in which the lead partner primarily practices in connection with a client's attest engagement—do not disassociate from the client by taking the following actions *before* they become a covered member:

- Dispose of all direct or material indirect financial interests in the client
- Collect or repay loans to or from the client, except as permitted under Ethics Interpretation No. 101-5, "Loans From Financial Institutions Clients and Related Terminology," of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.07)
- Stop participating in client-sponsored employee benefit plans<sup>9</sup>
- Liquidate or transfer all vested benefits in the attest client's retirement, deferred compensation, and similar plans at the earliest possible date allowed under the plan<sup>10</sup>

### Transition and Grandfathering Provisions

The new rules prohibit employment and certain other business relationships between attest clients and non-partner professional employees that were not prohibited under the old rules. For example, non-partners outside an office where a significant amount of attest services are provided for a client previously had been permitted to serve on that client's board of directors. Such relationships are proscribed, however, under the new rules. To allow individuals who were in compliance with the old rules adequate time to sever relationships that are now proscribed, the new rules provide for a six-month transition period.

The new rules also include grandfathering provisions for certain employment relationships permitted under the old rules that are now proscribed. For example, under the old rules, no employment restrictions existed for the spouse of a manager who provided more than 10 hours of nonattest services to an audit client provided the manager did not participate in the audit engagement or reside in the office where a significant portion of audit services were provided to that client. Under the new rules, that employment relationship is prohibited if a covered member's

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<sup>9</sup> The rules provide one exception: partners or managers may continue to participate in client-sponsored employee benefit plans if a client is legally required to allow individuals to participate in the plan (for example, under COBRA) and individuals pay 100 percent of the cost of participation on a current basis.

<sup>10</sup> Liquidation or transfer is not required under the new rules if a penalty significant to the benefits is imposed upon liquidation or transfer.

spouse is employed in a key position with the client. The grandfathering provisions do not require employment relationships between an attest client and a covered member's immediate family and close relatives to be severed if they existed when the new rules first become effective and were in compliance with preexisting rules.

### **Basis for Conclusions**

This section describes the rationale underlying the Committee's major decisions. It also discusses comments received on the exposure draft. Members, firms, professional organizations, state CPA societies, state boards of accountancy, and other legislative bodies generally supported the Committee's efforts to modernize the independence rules using the engagement team-focused—or covered member—approach. They also emphasized the importance of harmonizing the rules with those of various organizations, including the AICPA, SEC, state boards of accountancy, and others. Several respondents also stressed the need for simplicity and clarity. The Committee considered these comments, and responses to specific questions posed in the ED, when it adopted the final rules.

#### Applicability of the Rules

The Committee's basic approach was to prohibit those relationships between an attest client and any individual (or entity) that were deemed to pose an unacceptable threat to independence. Under this approach, restrictions are generally limited to individuals on an engagement team and those who can, through professional interaction, influence the engagement team and, as a result, the outcome of the attest engagement.

A large majority of the ED respondents supported the covered member approach whereby the Committee described six categories of covered members for whom, with few exceptions, the independence rules would apply. Some respondents, however, did ask the Committee to consider various changes in specific rules' applicability. Others sought more detailed guidance in certain areas, especially concerning the categories of covered members.

Individuals in a Position to Influence the Attest Engagement. Several respondents to the ED noted that, to be consistent with SEC rules, technical or industry consultants should be included as "individuals on the attest engagement team" rather than as "individuals in a position to influence the attest engagement." The Committee concluded, however, that people called in to consult with engagement teams on technical or industry matters ordinarily are able to influence engagements only through their involvement as consultants, a role that often is brief or occurs toward the end of an engagement. In addition, the new rules are equally applicable<sup>11</sup> to individuals on engagement teams and those in a position to influence engagements. As a result, the Committee concluded that changing the classification of technical or industry consultants would have little or no impact when the new rules are applied.

By including as covered members (that is, as "individuals in a position to influence the attest engagement") those who evaluate an attest engagement partner's performance or recommend his or

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<sup>11</sup> Except with respect to the individual's close relatives.

her compensation, the Committee's intent was to include all individuals in a firm who are responsible for judging that partner's performance or for recommending his or her compensation based on performance and other criteria. Accordingly, individuals directly responsible for specific compensation decisions—such as members of compensation, executive, or similar boards or committees—are covered members when they actively participate in decisions about compensating specific attest engagement partners. The Committee, however, did not intend to include all partners in firms as covered members on all attest engagements based solely on a firm's policy requiring all partners to approve all compensation decisions made within the firm. The Committee also did not intend to include administrative personnel, such as human resources staff, as covered members unless they are directly involved in making substantive compensation decisions with respect to specific attest engagement partners.

Under the new rules, all individuals who participate in or oversee quality control activities with respect to a specific attest engagement are considered to be covered members with respect to that engagement. The Committee's intention was to include all individuals who perform internal quality control functions for firms or who oversee the performance of those functions. The Committee did not consider individuals performing external peer reviews to be covered members; independence requirements for individuals performing peer reviews are included in specific standards relating to such reviews.

Use of 10-Hour Threshold. Several respondents questioned the use of an arbitrary, 10-hour threshold to identify partners or managers who are to be included as covered members. The Committee agreed that 10 hours provided a reasonable basis for identifying individuals who may be (or appear to be) able to influence an attest engagement. This threshold is consistent with SEC rules.

Partners in the Lead Engagement Partner's Office. Most respondents agreed with the Committee's proposal to include all "partners in the office in which the lead partner primarily practices in connection with the attest engagement" in the definition of covered member. Some respondents, however, felt that the provision was too broad because they believed that those partners ordinarily would not be able to influence engagements in any meaningful way unless they were otherwise involved in the engagement. One respondent noted that, under the definition, all of the partners in single-office firms would be classified as covered members for all of those firms' attest engagements. That respondent proposed that, rather than deem such partners to be covered members subject to restrictions, the Committee instead consider requiring independent, concurring partner reviews of attest engagements. A few believed that the proposal to include in the covered member definition all partners in the lead engagement partners' offices was not sufficiently broad and supported a covered member definition that would continue to include all of a firm's partners.

For reasons previously described (physical proximity, opportunity for regular, professional interaction), the Committee felt that all partners in the same office as a client's lead attest engagement partner should be subject to certain restrictions, else the appearance of independence could be affected.

This provision is also consistent with SEC requirements.

Definition of “Office in Which the Lead Attest Partner Primarily Practices in Connection With the Attest Engagement.” Some respondents asked the Committee to clarify the term “office” because it is critical in determining which partners are considered to be covered members with respect to a specific attest engagement. For example, one respondent asked the Committee whether an engagement partner’s office should always be their “home” office. The Committee believed that should not be the case, noting that other factors, such as the location and staffing of the engagement, also could be considered. The Committee noted that members should use their judgment in identifying offices based on their firm’s specific facts and circumstances.

Immediate Family Members. Some respondents asked the Committee to clarify the definitions of “spousal equivalent” and “dependent,” two types of immediate family members whose relationships are restricted under the new rules. The Committee decided not to include in the new rules formal definitions of these terms, concluding that “spousal equivalent” status should be evaluated on a case-by-case basis. For example, common law marriages are defined using various criteria under some state laws.<sup>12</sup>

The Committee also considered referencing the Internal Revenue Code definition of “dependent.” It concluded, however, that such a definition would not provide helpful guidance because it requires financial support and other tests that yield results not always consistent with the Committee’s intent. Generally, the Committee’s intention was to include as a covered member’s dependent any individual who receives more than half of his or her financial support from the covered member.

#### Investments and Other Financial Relationships

The restrictions governing investments and other financial relationships included in the new rules are, in large part, the same as previous AICPA rules. The Committee, however, did adopt two changes to the rules concerning financial interests of certain close relatives and ownership interests exceeding 5 percent of a client’s outstanding equity. In addition, the Committee’s proposal to allow immediate family of certain covered members to invest in clients through an employer’s compensation or benefit plan prompted several comments.

Exception to Allow Immediate Families of Certain Covered Members to Invest in Clients Through Employers’ Compensation or Benefit Plans. A covered member’s immediate family is generally subject to the same restrictions as the covered member. However, one exception allows the immediate families of certain covered members to invest in clients through employers’ compensation or benefit plans.<sup>13</sup>

Most respondents agreed that such an exception was appropriate, although several suggested modifications. One suggestion was to specify a limit on those investments to ensure that persons in a covered member’s immediate family do not exercise significant influence over the attest client or have a material financial interest in the client. Another suggested limiting investments to situations in which the investment was the unavoidable consequence of the immediate family member’s

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<sup>12</sup> It should be noted that the lack of a common law marriage under state law (or the lack of such law recognizing common law marriages in an individual’s state of residence) does not mean that an individual is not a spousal equivalent if other factors which lead to that conclusion are present.

<sup>13</sup> The second exception, which deals with certain permitted employment relationships, is described later under “Employment and Certain Other Business Relationships.”



employment—for example, when the family member’s only choice is to receive compensation in the form of securities in an attest client. Other respondents believed that no such investments by a covered member’s immediate family should be permitted. One respondent thought the rules should permit the family member to receive immaterial amounts of stock compensation provided he or she was not currently entitled to possess the client’s securities, as in the case of unvested stock options. One final suggestion was to allow these situations as long as their existence was disclosed in the clients’ financial statements.

The Committee considered these suggestions but decided not to modify the proposed rule for several reasons: (1) allowing investments only when immediate family members have no other available choices is overly restrictive because they would have to forego investment opportunities that pose little risk of impairing independence, (2) owning investments acquired through participation in an employer’s benefit plan rarely leads to significant influence over the employer, and (3) the exception is generally consistent with SEC rules.

Application of Rules to Certain Covered Members’ Close Relatives. Respondents generally agreed with the Committee’s proposals concerning these provisions, although a few respondents found the proposed rules to be overly restrictive. For example, one noted that one aspect of the proposal was more strict than SEC requirements (that is, independence would be considered to be impaired if an individual on the attest engagement team knew of his or her close relative’s material financial interest in the client). Another suggested that the Committee eliminate the materiality test for close relatives’ investments in attest clients and proscribe only those interests that allow the close relative to exercise significant influence over the client. One respondent believed that the materiality of close relatives’ investments should be measured with respect to covered members as well as their close relatives.

The Committee’s decision to adopt a rule that was—in one respect—more restrictive than the SEC rule was a difficult one, but one that it believed to be necessary. Specifically, members firmly believed that the close relative (parent, nondependent children, or sibling) of an attest engagement team member should *not* have a financial interest that is material to the relative’s net worth<sup>14</sup> (regardless of the relative’s proportional ownership of the client). That position retains the previous AICPA rule and represents a higher standard for attest engagement team members than for those in a position to influence the engagement and partners in the office in which the lead attest engagement partner primarily practices in connection with the engagement.<sup>15</sup> The Committee felt that such a “tiered” approach was appropriate because an attest engagement participant would be in a position to make decisions that could have a positive effect on his or her relative’s investment in the client and may be willing to do so if the investment were material to the relative. For other covered members who are not actually performing functions related to the attest engagement, such threat would be less likely, thereby permitting a more relaxed standard.

Financial Interests Exceeding 5 Percent of a Client’s Outstanding Equity Securities. In the ED, the Committee proposed restrictions on one type of financial relationship posing an especially

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<sup>14</sup> And of which the engagement team participant has knowledge.

<sup>15</sup> For those categories of covered members, the close relative’s known, material financial interest would also have to enable the relative to exercise significant influence over the client for independence to be considered impaired.

significant threat to independence—if an individual in a firm or his or her immediate family members, either acting separately or together, have a financial interest in one of the firm’s attest clients that permits the individual or individuals to exercise significant influence over that attest client. The proposal defined “significant influence” as consistent with Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and its interpretations. Although many respondents agreed with that definition (under which significant influence is generally presumed to exist for stock ownership of 20 percent or more), others suggested an ownership threshold of 5 percent, which is consistent with SEC rules. Some respondents also were concerned about using the guidelines in APB Opinion No. 18. They wanted a more objective measure of when significant influence was present.

The Committee concluded that the new rules would be both less subjective and consistent with current SEC rules if the ownership threshold were 5 percent of attest clients’ outstanding equity securities or other ownership interests rather than significant influence as defined in APB Opinion No. 18. Accordingly, Interpretation No. 101-1.B states that independence is impaired if any partner or professional employee in the firm (or his or her immediate family) owns more than 5 percent of the client’s outstanding equity securities (or similar interests). The Committee decided to adopt the proposed definition of “significant influence” as a definition in the Code of Professional Conduct, however, for purposes of other provisions, such as the close relative rule, which applies such test to investments held by relatives of certain covered members.

#### Employment and Certain Other Business Relationships

Previous AICPA rules involving employment and certain other business relationships (for example, being a director or officer of a client or a promoter or underwriter of the client’s securities) have applied to a wide range of individuals in firms. The Committee proposed to continue the requirement that all partners in firms and all professional staff in an office participating in a significant portion of an attest engagement be prohibited from having employment and certain other business relationships with such attest clients.<sup>16</sup>

Respondents to the ED generally supported proposed rules concerning restrictions on employment and certain other business relationships. In one area, however, a number of respondents indicated that the proposal was too liberal: the ED would have allowed nonpartners who are not considered covered members regarding a specific client’s attest engagement to have business or employment relationships with that client—for example, a staff person who provides no professional services to an attest client could serve on that client’s board of directors. These respondents believed that such relationships were highly likely to be perceived to impair independence and, as a result, all professional personnel in a firm should be prohibited from having employment or certain other business relationships with any of the firm’s attest clients. Other respondents proposed a compromise position, permitting only certain associations between individuals in firms and clients that are not-for-profit organizations.

The Committee reconsidered the ED provision and decided to extend the restrictions on employment and certain other relationships to all partners and professional employees. In agreeing to make the rule more restrictive, the Committee concluded that relationships with attest clients,

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<sup>16</sup> In the case of partners, the prohibitions extended to all of a firm’s attest clients.

such as board memberships, posed too great a threat to the appearance of independence. Simplicity (that is, broader application eliminates the need to identify significant performing offices to determine which professional staff need to comply with the rule) and harmonization of the AICPA and SEC rules were also important factors in the Committee's decision.

Exception to Allow a Covered Member's Immediate Family and Close Relatives to Be Employed by a Client in Certain Positions. Almost all of the ED respondents supported the proposed rule permitting a covered member's immediate family and close relatives to be employed by a client in any position that is not a "key position." One respondent suggested that the Committee consider prohibiting immediate family members of individuals participating on attest engagement teams from holding any position with those attest clients. The Committee, however, concluded that such restrictions were unnecessary because positions that are not key positions do not permit immediate family members to materially affect a client's financial statements (or, if the engagement is an attestation engagement involving other information, other data) to which firms are attesting.

Most respondents also supported the proposed definition of "key position." Several respondents, however, suggested adding position titles or other descriptions—such as chief information officer, tax director, and operational or sales executive—to those included in the ED. Others felt that including a list of position descriptions as examples of key positions was not helpful.

The Committee concluded that the employment restrictions involving a covered member's immediate members and close relatives should generally apply only with respect to an attest client's key positions and that the list of positions in the definition illustrates those positions considered to be key. However, it intends that the phrase "or any equivalent position" included at the end of the list be considered to determine whether any position that includes a role or function equivalent to those identified should be included as a key position, even if the specific position title is not listed.

Other ED respondents asked the Committee to clarify two of the criteria used to identify a key position: "has primary responsibility for significant accounting functions that support material components of the financial statements" and "has primary responsibility for the preparation of the financial statements." Although the final rules do not elaborate on those criteria, the Committee's intent was to limit the meaning of key positions to those requiring the use of judgments and estimates that significantly affect material components of a client's financial statements (or other subject matter if the attest engagement is related to something other than financial statements). Key positions do not include those involving the exercise of little or no judgment regarding significant accounting matters, such as may be the case with clerical or certain bookkeeping work. For example, jobs that involve purely mechanical computations would not be key positions even if the results of those computations were material to the client's financial statements taken as a whole.

### **Summary**

The new AICPA independence rules proscribe certain financial, employment, and business relationships between an attest client and its attest firm and any individual or entity that is deemed to pose an unacceptable threat to independence. The Committee believes these rules are responsive to the current environment in which accounting firms and their clients currently operate. Appendices 1 and 2 contain the final version of those rules. Appendix 3 compares the new rules to

those of the SEC. Appendix 4 summarizes the most important provisions of the rules. Appendix 5 briefly illustrates AICPA rule changes.

# **APPENDIX 1**

## **Interpretation of Rule 101, *Independence***

### **Code of Professional Conduct**

## ET Section 101.02

### Independence shall be considered to be impaired if:

- A. During the **period of the professional engagement**\* a **covered member**
  - 1. Had or was committed to acquire any direct or material indirect financial interest in the **client**.
  - 2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client.
  - 3. Had a **joint closely held investment** that was material to the covered member.
  - 4. Except as specifically permitted in interpretation 101-5 [ET section 101.07], had any **loan** to or from the client, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests.
- B. During the period of the professional engagement, a **partner** or professional employee of the **firm**, his or her **immediate family**, or any group of such persons acting together owned more than five percent of a client's outstanding equity securities or other ownership interests.
- C. During the period covered by the **financial statements** or during the period of the professional engagement, a partner or professional employee of the firm was simultaneously associated with the client as a(n)
  - 1. Director, officer, or employee, or in any capacity equivalent to that of a member of management;
  - 2. Promoter, underwriter, or voting trustee; or
  - 3. Trustee for any pension or profit-sharing trust of the client.

### Transition Period for Certain Business and Employment Relationships

A business or employment relationship with a client that impairs independence under interpretation 101-1.C [ET section 101.02], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under rule 101 [ET section 101.01], and its interpretations and rulings as of November 2001, and the individual severed that relationship on or before May 31, 2002.

### Application of the Independence Rules to Covered Members Formerly Employed by or Associated With a Client

An individual who was formerly employed by or associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client would impair his or her firm's independence if the individual—

- 1. Participated on the **attest engagement team** or was an **individual in a position to influence the attest engagement** for the client when the attest engagement covers any period that includes his or her former employment or association with that client; or

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\* Terms shown in boldface type upon first usage in this interpretation are defined in ET section 92, *Definitions* (AICPA, *Professional Standards*, vol. 2). See Appendix 2 of this White Paper for the final version of these definitions.

2. Provided ten or more hours of non-attest services to the client or was a partner in the **office** in which the lead attest engagement partner primarily practices in connection with the attest engagement for the client unless the individual first disassociates from the client by—
  - (a) Terminating any relationships with the client described in interpretation 101-1.C [ET section 101.02];
  - (b) Disposing of any direct or material indirect financial interest in the client;
  - (c) Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under interpretation 101-5 [ET section 101.07];
  - (d) Ceasing to participate <sup>1</sup> in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and
  - (e) Liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty <sup>2</sup> significant to the benefits is imposed upon liquidation or transfer.

#### **Application of the Independence Rules to a Covered Member's Immediate Family**

Except as stated in the following paragraph, a covered member's immediate family is subject to rule 101 [ET section 101.01], and its interpretations and rulings.

The exceptions are that independence would not be considered to be impaired solely as a result of the following:

1. An individual in a covered member's immediate family was employed by the client in a position other than a **key position**.
2. In connection with his or her employment, an individual in the immediate family of one of the following covered members participated in a retirement, savings, compensation, or similar plan that is sponsored by a client or that invests in a client (provided such plan is normally offered to all employees in similar positions):
  - a. A partner or **manager** who provides ten or more hours of non-attest services to the client; or
  - b. Any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement.

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<sup>1</sup> See Ethics Ruling No. 107, "Participation in Health and Welfare Plan of Client" (ET sec. 191.214–.215), for instances in which participation was the result of permitted employment of the individual's spouse or spousal equivalent.

<sup>2</sup> 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.

For purposes of determining materiality under rule 101 [ET section 101.01] the financial interests of the covered member and his or her immediate family should be aggregated.

### **Application of the Independence Rules to Close Relatives**

Independence would be considered to be impaired if—

1. An individual participating on the attest engagement team has a **close relative** who had
  - a. A key position with the client, or
  - b. A financial interest in the client that
    - (i) Was material to the close relative and of which the individual has knowledge; or
    - (ii) Enabled the close relative to exercise **significant influence** over the client.
2. An individual in a position to influence the attest engagement or any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement has a close relative who had
  - a. A key position with the client; or
  - b. A financial interest in the client that
    - (i) Was material to the close relative and of which the individual or partner has knowledge; and
    - (ii) Enabled the close relative to exercise significant influence over the client.

### **Grandfathered Employment Relationships**

Employment relationships of a covered member's immediate family and close relatives with an existing attest client that impair independence under this interpretation and that existed as of November 2001, will not be deemed to impair independence provided such relationships were permitted under preexisting requirements of rule 101 [ET section 101.01], and its interpretations and rulings.

### **Other Considerations**

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. Members should consider whether personal and business relationships between the member and the client or an individual associated with the client would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member's and the firm's independence.

[Paragraph added by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, November 1991, effective January 1, 1992, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective February 28, 1998, by the Professional Ethics Executive Committee. Revised November 2001, effective May 31, 2002, with earlier application encouraged, by the Professional Ethics Executive Committee.]



# **APPENDIX 2**

## ***Definitions***

### **Code of Professional Conduct**

## ET Section 92

- .01 Attest engagement.** An attest engagement is an engagement that requires independence as defined in AICPA Professional Standards.  
[Revised November 2001.]
- .02 Attest engagement team.** The attest engagement team consists of individuals participating in the attest engagement, including those who perform concurring and second partner reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists as discussed in SAS No. 73, *Using the Work of a Specialist* [AU section 336], and individuals who perform only routine clerical functions, such as word processing and photocopying.  
[Revised November 2001.]
- .03 Client.** A client is any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services or a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term "employer" does not include—
- a. Entities engaged in the practice of public accounting; or
  - b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities—
    - i. Is directly elected by voters of the government or component unit thereof with respect to which professional services are performed; or
    - ii. Is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
    - iii. Is appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.
- [Revised December 1998.]
- .04 Close relative.** A close relative is a parent, sibling, or nondependent child.  
[Revised November 2001.]
- .05 Council.** The Council of the American Institute of Certified Public Accountants.
- .06 Covered member.** A covered member is—
- a. An individual on the attest engagement team;
  - b. An individual in a position to influence the attest engagement;
  - c. A partner or manager who provides nonattest services to the attest client beginning once he or she provides ten hours of nonattest services to the client within any fiscal year and ending on the later of the date (i) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) he or she no longer expects to provide ten or more hours of nonattest services to the attest client on a recurring basis;
  - d. A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
  - e. The firm, including the firm's employee benefit plans; or
  - f. An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described in (a) through (e) or by two

or more such individuals or entities if they act together.

[Revised November 2001.]

[.07] **Enterprise.** [Revised November 2001.]

**.08 Financial statements.** A presentation of financial data, including accompanying notes, if any, intended to communicate an entity's economic resources and/or obligations at a point in time or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

Incidental financial data to support recommendations to a client or in documents for which the reporting is governed by Statements on Standards for Attestation Engagements and tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

**.09 Firm.** A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting. Except for purposes of applying Rule 101: *Independence* [ET section 101.01], the firm includes the individual partners thereof.

[Revised November 2001.]

**.10 Holding out.** In general, any action initiated by a member that informs others of his or her status as a CPA or AICPA-accredited specialist constitutes holding out as a CPA. This would include, for example, any oral or written representation to another regarding CPA status, use of the CPA designation on business cards or letterhead, the display of a certificate evidencing a member's CPA designation, or listing as a CPA in local telephone directories.

**.11 Immediate family.** Immediate family is a spouse, spousal equivalent, or dependent (whether or not related).

[Revised November 2001.]

**.12 Individual in a position to influence the attest engagement.** An individual in a position to influence the attest engagement is one who—

- a. Evaluates the performance or recommends the compensation of the attest engagement partner;
- b. Directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm's chief executive;
- c. Consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement; or
- d. Participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring, with respect to the specific attest engagement.

[Revised November 2001.]

**.13 Institute.** The American Institute of Certified Public Accountants.

**.14 Interpretations of rules of conduct.** Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct.

**.15 Joint closely held investment.** A joint closely held investment is an investment in an entity or property by the member and the client (or the client's officers or directors, or any owner who has the ability to exercise significant influence over the client) that enables them to control (as defined by GAAP for consolidation purposes) the entity or property.

[Revised November 2001.]

- .16 Key position.** A key position is a position in which an individual:
- a. Has primary responsibility for significant accounting functions that support material components of the financial statements;
  - b. Has primary responsibility for the preparation of the financial statements; or
  - c. Has the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of attest engagements not involving a client's financial statements, a key position is one in which an individual is primarily responsible for, or able to influence, the subject matter of the attest engagement, as described above.

[Revised November 2001.]

- .17 Loan.** A loan is a financial transaction, the characteristics of which generally include, but are not limited to, an agreement that provides for repayment terms and a rate of interest. A loan includes, but is not limited to, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment.

[Revised November 2001.]

- .18 Manager.** A manager is a professional employee of the firm who has either of the following responsibilities:

- a. Continuing responsibility for the overall planning and supervision of engagements for specified clients.
- b. Authority to determine that an engagement is complete subject to final partner approval if required.

[Revised November 2001.]

- .19 Member.** A member, associate member, or international associate of the American Institute of Certified Public Accountants.

- .20 Office.** An office is a reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, where personnel who make up the subgroup generally serve the same group of clients or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual's physical location.

[Revised November 2001.]

- .21 Partner.** A partner is a proprietor, shareholder, equity or non-equity partner or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

[Revised November 2001.]

- .22 Period of the professional engagement.** The period of the professional engagement begins when a member either signs an initial engagement letter or other agreement to perform attest services or begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship (which could cover many periods) and ends with the formal or informal notification, either by the member or the client, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and

recommence with the beginning of the following year's attest engagement.

[Revised November 2001.]

- .23 Practice of public accounting.** The practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as CPA(s), of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements.

However, a member or a member's firm, while holding out as CPA(s), is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.

- .24 Professional services.** Professional services include all services performed by a member while holding out as a CPA.

- .25 Significant influence.** The term *significant influence* is as defined in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations.

[Revised November 2001.]

## **APPENDIX 3**

### **AICPA and SEC Independence Rule Comparison**

The following comparison highlights (from left to right): the Committee’s November 2001 modernized independence rules, “AICPA Rule”, corresponding rules of the Securities and Exchange Commission (“SEC Rule”), and a description of how the rules compare, “Comparison”. Wherever the term “client” is used, it signifies an attest client—that is, a client with respect to which independence is required under AICPA standards or SEC regulations (as appropriate).

***Note: This document does not cover all of the various AICPA and SEC independence rules; rather it only addresses those pertaining to November 2001 AICPA rule changes.***

Covered Member (AICPA)/Covered Person (SEC)		
AICPA Rule	SEC Rule	Comparison
<p>The <b>Attest Engagement Team</b>, including those who perform concurring and second partner reviews;</p> <p><b>Individuals who are in a position to Influence the Attest Engagement:</b></p> <ul style="list-style-type: none"> <li>○ Evaluate performance or recommend compensation of engagement partner;</li> <li>○ Directly supervise engagement partner and all successively senior levels through the firm’s chief executive</li> <li>○ Consult with the engagement team during the engagement on technical or industry-specific issues, transactions or events;</li> <li>○ Provide quality control or other oversight of the engagement, including internal monitoring.</li> </ul>	<p>The <b>Audit Engagement Team</b>;</p> <p>The <b>Chain of Command</b>; or persons who:</p> <ul style="list-style-type: none"> <li>○ Supervise or have direct management responsibility for the audit, including at all successively senior levels through the firm's chief executive;</li> <li>○ Evaluate performance or recommend compensation of the audit engagement partner; or</li> <li>○ Provide quality control or other oversight of the audit</li> </ul>	<p>The rules are consistent, however, under the SEC rule, individuals who consult with the attest engagement team on technical or industry related matters are considered participants on the engagement team. Under AICPA rules, consultants are considered to be in a position to influence the engagement, but are not deemed to be engagement team participants.</p>



<b>Covered Member (AICPA)/Covered Person (SEC), cont.</b>		
<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
<p>Partners or Managers who provide 10 or more hours of <b>non-attest services</b> to the client;<sup>1</sup></p> <p>Other partners<sup>2</sup> in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;</p> <p>The firm; and</p> <p>Entities controlled by any of the above individuals or entities.</p>	<p>Partners or Managers who provide 10 or more hours of <b>non-audit services</b> to the client;<sup>3</sup> and</p> <p>Other partners (or equivalent) from an "office" of the firm in which the lead audit engagement partner primarily practices in connection with the audit.</p>	<p>SEC rules refer to restrictions pertaining to the accounting firm in the rules, rather than include the firm as a “covered person”.</p>

<sup>1</sup> For the period beginning on the date such services are provided and ending on the date the accounting firm signs the report on the financial statements for the fiscal year during which those services are provided, or who expects to provide ten or more hours of non-audit services to the audit client on a recurring basis.

<sup>2</sup> A partner is a proprietor, shareholder, equity or non-equity partner or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

<sup>3</sup> For the period beginning on the date such services are provided and ending on the date the accounting firm signs the report on the financial statements for the fiscal year during which those services are provided, or who expects to provide ten or more hours of non-audit services to the audit client on a recurring basis;

**Sample Financial Relationships that Impair Independence—  
Covered Members (Persons) or their Immediate Families**

AICPA Rule	SEC Rule	Comparison
Direct or indirect material financial interest in a client.	Direct or indirect material financial interest in a client.	Rules on direct and indirect financial interests are generally similar. SEC specifies what constitutes a direct investment through an intermediary entity <sup>4</sup> and exempts indirect interests held through a diversified management investment company (e.g.; mutual fund) where 5% or less of the outstanding shares of the fund are held. <sup>5</sup>
Serves as trustee or executor of an estate or trust that has a direct or material indirect financial interest in a client.	Serves as voting trustee of a trust, or executor of an estate, containing the securities of a client, unless the trustee or executor has no authority to make investment decisions for the trust or estate.	The AICPA rule on trustee/executor positions is currently more restrictive; it does not permit such relationships when the individual does not have the authority to make investment decisions for the trust or estate. The Committee intends to study the issue further, therefore, its Enforcement Policy applies. <sup>6</sup>

<sup>4</sup> See Rule 2-01 (c)(1)(i)(A).

<sup>5</sup> See Rule 2-01(c)(1)(i)(D).

<sup>6</sup> “The AICPA Professional Ethics Executive Committee (PEEC) will not consider a member's independence to be impaired if the member complies with an...SEC independence requirement that is less restrictive than an AICPA independence requirement on the same subject until PEEC issues a new or revised independence requirement on that subject or decides after due process to retain the existing requirement .”

**Sample Financial Relationships that Impair Independence—  
Covered Members (Persons) or their Immediate Families, cont.**

AICPA Rule	SEC Rule	Comparison
<p>A material, joint closely held investment with a client, an officer or director of the client, or a shareholder who is able to exercise significant influence over the client.</p>	<p>Any direct or material indirect business relationship<sup>8</sup> with a client, or with persons associated with the client's officers, directors, or substantial stockholders.<sup>9</sup></p>	<p>The AICPA rule on joint investments prohibits situations where a covered member and the client control the investment and it is material to the covered member's net worth. The SEC, which classifies joint business ventures as a business relationship (along with limited partnership agreements, leasing interests, etc.) considers neither materiality nor the existence of control.</p>
<p>Any loan to or from the client, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests.<sup>7</sup></p>	<p>Any loan to or from the client, or a client's officers, directors, or beneficial owners of more than ten percent of the client's equity securities.<sup>10</sup></p>	<p>Loan rules differ in that:</p> <ul style="list-style-type: none"> <li>• SEC rules only address grandfathering of mortgages on primary residences whereas AICPA rules also address grandfathering of other secured loans or immaterial, unsecured loans.</li> <li>• The SEC permits a \$10K credit card balance to be maintained, while AICPA permits \$5K. (Also see Enforcement policy.)<sup>6</sup></li> </ul> <p>Permissible loans are similar under both rules.</p>

<sup>7</sup> Except as specifically permitted in Interpretation 101-5 [ET section 101.07].

<sup>8</sup> The term "business relationship" is described to some extent in the Codification of Financial Reporting Policies, section 602.02.e and includes joint business ventures.

<sup>9</sup> See Rule 2-01(c)(4).

<sup>10</sup> Except for certain loans obtained from a financial institution under its normal lending procedures, terms, and requirements.

**Application of Independence Rules—**

**Immediate Family**

<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
<p>Immediate family must comply with the same rules as covered members, subject to two specific exceptions.</p> <p>Immediate family are a covered member's spouse, spousal equivalent or dependent.</p>	<p>Immediate family must comply with the same rules as covered persons, subject to two specific exceptions.</p> <p>Immediate family are a covered person's spouse, spousal equivalent or dependent.</p>	<p>These rules are identical.</p>

**Exception for Financial Interests held in an Employee Benefit Plan—**

**Immediate Family**

<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
<p>The immediate family of a partner or manager providing non-attest services or other partners in the lead attest engagement partner’s primary office may have financial interests through an employer’s retirement, savings, compensation or similar plan provided the plan is offered equitably to all similar employees.</p> <p>The immediate family of persons on the attest engagement team or those in a position to influence the engagement may not use the exception.</p>	<p>The immediate family of a partner or manager providing non-attest services or other partners in the lead attest engagement partner’s primary office may have a financial interest in a client that:</p> <ul style="list-style-type: none"> <li>○ Resulted as an unavoidable consequence of participation in his or her employer's compensation or benefits program; and</li> <li>○ Is disposed of as soon as practicable, but no later than 30 days after the person has the right to dispose of the financial interest.</li> </ul> <p>The immediate family of persons on the audit engagement team or those in a position to influence the engagement may not use the exception.</p>	<p>The AICPA rule is generally consistent with the SEC’s, although it is less stringent. Under the SEC rule, the immediate family of exempted covered persons cannot invest in clients <i>unless</i> the investment results from the unavoidable consequence of participating in an employer’s benefit plan.<sup>11</sup> The AICPA rule does not provide such a restriction.</p>

<sup>11</sup> SEC rule 2-01(c)(1)(iii)(C).

**Financial Interests that Impair Independence—  
Partners and Professional Employees and their Immediate Families**

<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
Any partner or professional employee, his or her immediate family (or group of such persons acting together) has a financial interest exceeding 5 % of a client’s outstanding equity securities (or other ownership interests).	Any partner (or equivalent), professional employee, or his or her immediate family (or group of such persons) has filed a Schedule 13D or 13G with the Commission indicating beneficial ownership of more than 5 % of a client's equity securities. <sup>12</sup>	These rules are substantially the same.

<sup>12</sup> SEC rule 2-01(c)(1)(i)(A) and (D).

**Employment and Certain Other Business Relationships that Impair Independence—**

**Partners and Professional Employees**

<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
<p>A partner or professional employee is simultaneously employed by or has any of the following business relationships with a client (officer, director, officer [or similar management capacity], promoter, underwriter, voting trustee, or trustee of client’s pension or profit-sharing trust).</p>	<p>A current partner (or equivalent) or professional employee is employed by a client or serves as a member of the board of directors or similar management body of the client.</p>	<p>These rules are substantially the same although AICPA rules detail more relationships that impair independence (e.g.; trustee of client’s profit sharing trust).</p>

**Financial Interests that Impair Independence—**

**Close Relatives**

AICPA Rule	SEC Rule	Comparison
<p>An individual participating on the attest engagement team has a close relative<sup>13</sup> who had a financial interest in the client that:</p> <ul style="list-style-type: none"> <li>(i) Was material to the relative<sup>14</sup>; OR</li> <li>(ii) Enabled the relative to exercise significant influence over the client.</li> </ul>	<p>A covered person’s close family<sup>15</sup> has filed a Schedule 13D or 13G with the Commission indicating beneficial ownership of more than 5 % of a client's equity securities or controls an audit client.</p> <p>A partner’s (or equivalent) close family controls a client.</p>	<p>For interests of less than 5 % of a client’s equity, the AICPA rule pertaining to relatives of persons participating on the attest engagement team is more restrictive than the SEC rule—<i>when the interest is material to the close relative and the engagement team participant has knowledge of such interest.</i></p> <p>In other respects, the SEC rules are <i>generally</i> more restrictive than AICPA since AICPA rules:</p> <ul style="list-style-type: none"> <li>○ Apply a higher threshold (significant influence—generally presumed at 20% ownership vs. 5 %).<sup>16</sup></li> <li>○ Take materiality of the investment to the relative into account.</li> <li>○ Use a “tiered approach” (apply a higher standard to relatives of persons on the engagement than for other covered members).</li> </ul>

<sup>13</sup> A parent, nondependent child or sibling.

<sup>14</sup> Of which the covered member has knowledge.

<sup>15</sup> Includes a parent, nondependent child or sibling.

<sup>16</sup> The term significant influence is as defined in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations.



**Financial Interests that Impair Independence—  
Close Relatives, cont.**

AICPA Rule	SEC Rule	Comparison
<p>An individual in a position to influence the attest engagement or any partner in the office in which the lead attest engagement partner practices has a close relative who had a financial interest in the client that:</p> <ul style="list-style-type: none"> <li>(i) Was material to the relative <sup>17</sup>; AND</li> <li>(ii) Enabled the relative to exercise significant influence over the client.</li> </ul>	<p>A covered person’s close family <sup>18</sup> has filed a Schedule 13D or 13G with the Commission indicating beneficial ownership of more than 5 % of a client's equity securities or controls an audit client.</p> <p>A partner’s (or equivalent) close family controls a client.</p>	<p>SEC rules are <i>generally</i> more restrictive than AICPA rules as AICPA rules:</p> <ul style="list-style-type: none"> <li>○ Exempt relatives of covered members who solely provide nonattest services.</li> <li>○ Apply to close relatives of certain covered members only. SEC rules apply to all partners in the firm when relative controls the client. <sup>19</sup></li> </ul>

<sup>17</sup> Of which the individual or partner has knowledge.

<sup>18</sup> Includes a parent, nondependent child or sibling.

<sup>19</sup> Regardless of the close relative’s proportional ownership, if such partner is not a covered member subject to these provisions (member of the attest engagement team, individual who can influence the engagement, or a partner in the office where the lead partner primarily practices in connection with the engagement), independence would not be considered to be impaired under AICPA rules.

<b>Employment Relationships that Impair Independence—</b>		
<b>Immediate Family</b>		
<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
A covered member's immediate family has a key position (see page 42) with the client.	A covered person's immediate family is in an accounting role or financial reporting oversight role (see page 42) at a client.	The rules are substantially the same.

<b>Employment Relationships that Impair Independence—</b>		
<b>Close Relatives</b>		
<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
A covered member, except a partner or manager who is a covered member <i>solely</i> because he or she provides non-attest services to the client, has a close relative <sup>20</sup> who is employed in a key position (see page 42) with the client.	A covered person's parent, nondependent child or sibling is in an accounting role or financial reporting oversight role (see page 42) at a client.	The rules are substantially the same with the exception that under the AICPA rule, the restriction does not apply to partners or managers who only provide non-attest services to the client.

<sup>20</sup> Parent, sibling, or nondependent child.

**Definition of “Key Position” (AICPA) or “Accounting Role or Financial Reporting Oversight Role” (SEC)**

<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
<p>A key position is one in which an individual has:</p> <p>(1) Primary responsibility for significant accounting functions that support material components of the financial statements; or</p> <p>(2) Primary responsibility for the preparation of the financial statements; or</p> <p>(3) The ability to exercise influence over the contents of the financial statements (for example, as a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position).</p>	<p>Accounting role or financial reporting oversight role means a role in which a person is in a position to or does:</p> <p>(i) Exercise more than minimal influence over the contents of the accounting records or anyone who prepares them; or</p> <p>(ii) Exercise influence over the contents of the financial statements or anyone who prepares them (for example, as a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, vice president of marketing, or any equivalent position).</p>	<p>Rules are substantially the same although some wording differences exist.</p> <p>AICPA does not include VP-Marketing in list of positions in which the individual is presumed to exercise influence over the financial statements.</p>

<b>Former Employment or Other Associations with Client— Covered Member</b>		
<b>AICPA Rule</b>	<b>SEC Rule</b>	<b>Comparison</b>
<p>Former employment or association with a client <sup>21</sup> impairs independence if the individual participates on the attest engagement team or is able influence the attest engagement for the client when such engagement covers any period that includes his or her former employment or association with that client.</p> <p>Other covered members with previous affiliations impair independence if they do not disassociate from client before becoming a covered member by taking specified actions (e.g.; cease participation in client’s benefit plans). <sup>22</sup></p>	<p>Former officer, director, or employee of a client who becomes a partner or professional employee of the firm impairs independence unless he or she does not participate in, and is not in a position to influence, the audit of the client’s financial statements covering any period during which he or she was employed by or associated with that client.</p>	<p>Rules relating to persons on the attest engagement team and those able to influence the engagement are substantially the same, although AICPA rule specifies a wider range of former associations than SEC rules.</p> <p>AICPA rules pertaining to other covered members specify actions that such persons must carry out to disassociate from the client whereas SEC rules do not.</p>

<sup>21</sup> As a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client

<sup>22</sup> See Interpretation 101-1.

## **APPENDIX 4**

# **SUMMARY OF AICPA RULES**

Group	Financial Relationships (101-1.A)			Financial Interest With Significant Influence (101-1.B)			Employment and Certain Other Business Relationships (101-1.C)		
	Firm Professional	Immediate Family	Close Relative (CR)	Firm Professional	Immediate Family	Close Relative (CR)	Firm Professional	Immediate Family	Close Relative (CR)
Attest Engagement Team	YES	YES	YES, if material to CR and known to individual	YES	YES	YES	YES	YES, if key position	YES, if key position
Individuals in a Position to Influence an Attest Engagement	YES	YES	NO	YES	YES	YES, if material to CR and known to individual	YES	YES, if key position	YES, if key position
Partners and Managers providing 10 + hours of Non-attest Services	YES	YES, except certain interests held thru employee benefit plan	NO	YES	YES	NO	YES	YES, if key position	NO
Partners in Lead Office	YES	YES, except certain interests held thru employee benefit plan	NO	YES	YES	YES, if material to CR and known to individual	YES	YES, if key position	YES, if key position
All other Partners/Professionals	NO	NO	NO	YES	YES	NO	YES	NO	NO

***Is independence considered to be impaired?***

## **APPENDIX 5**

# **SUMMARY OF AICPA RULE CHANGES**

<i>Previous AICPA Rule</i>	<i>Description of Change(s)</i>
<p><b>Definition of “Member”</b></p> <p>Interpretation No. 101-9, “The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence,” of ET section 101, <i>Independence</i> (AICPA, <i>Professional Standards</i>, vol. 2, ET sec. 101.11)</p>	<ul style="list-style-type: none"> <li>• Term changed to “covered member”</li> <li>• Moved to ET section 92, <i>Definitions</i> (AICPA, <i>Professional Standards</i>, vol. 2)</li> <li>• Engagement team focus <ul style="list-style-type: none"> <li>○ Individual in a position to influence engagement can draw in additional managers</li> <li>○ Managers providing 10 or more hours of nonattest services draws in managers outside office performing attest services</li> <li>○ Partners outside office performing attest services not subject to rules if provide no services and cannot influence engagement</li> </ul> </li> </ul>
<p><b>Definition of “Close Relative”</b></p> <p>Interpretation No. 101-9</p>	<ul style="list-style-type: none"> <li>• Narrowed to include only parents, nondependent children, and siblings</li> <li>• Eliminates in-laws and grandparents</li> </ul>
<p><b>Joint closely held investment</b></p> <p>Ethics Ruling No. 80, “The Meaning of a Joint Closely Held Business Investment,” (AICPA, <i>Professional Standards</i>, vol. 2, ET sec. 191.160-61)</p>	<ul style="list-style-type: none"> <li>• Moved to ET section 92</li> <li>• Prohibits joint closely held investment between covered member and stockholder able to exercise significant influence over client (per Accounting Principles Board [APB] Opinion No. 18, <i>The Equity Method of Accounting for Investments in Common Stock</i>); previously applied to principle stockholders</li> </ul>
<p><b>Definition of “Manager”</b></p> <p>Interpretation No. 101-9</p>	<ul style="list-style-type: none"> <li>• Moved to ET section 92,</li> <li>• Definition narrowed</li> </ul>
<p><b>Definition of “Position of Significant Influence”</b></p> <p>Interpretation No. 101-9</p>	<ul style="list-style-type: none"> <li>• Term changed to “key position” <ul style="list-style-type: none"> <li>○ Narrowed to include only positions that provide opportunity to influence financial statements in a significant way</li> <li>○ Examples provided</li> </ul> </li> <li>• Separately define “significant influence” as described in APB Opinion No. 18 <ul style="list-style-type: none"> <li>○ Eliminates other aspects of definition; policy-making positions, being connected with client as a promoter, underwriter, voting trustee, general partner or director</li> </ul> </li> <li>• “Audit sensitive” positions held by spouses, dependents, and close relatives of certain members are no longer considered to impair independence unless they meet the criteria of a key position</li> </ul>



<i>Previous AICPA Rule</i>	<i>Description of Change(s)</i>
<p><b>Definition of “Office Participating in a Significant Portion of the Engagement”</b></p> <p>Interpretation No. 101-9</p>	<ul style="list-style-type: none"> <li>• Term changed to “office”</li> <li>• Moved to ET section 92</li> <li>• More subjective; emphasizes substance over form</li> </ul>
<p><b>Financial Relationships</b></p> <p>Interpretation 101-9</p>	<ul style="list-style-type: none"> <li>• Prohibits <i>all</i> partners and professional employees (and their immediate family) from having interests exceeding 5 percent of client’s outstanding equity securities (see Interpretation No. 101-1.B); previous rules did not limit a nonmember’s ownership in client</li> <li>• Prohibits loans between covered members and stockholders with 10 percent or greater interest (see Interpretation No. 101-1.A.4; previously applied to principle stockholders)</li> <li>• Application of rules to close relatives<sup>23</sup> <ul style="list-style-type: none"> <li>○ Moved to Interpretation No. 101-1, “Interpretation of Rule 101,” of ET section 101, <i>Independence</i> (AICPA, <i>Professional Standards</i>, ET sec. 101.02), from Interpretation No. 101-9</li> <li>○ Close relatives of individuals able to influence the engagement cannot have a known, material financial interest that allows the relative to exercise significant influence; previous rule did not include the relatives of such individuals</li> <li>○ Close relatives of partners in the office of the lead attest engagement partner cannot have a known, material financial interest that allows the relative to exercise significant influence; previous rule did not consider materiality</li> </ul> </li> </ul>
<p><b>Employment and Certain Other Business Relationships</b></p> <p>Interpretation No. 101-9</p>	<ul style="list-style-type: none"> <li>• Moved to Interpretation No. 101-1.C</li> <li>• Prohibits <i>all</i> partners and professional employees from being employed by or having certain other business relationships (for example; officer, director) with a client; previous rule did not restrict professional employees who were located outside an office from participating in a significant portion of engagement</li> </ul>

<sup>23</sup> Note: Rules for close relatives of individuals on the attest engagement team remain the same.

<i>Previous AICPA Rule</i>	<i>Description of Change(s)</i>
<p><b>Individuals Formerly Employed by or Associated With a Client</b></p> <p>Interpretation No. 101-9</p>	<ul style="list-style-type: none"> <li>• Moved to Interpretation No. 101-1</li> <li>• Individuals who were formerly employed by a client, or associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a client’s benefit plan, cannot participate on the attest engagement or be in a position to influence the engagement covering any period that includes his or her former employment or association with the client; previous rule did not prohibit such individuals from being in a position to influence the engagement</li> <li>• Partners and managers who provide 10 or more hours of nonattest services to the client and partners in the office where lead partner practices in connection with the attest engagement will be considered to be independent provided they disassociate from the client by meeting specific criteria prior to becoming a covered member</li> </ul>