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**AICPA professional standards as of June 1, 2014, Volume 2:  
accounting and review services, code of professional conduct,  
bylaws, valuation services, consulting services, quality control,  
peer review, tax services, personal financial planning, continuing  
professional education**

American Institute of Certified Public Accountants (AICPA)

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# AICPA Professional Standards

As of June 1, 2014



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- > Quality Control
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**AICPA Professional Standards**  
As of June 1, 2014

AICPA®

## AICPA Professional Standards

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VOLUME 2

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### Statements on Standards for Accounting and Review Services \*

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>	<i>Section</i>
1	Dec. 1978	Compilation and Review of Financial Statements [Superseded, December 2010, by SSARS No. 19.]	
<b>2</b>	<b>Oct. 1979</b>	<b>Reporting on Comparative Financial Statements</b>	<b>200</b>
<b>3</b>	<b>Dec. 1981</b>	<b>Compilation Reports on Financial Statements Included in Certain Prescribed Forms<sup>1</sup></b>	<b>300</b>
<b>4</b>	<b>Dec. 1981</b>	<b>Communications Between Predecessor and Successor Accountants<sup>2</sup></b>	<b>400</b>
5	July 1982	Reporting on Compiled Financial Statements [Deleted, November 1992, by SSARS No. 7.] <sup>3</sup>	
<b>6</b>	<b>Sept. 1986</b>	<b>Reporting on Personal Financial Statements Included in Written Personal Financial Plans</b>	<b>600</b>
<b>7</b>	<b>Nov. 1992</b>	<b>Omnibus Statement on Standards for Accounting and Review Services—1992<sup>4</sup></b>	
8	Oct. 2000	Amendment to Statement on Standards for Accounting and Review Services No. 1, <i>Compilation and Review of Financial Statements</i>	
<b>9</b>	<b>Nov. 2002</b>	<b>Omnibus Statement on Standards for Accounting and Review Services—2002<sup>5</sup></b>	
10	May 2004	Performance of Review Engagements	
11	May 2004	Standards for Accounting and Review Services [Superseded, December 2010, by SSARS No. 19.] <sup>6</sup>	

(continued)

\* Pronouncements in effect are indicated in **boldface** type.

<sup>1</sup> SSARS No. 3 amends section 200.02.

<sup>2</sup> SSARS No. 4 amends section 200.16.

<sup>3</sup> The provisions of SSARS No. 5 have been incorporated into section 300

<sup>4</sup> SSARS No. 7 has been integrated to amend sections 200, 300, and 400; SSARS No. 7 also deletes SSARS No. 5.

<sup>5</sup> SSARS No. 9 amends sections 400.01–.06 and 400.08–.10, deletes section 400.07, and adds sections 400.11–.12.

<sup>6</sup> SSARS No. 11 amends section 200.17.

**1608**      **Statements on Standards for Accounting and Review Services**

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>	<i>Section</i>
<b>12</b>	<b>July 2005</b>	<b>Omnibus Statement on Standards for Accounting and Review Services—2005<sup>7</sup></b>	
<b>13</b>	<b>July 2005</b>	<b>Compilation of Specified Elements, Accounts, or Items of a Financial Statement</b>	<b>110</b>
<b>14</b>	<b>July 2005</b>	<b>Compilation of Pro Forma Financial Information</b>	<b>120</b>
<b>15</b>	<b>July 2007</b>	<b>Elimination of Certain References to Statements on Auditing Standards and Incorporation of Appropriate Guidance Into Statements on Standards for Accounting and Review Services<sup>8</sup></b>	
16	Dec. 2007	Defining Professional Requirements in Statements on Standards for Accounting and Review Services [Superseded, December 2010, by SSARS No. 19.]	
<b>17</b>	<b>Feb. 2008</b>	<b>Omnibus Statement on Standards for Accounting and Review Services—2008<sup>9</sup></b>	
18	Feb. 2009	Applicability of Statements on Standards for Accounting and Review Services	
<b>19</b>	<b>Dec. 2009</b>	<b>Compilation and Review Engagements<sup>10</sup></b>	<b>60, 80, and 90</b>
<b>20</b>	<b>Feb. 2011</b>	<b>Revised Applicability of Statements on Standards for Accounting and Review Services<sup>11</sup></b>	

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<sup>7</sup> SSARS No. 12 amends sections 200.25–26 and adds section 200.27 (subsequent paragraphs and footnotes have been renumbered accordingly).

<sup>8</sup> SSARS No. 15 amends section 200.05, section 300.01, and section 400.09.

<sup>9</sup> SSARS No. 17 amends section 110.15; section 120.18; sections 200.01, .29, and .33; sections 300.01–.03; and section 400.01.

<sup>10</sup> SSARS No. 19 supersedes sections 20, 50, and 100.

<sup>11</sup> SSARS No. 20 amends section 90.01.

## Sources of Sections in Current Text

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60	Framework for Performing and Reporting on Compilation and Review Engagements	SSARS No. 19
80	Compilation of Financial Statements	SSARS No. 19
90	Review of Financial Statements	SSARS No. 19
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200	Reporting on Comparative Financial Statements	SSARS No. 2
300	Compilation Reports on Financial Statements Included in Certain Prescribed Forms	SSARS No. 3
400	Communications Between Predecessor and Successor Accountants	SSARS No. 4
600	Reporting on Personal Financial Statements Included in Written Personal Financial Plans	SSARS No. 6

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## AR Section

# STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

Statements on Standards for Accounting and Review Services (SSARS) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior committee of the AICPA designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Council has designated ARSC as a body to establish technical standards under Rule 202 of the AICPA's Code of Professional Conduct (ET sec. 202 par. 01).

Interpretations are issued to provide guidance on the application of SSARS. Interpretations are issued after all members of ARSC have been provided an opportunity to consider and comment on whether the proposed interpretation is consistent with SSARS. An interpretation is not as authoritative as a SSARS, but members should be aware that they may have to justify a departure from an interpretation if the quality of their work is questioned.

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## AR Section 20

# ***Defining Professional Requirements in Statements on Standards for Accounting and Review Services***

Superseded, December 2010, by the issuance of SSARS No. 19.

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## **AR Section 50**

# ***Standards for Accounting and Review Services***

Superseded, December 2010, by the issuance of SSARS No. 19.

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## AR Section 60

# *Framework for Performing and Reporting on Compilation and Review Engagements*

Issue date, unless otherwise indicated: December 2009

Source: SSARS No. 19

### Introduction

**.01** This section provides a framework and defines and describes the objectives and elements of compilation and review engagements. This section also sets forth the meaning of certain terms used in Statements on Standards for Accounting and Review Services (SSARSs) issued by the Accounting and Review Services Committee (ARSC) in describing the professional requirements imposed on accountants performing compilation and review engagements.

**.02** The following is an overview of this section:

- "Relevant Definitions." This section defines various terms used throughout SSARSs.
- "Objectives and Limitations of Compilation and Review Engagements." This section sets forth the objectives and limitations of compilation and review engagements and identifies the differences between each engagement.
- "Professional Requirements." This section sets forth the meaning of certain terms used in SSARSs in describing the professional requirements imposed on accountants performing a compilation or review engagement.
- "Hierarchy of Compilation and Review Standards and Guidance." This section sets forth the hierarchy of SSARSs literature.
- "Elements of a Compilation or Review Engagement." This section identifies and discusses five engagement elements: a three party relationship involving management, an accountant, and intended users; an applicable financial reporting framework; financial statements; evidence (in a review engagement); and a written communication or report. It explains important distinctions between compilation engagements in which the accountant obtains no assurance and review engagements that are designed to obtain limited assurance.
- "Materiality." This section discusses the concept of materiality in the context of the preparation and presentation of financial statements.

**.03** This section is intended to help accountants better understand their professional responsibilities when engaged to compile or review financial statements or financial information. Additional standards of SSARSs have been established to set forth specific performance and reporting requirements. Such

additional standards are based on the framework provided by this standard, and any requirements created by this standard also have been incorporated into the additional standards of SSARs.

## Relevant Definitions

.04 Terms defined for purposes of SSARs are as follows:

**Applicable financial reporting framework.** The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

**Assurance engagement.** An engagement in which an accountant issues a report designed to enhance the degree of confidence of third parties and management about the outcome of an evaluation or measurement of financial statements (subject matter) against an applicable financial reporting framework (criteria).

**Attest engagement.** An engagement that requires independence, as defined in *AICPA Professional Standards*.

**Financial reporting framework.** A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.

**Financial statements.** A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement or financial statements without notes.

**Management.** The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

**Nonissuer.** All entities except for those defined in Section 3 of the Securities Exchange Act of 1934 [15 U.S.C. 78c], the securities of which are registered under Section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under Section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

**Other comprehensive basis of accounting (OCBOA).** A definite set of criteria, other than accounting principles generally accepted in the United States of America or International Financial Reporting Standards (IFRSs), having substantial support underlying the preparation of financial statements prepared pursuant to that basis.

Examples of an OCBOA are as follows:

- a. A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a

governmental regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the rules of a state insurance commission).

- b. A basis of accounting that the reporting entity uses or expects to use to file its income tax return for the period covered by the financial statements.
- c. The cash basis of accounting and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets). Ordinarily, a modification would have substantial support if the method is equivalent to the accrual basis of accounting for that item and if the method is not illogical.

**Review evidence.** Information used by the accountant to provide a reasonable basis for the obtaining of limited assurance.

**Submission of financial statements.** Presenting to management financial statements that an accountant has prepared.\*

**Third party.** All persons, including those charged with governance, except for members of management.

**Those charged with governance.** The person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance are specifically excluded from management, unless they perform management functions.

## Objectives and Limitations of Compilation and Review Engagements

**.05** A compilation is a service, the objective of which is to assist management in presenting financial information in the form of financial statements<sup>1</sup> without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. Although a compilation is not an assurance engagement, it is an attest engagement.

**.06** A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient

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\* In January 2013, the Professional Ethics Executive Committee adopted a provision in the "Activities Related to Attest Services" section of Interpretation No. 101-3, "Nonattest Services," under Rule 101, *Independence* (ET sec. 101 par. .05), of the AICPA Code of Professional Conduct. This provision provides, among other things, that financial statement preparation is considered outside the scope of the attest engagement and, therefore, constitutes a nonattest service subject to the general requirements of the interpretation. The provision is effective for engagements covering periods beginning on or after December 15, 2014. [Footnote added, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3.]

<sup>1</sup> For purposes of the Statements on Standards for Accounting and Review Services, with respect to compilation engagements, references to "financial statements" include, when applicable, other specified elements, accounts, or items of a financial statement and pro forma financial information.

appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for obtaining or providing any assurance regarding the financial statements.

.07 A review is a service, the objective of which is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. In a review engagement, the accountant should accumulate review evidence to obtain a limited level of assurance. A review engagement is an assurance engagement as well as an attest engagement.

.08 A review differs significantly from an audit of financial statements in which the auditor obtains a high level of assurance (expressed in the auditor's report as obtaining reasonable assurance) that the financial statements are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, in a review, the accountant does not obtain assurance that he or she will become aware of all significant matters that would be disclosed in an audit. Therefore, a review is designed to obtain only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

## Professional Requirements

### Requirements

.09 SSARSs contain professional requirements, together with related guidance, in the form of explanatory material. Accountants performing a compilation or review have a responsibility to consider the entire text of a SSARS in carrying out their work on an engagement and in understanding and applying the professional requirements of the relevant SSARSs.

.10 Not every paragraph of a SSARS carries a professional requirement that the accountant is expected to fulfill. Rather, the professional requirements are communicated by the language and the meaning of the words used in SSARSs.

.11 SSARSs use two categories of professional requirements identified by specific terms to describe the degree of responsibility they impose on accountants. They are as follows:

- *Unconditional requirements.* The accountant is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SSARSs use the words *must* or *is required* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The accountant also is required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the accountant may depart from a presumptively mandatory requirement provided that the accountant documents his or



her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SSARSs use the word *should* to indicate a presumptively mandatory requirement.

If a SSARS provides that a procedure or action is one that the accountant "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of a SSARS are to be understood and applied in the context of the explanatory material that provides guidance for their application. The specific terms used to define professional requirements are not intended to apply to interpretative publications issued under the authority of the ARSC because interpretative publications are not SSARSs.

## Explanatory Material

**.12** *Explanatory material* is defined as the text within a SSARS (excluding any related appendixes or interpretations) that may do the following:

- Provide further explanation and guidance on the professional requirements
- Identify and describe other procedures or actions relating to the activities of the accountant

**.13** Explanatory material that provides further explanation and guidance on the professional requirements is intended to be descriptive rather than imperative. That is, it explains the objective of the professional requirements (when not otherwise self-evident); it explains why the accountant might consider or employ particular procedures, depending on the circumstances; and it provides additional information for the accountant to consider in exercising professional judgment in performing the engagement.

**.14** Explanatory material that identifies and describes other procedures or actions relating to the activities of the accountant is not intended to impose a professional requirement for the accountant to perform the suggested procedures or actions. Rather, these procedures or actions require the accountant's attention and understanding; how and whether the accountant carries out such procedures or actions in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the standard. The words *may*, *might*, and *could* are used to describe these actions and procedures.

## Hierarchy of Compilation and Review Standards and Guidance

### Compilation and Review Standards

**.15** An accountant must perform a compilation or review engagement of a nonissuer in accordance with SSARSs, except for certain reviews of interim financial information as discussed in paragraph .01 of section 90, *Review of Financial Statements*. SSARSs provide a measure of quality and the objectives to be achieved in both a compilation and review engagement.

**.16** Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), requires an AICPA member who performs compilations or reviews to comply with standards promulgated by the ARSC. The ARSC develops and issues standards in

the form of SSARSs through a due process that includes deliberations in meetings open to the public, public exposure of proposed SSARSs, and a formal vote. Finalized SSARSs are codified.

.17 The nature of SSARSs requires an accountant to exercise professional judgment in applying them.

## **Interpretative Publications**

.18 Interpretative publications consist of compilation and review interpretations of SSARSs; appendixes to SSARSs; compilation and review guidance included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to compilation and review engagements. Interpretative publications are not standards for accounting and review services. Interpretative publications are recommendations on the application of SSARSs in specific circumstances, including engagements for entities in specialized industries. An interpretative publication is issued under the authority of the ARSC after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretative publication is consistent with SSARSs.

.19 The accountant should be aware of and consider interpretative publications applicable to his or her compilation or review. If the accountant does not apply the guidance included in an applicable interpretative publication, the accountant should be prepared to explain how he or she complied with the provisions of SSARSs addressed by such guidance.

## **Other Compilation and Review Publications**

.20 Other compilation and review publications include AICPA accounting and review publications not referred to previously; the AICPA's annual *Compilation and Review Alert*; compilation and review articles in the *Journal of Accountancy* and other professional journals; compilation and review articles in the AICPA's *The CPA Letter*; continuing professional education programs and other instructional materials, textbooks, guide books, compilation and review programs, and checklists; and other compilation and review publications from state CPA societies, other organizations, and individuals. Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply SSARSs. An accountant is not expected to be aware of the full body of other compilation and review publications.

.21 If an accountant applies the guidance included in an other compilation and review publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the engagement and appropriate. In determining whether an other compilation and review publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate, the accountant may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying SSARSs and the degree to which the issuer or author is recognized as an authority in compilation and review matters. Other compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate.

## **Ethical Principles and Quality Control Standards**

.22 In addition to SSARSs, AICPA members who perform compilation and review engagements are governed by

- a.* the AICPA's Code of Professional Conduct (code), which expresses the profession's recognition of its responsibilities to the public, to clients, and to colleagues. The principles of the code guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.
- b.* Statements on Quality Control Standards (SQCSs), which establish standards and provide guidance on a firm's system of quality control.

**.23** The code sets out the fundamental ethical principles that all AICPA members are required to observe. When performing a compilation or review engagement, the code requires an accountant to maintain objectivity and integrity and comply with all other applicable provisions.

**.24** An accountant has the responsibility to adopt a system of quality control in conducting an accounting practice. Thus, a firm should establish quality control policies and procedures to provide reasonable assurance that personnel comply with SSARs in compilation and review engagements. The nature and extent of a firm's quality control policies and procedures depend on factors such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

**.25** SSARs relate to the conduct of individual compilation and review engagements; SQCSs relate to the conduct of a firm's accounting practice. Thus, SSARs and SQCSs are related, and the quality control policies and procedures that a firm adopts may affect both the conduct of an individual engagement and the firm's accounting practice as a whole. However, deficiencies in, or instances of noncompliance with, a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular review or compilation engagement was not performed in accordance with SSARs.

## Elements of a Compilation or Review Engagement

**.26** The following elements of a compilation and review engagement are discussed in this section:

- a.* A three party relationship involving management, an accountant, and intended users
- b.* An applicable financial reporting framework
- c.* Financial statements or financial information
- d.* In a review, sufficient appropriate review evidence
- e.* A written communication or report

## Three Party Relationship

**.27** A compilation or review engagement involves three parties: management (or the responsible party); an accountant in the practice of public accounting, as defined by the AICPA code; and intended users of the financial statements or financial information.

**.28** In some cases, management and the intended users may be the same. Intended users may be from different entities (for example, a banker or potential investor) or the same entity.

.29 If an accountant is not in the practice of public accounting, the issuance of a written communication or report under SSARs would be inappropriate.

### ***Management (Responsible Party)***

.30 Management responsibilities include taking responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and taking responsibility for designing, implementing, and maintaining internal control.<sup>2</sup>

.31 A basic premise underlying the performance of a compilation or review engagement is that the accountant is performing an attest service on subject matter that is the responsibility of the client's management. Therefore, an accountant is precluded from issuing an unmodified compilation report or a review report on financial statements when management is unwilling to accept responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework or to take responsibility for the design, implementation, and maintenance of internal control.

.32 As part of their responsibility for the preparation and presentation of the financial statements, management and, when appropriate, those charged with governance, are responsible for the identification of the applicable financial reporting framework and the preparation and presentation of the financial statements in accordance with that framework.

.33 During the performance of a compilation or review engagement, the accountant may make suggestions about the form or content of the financial statements or prepare them, in whole or in part, based on information that is the representation of management.\*

### ***Accountant in the Practice of Public Accounting***

.34 The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates that will enable him or her to compile or review financial statements that are appropriate in form for an entity operating in that industry. As addressed in the firm's quality control system, an accountant should not accept an engagement if preliminary knowledge of the engagement circumstances indicates that ethical requirements regarding professional competence will not be satisfied. In some cases, this requirement can be satisfied by the accountant using the work of persons from other professional disciplines, referred to as *experts*. In such cases, the accountant should be satisfied that those persons carrying out aspects of the engagement possess the requisite skills and knowledge and that

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<sup>2</sup> The Committee of Sponsoring Organizations of the Treadway Commission defines *internal control* as a process effected by management (or those charged with governance and other personnel) designed to provide reasonable assurance about the achievement of the entity's objectives. Internal control consists of five interrelated components:

1. Control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
2. Entity's risk assessment is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
3. Information and communication systems support the identification, capture, and exchange of information in a form and time frame that enables people to carry out their responsibilities.
4. Control activities are the policies and procedures that help ensure that management directives are carried out.
5. Monitoring is a process that assesses the quality of internal control performance over time.

\* See footnote \* in paragraph .04 in this chapter.

the accountant has an adequate level of involvement in the engagement and understanding of the work for which any expert is used.

### ***Intended Users of the Financial Statements or Financial Information***

**.35** The intended users are the person(s) or class of persons who understand the limitations of the compilation or review engagement and financial statements. The accountant has no responsibility to identify the intended users.

**.36** In some cases, intended users (for example, bankers and regulators) may impose a requirement on or request the client to arrange for additional procedures to be performed for a specific purpose. For example, a banker may request that certain agreed-upon procedures be performed with respect to the entity's accounts receivable in addition to the financial statements being compiled. An accountant may perform additional services in conjunction with the compilation or review, as long as he or she adheres to professional standards with respect to those additional services.

## **An Applicable Financial Reporting Framework**

**.37** Management and, when applicable, those charged with governance are responsible for the selection of the entity's applicable financial reporting framework, as well as individual accounting policies when the financial reporting framework contains acceptable alternatives. The financial reporting framework encompasses financial accounting standards established by an authorized or recognized standards setting organization.

**.38** The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.

**.39** Examples of financial reporting frameworks include accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board, the Governmental Accounting Standards Board, or the Federal Accounting Standards Advisory Board; IFRSs issued by the International Accounting Standards Board; and OCBOA.

## **Financial Statement or Financial Information**

**.40** An accountant may be engaged to compile or review a complete set of financial statements or an individual financial statement (for example, balance sheet only). The financial statements may be for an annual period or for a shorter or longer period, depending on management's needs.

**.41** The requirements of the applicable financial reporting framework determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance, and cash flows of an entity. For example, a complete set of financial statements might include a balance sheet, an income statement, a statement of retained earnings, a cash flow statement, and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements.

.42 The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.

## **Evidence**

.43 When performing a compilation engagement, the accountant has no responsibility to obtain any evidence about the accuracy or completeness of the financial statements. As a result, a compilation does not provide a basis for obtaining any level of assurance on the financial statements being compiled.

.44 When performing a review engagement, the accountant should perform procedures designed to accumulate review evidence that will provide a reasonable basis for obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. The accountant should apply professional judgment in determining the specific nature, timing, and extent of review procedures. Such procedures should be tailored based on the accountant's understanding of the industry in which the client operates and the accountant's knowledge of the entity. The nature, timing, and extent of procedures for gathering review evidence are deliberately limited relative to an audit.

.45 Review evidence obtained through the performance of analytical procedures and inquiries ordinarily will provide the accountant with a reasonable basis for obtaining limited assurance.

## **Compilation and Review Reports**

.46 If the accountant performs a compilation, a report or written communication is required unless the accountant withdraws from the engagement.<sup>3</sup> If the accountant is not independent, he or she may issue a compilation report, provided that the accountant complies with the compilation standards. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA's Code of Professional Conduct.

.47 If the accountant performs a review, a written review report is required unless the accountant withdraws from the engagement.

## **Materiality**

.48 Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;

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<sup>3</sup> As further described in paragraphs .22–.24 of section 80, *Compilation of Financial Statements*, an accountant may be associated with the submission of financial statements not expected to be used by a third party. Such service does not require the accountant to issue a report on the financial statements.

- judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement or a combination of both; and
- judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

**.49** Such a discussion, if present in the applicable financial reporting framework, provides a frame of reference to the accountant in determining whether there are any material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .48 provide the accountant with such a frame of reference.

**.50** The accountant's determination of materiality is a matter of professional judgment and is affected by the accountant's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the accountant to assume that users

- a.* have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- b.* understand that financial statements are prepared, presented, and reviewed to levels of materiality;
- c.* recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and
- d.* make reasonable economic decisions on the basis of the information in the financial statements.

## Effective Date

**.51** This section is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2010.

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## AR Section 80

# *Compilation of Financial Statements*

Issue date, unless otherwise indicated: December 2009

Source: SSARS No. 19

**.01** This section establishes standards and provides guidance on compilations of financial statements. The accountant is required to comply with the provisions of this section whenever he or she is engaged to report on compiled financial statements or submits financial statements to a client or to third parties.

### Establishing an Understanding

**.02** The accountant should establish an understanding with management regarding the services to be performed for compilation engagements<sup>1</sup> and should document the understanding through a written communication with management. Such an understanding reduces the risks that either the accountant or management may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or to perform certain functions that are management's responsibility. The accountant should ensure that the understanding includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. In some cases, the accountant may establish such understanding with those charged with governance.

**.03** An understanding with management and, if applicable, those charged with governance, regarding a compilation of financial statements should include the following matters:

- The objective of a compilation is to assist management in presenting financial information in the form of financial statements.
- The accountant utilizes information that is the representation of management (owners) without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.
- Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
- Management is responsible for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- Management is responsible to prevent and detect fraud.

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<sup>1</sup> See paragraph .29 of QC section 10, *A Firm's System of Quality Control*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SQCS No. 8.]

- Management is responsible for identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- Management is responsible for making all financial records and related information available to the accountant.
- The accountant is responsible for conducting the engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the AICPA.
- A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion or provide any assurance regarding the financial statements.
- The engagement cannot be relied upon to disclose errors, fraud,<sup>2</sup> or illegal acts.<sup>3</sup>
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred.<sup>4</sup> The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.
- The effect of any independence impairments on the expected form of the accountant's compilation report, if applicable.

These matters should be communicated in the form of an engagement letter. Examples of engagement letters for a compilation of financial statements are presented in Compilation Exhibit A, "Illustrative Engagement Letters."

**.04** An understanding with management or, if applicable, those charged with governance, also may include other matters, such as the following:

- Fees and billings

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<sup>2</sup> For purposes of the SSARSs, *fraud* is an intentional act that results in a misstatement in compiled financial statements.

<sup>3</sup> For purposes of the SSARSs, *illegal acts* are violations of laws or government regulations, excluding fraud.

<sup>4</sup> Whether an act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on financial statements, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination about whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

- Any limitation of or other arrangements regarding the liability of the accountant or the client, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements)
- Conditions under which access to compilation documentation may be granted to others
- Additional services to be provided relating to regulatory requirements

**.05** If the compiled financial statements are not expected to be used by a third party and the accountant does not expect to issue a compilation report on the financial statements, the accountant should include in the engagement letter an acknowledgment of management's representation and agreement that the financial statements are not to be used by a third party. The engagement letter also should address the following additional matters if applicable:

- Material departures from the applicable financial reporting framework may exist, and the effects of those departures, if any, on the financial statements may not be disclosed.
- Substantially all disclosures (and statement of cash flows, if applicable) required by the applicable financial reporting framework may be omitted.
- Reference to supplementary information.

## Compilation Performance Requirements

### Understanding of the Industry

**.06** The accountant should possess an understanding of the industry in which the client operates, including the accounting principles and practices generally used in the industry sufficient to enable the accountant to compile financial statements that are appropriate in form for an entity operating in that industry.

**.07** The requirement that the accountant possess a level of knowledge of the industry in which the client operates does not prevent the accountant from accepting a compilation engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals knowledgeable about the industry.

### Knowledge of the Client

**.08** The accountant should obtain knowledge about the client, including

- an understanding of the client's business and
- an understanding of the accounting principles and practices used by the client.

**.09** In obtaining an understanding of the client's business, the accountant should have a general understanding of the client's organization; its operating

characteristics; and the nature of its assets, liabilities, revenues, and expenses. The accountant's understanding of the entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of the entity's personnel.

**.10** The accountant should obtain an understanding of the accounting principles and practices used by the client in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements. The accountant's understanding also may include matters such as changes in accounting practices and principles and differences in the client's business model as compared with normal practices within the industry.

**.11** In obtaining this understanding of the client's accounting policies and practices, the accountant should be alert to unusual accounting policies and procedures that come to the accountant's attention as a result of his or her knowledge of the industry.

## **Reading the Financial Statements**

**.12** Before submission, the accountant should read the financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term *error* refers to mistakes in the preparation of financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosure.

## **Other Compilation Procedures**

**.13** The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have made inquiries or performed other procedures. The results of such inquiries or procedures, knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to become aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory or that fraud or an illegal act may have occurred. The accountant should request that management consider the effect of these matters on the financial statements and communicate the results of such consideration to the accountant. Additionally, the accountant should consider the effect of management's conclusions regarding these matters on the accountant's compilation report. In circumstances when the accountant believes that the financial statements may be materially misstated, the accountant should obtain additional or revised information. If the entity refuses to provide additional or revised information, the accountant should withdraw from the engagement.

## **Documentation in a Compilation Engagement**

**.14** The accountant should prepare documentation in connection with each compilation engagement in sufficient detail to provide a clear understanding of the work performed. Documentation provides the principal support for the representation in the accountant's compilation report that the accountant performed the compilation in accordance with SSARs.

The accountant is not precluded from supporting the compilation report by other means in addition to the compilation documentation. Such other means might include written documentation contained in other engagement files or

quality control files (for example, consultation files) and, in limited situations, oral explanations.

.15 The form, content, and extent of documentation depend on the circumstances of the engagement, the methodology and tools used, and the accountant's professional judgment. The accountant's documentation should include the following:

- a. The engagement letter documenting the understanding with the client
- b. Any findings or issues that, in the accountant's judgment, are significant (for example, the results of compilation procedures that indicate that the financial statements could be materially misstated, including actions taken to address such findings and, to the extent that the accountant had any questions or concerns as a result of his or her compilation procedures, how those issues were resolved)
- c. Communications, whether oral or written, to the appropriate level of management regarding fraud or illegal acts that come to the accountant's attention

## Reporting on the Financial Statements

.16 When the accountant is engaged to report on compiled financial statements or submits financial statements that are reasonably expected to be used by a third party, the financial statements should be accompanied by a written report. The accountant's objective in reporting on the financial statements is to prevent misinterpretation of the degree of responsibility the accountant is assuming when his or her name is associated with the financial statements.

.17 The basic elements of the report are as follows:

- a. *Title.* The accountant's compilation report should have a title that clearly indicates that it is the accountant's compilation report. The accountant may indicate that he or she is independent in the title, if applicable. Appropriate titles would be "Accountant's Compilation Report" or "Independent Accountant's Compilation Report."
- b. *Addressee.* The accountant's report should be addressed as appropriate in the circumstances of the engagement.
- c. *Introductory paragraph.* The introductory paragraph in the accountant's report should
  - i. identify the entity whose financial statements have been compiled;
  - ii. state that the financial statements have been compiled;
  - iii. identify the financial statements that have been compiled;
  - iv. specify the date or period covered by the financial statements; and
  - v. include a statement that the accountant has not audited or reviewed the financial statements and, accordingly, does not express an opinion or provide any assurance about whether the financial statements are in accordance with the applicable financial reporting framework.
- d. *Management's responsibility for the financial statements and for internal control over financial reporting.* A statement that

management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

- e. *Accountant's responsibility.* A statement that the accountant's responsibility is to conduct the compilation in accordance with SSARs issued by the AICPA.  
A statement that the objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.
- f. *Signature of the accountant.* The manual or printed signature of the accounting firm or the accountant, as appropriate.
- g. *Date of the accountant's report.* The date of the compilation report (the date of completion of the compilation should be used as the date of the accountant's report).

Procedures that the accountant might have performed as part of the compilation engagement should not be described in the report.

See Compilation Exhibit B, "Illustrative Compilation Reports," for illustrative compilation reports.

**.18** Each page of the financial statements compiled by the accountant should include a reference, such as "See accountant's compilation report" or "See independent accountant's compilation report."

**.19** Financial statements prepared in accordance with an other comprehensive basis of accounting (OCBOA) are not considered appropriate in form unless the financial statements include

- a. a description of the OCBOA, including a summary of significant accounting policies and a description of the primary differences from generally accepted accounting principles (GAAP). The effects of the differences need not be quantified.
- b. informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

## Reporting on Financial Statements That Omit Substantially All Disclosures

**.20** An entity may request the accountant to compile financial statements that omit substantially all the disclosures required by an applicable financial reporting framework, including disclosures that might appear in the body of the financial statements.<sup>5</sup> The accountant may compile such financial statements, provided that the omission of substantially all disclosures is not, to his or her knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. When reporting

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<sup>5</sup> See paragraphs .27–.29 for the accountant's responsibilities when he or she is aware of other departures from an applicable financial reporting framework. However, see section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*, for guidance when such financial statements are included in a prescribed form, and the prescribed form or related instructions do not request the disclosures required by an applicable financial reporting framework.

on financial statements that omit substantially all disclosures, the accountant should include, after the paragraph describing the accountant's responsibility, a paragraph in the compilation report that includes the following elements:

- a. A statement that management has elected to omit substantially all the disclosures (and the statement of cash flows, if applicable) required by the applicable financial reporting framework (or ordinarily included in the financial statements if the financial statements are prepared in accordance with an OCBOA)
- b. A statement that if the omitted disclosures (and statement of cash flows, if applicable) were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows (or equivalent for presentations other than accounting principles generally accepted in the United States of America)
- c. A statement that, accordingly, the financial statements are not designed for those who are not informed about such matters

When the entity wishes to include disclosures about only a few matters in the form of notes to such financial statements, such disclosures should be labeled "Selected Information—Substantially All Disclosures Required by [*identify the applicable financial reporting framework (for example "Accepted Accounting Principles Generally Accepted in the United States of America")*] Are Not Included."

See Compilation Exhibit B for examples of compilation reports when substantially all disclosures required by an applicable financial reporting framework are omitted.

## Reporting When the Accountant Is Not Independent

.21 When the accountant is issuing a report with respect to a compilation of financial statements for an entity, with respect to which the accountant is not independent, the accountant's report should be modified. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA's Code of Professional Conduct. The accountant should indicate his or her lack of independence in a final paragraph of the accountant's compilation report. An example of such a disclosure would be

I am (We are) not independent with respect to XYZ Company.

The accountant is not precluded from disclosing a description about the reason(s) that his or her independence is impaired. The following are examples of descriptions the accountant may use:

- a. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company;
- b. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company; or
- c. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

## 1642 Statements on Standards for Accounting and Review Services

If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.

See Compilation Exhibit B for illustrative examples of accountant's compilation reports when the accountant's independence has been impaired.

### Accountant's Communications With the Client When the Compiled Financial Statements Are Not Expected to Be Used by a Third Party

**.22** When the accountant submits compiled financial statements to his or her client that are not expected to be used by a third party, he or she is not required to issue a compilation report.

**.23** The accountant should include a reference on each page of the financial statements restricting their use, such as "Restricted for Management's Use Only," or "Solely for the information and use by the management of [*name of entity*] and not intended to be and should not be used by any other party."

**.24** If the accountant becomes aware that the financial statements have been distributed to third parties, the accountant should discuss the situation with the client and determine the appropriate course of action, including considering requesting that the client have the statements returned. If the accountant requests that the financial statements be returned and the client does not comply with that request within a reasonable period of time, the accountant should notify known third parties that the financial statements are not intended for third party use, preferably in consultation with his or her attorney.

### Emphasis of a Matter

**.25** The accountant may emphasize, in any report on financial statements, a matter disclosed in the financial statements. Such explanatory information should be presented in a separate paragraph of the accountant's report. Emphasis paragraphs are never required; they may be added solely at the accountant's discretion.

Examples of matters that the accountant may wish to emphasize are

- uncertainties.
- that the entity is a component of a larger business enterprise.
- that the entity has had significant transactions with related parties.
- unusually important subsequent events.
- accounting matters affecting the comparability of the financial statements with those of the preceding period.

**.26** Because an emphasis of matter paragraph should not be used in lieu of management disclosures, the accountant should not include an emphasis paragraph in a compilation report on financial statements that omit substantially all disclosures unless the matter is disclosed in the financial statements. The accountant should refer to paragraph .20 if he or she believes that a disclosure is necessary to keep the financial statements from being misleading.



## Departures From the Applicable Financial Reporting Framework

**.27** An accountant who is engaged to compile financial statements may become aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements. Paragraph .20 provides guidance to the accountant when the departure relates to the omission of substantially all disclosures in the financial statements that he or she has compiled. section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*, provides guidance when the departure is called for by a prescribed form or related instructions. In all other circumstances, if the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure.

**.28** If the accountant concludes that modification of the standard report is appropriate, the departure should be disclosed in a separate paragraph of the report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the accountant's procedures. The accountant is not required to determine the effects of a departure if management has not done so, provided that the accountant states in the report that such determination has not been made.

See Compilation Exhibit B for examples of compilation reports that disclose departures from the applicable financial reporting framework.

**.29** If the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the compilation engagement and provide no further services with respect to those financial statements. The accountant may wish to consult with his or her legal counsel in those circumstances.

## Restricting the Use of an Accountant's Compilation Report

### *General Use and Restricted Use Reports*

**.30** The term *general use* applies to accountants' reports that are not restricted to specified parties. Accountants' reports on financial statements prepared in conformity with an applicable financial reporting framework ordinarily are not restricted regarding use. However, nothing in this section precludes the accountant from restricting the use of any report.

**.31** The term *restricted use* applies to accountants' reports intended only for one or more specified third parties. The need for restriction on the use of a report may result from a number of circumstances, including, but not limited to, the purpose of the report and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used.

**.32** The accountant should restrict the use of a report when the subject matter of the accountant's report or the presentation being reported on is based on measurement or disclosure criteria contained in contractual agreements<sup>6</sup> or regulatory provisions that are not in conformity with an applicable financial reporting framework.

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<sup>6</sup> A *contractual agreement*, as discussed in this section, is an agreement between the client and one or more third parties other than the accountant.

***Reporting on Subject Matter or Presentations Based on Measurement or Disclosure Criteria Contained in Contractual Agreements or Regulatory Provisions***

.33 When reports are issued on subject matter or presentations based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions that are not in conformity with an applicable financial reporting framework, the accountant should restrict the report because the basis, assumptions, or purpose of such presentations (contained in such agreements or regulatory provisions) are developed for, and directed only to, the parties to the agreement or regulatory agency responsible for the provisions. The report also should be restricted because the report, the subject matter, or the presentation may be misunderstood by those who are not adequately informed of the basis, assumptions, or purpose of the presentation.

***Combined Reports Covering Both Restricted Use and General Use Subject Matter or Presentations***

.34 If the accountant issues a single combined report covering both (a) subject matter or presentations that require a restriction on use to specified parties and (b) subject matter or presentations that ordinarily do not require such a restriction, the use of such a single combined report should be restricted to the specified parties.

***Inclusion of a Separate Restricted Use Report in the Same Document With a General Use Report***

.35 When required by law or regulation, a separate restricted use report may be included in a document that also contains a general use report. The inclusion of a separate restricted use report in a document that contains a general use report does not affect the intended use of either report. The restricted use report remains restricted regarding use, and the general use report continues for general use.

***Adding Other Specified Parties***

.36 Subsequent to the completion of an engagement resulting in a restricted use report, or in the course of such an engagement, the accountant may be asked to consider adding other parties as specified parties.

.37 If the accountant is reporting on subject matter or a presentation based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions, as described in paragraph .33, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors such as the identity of the other parties, their knowledge of the basis of the measurement or disclosure criteria, and the intended use of the report. If the accountant agrees to add other parties as specified parties, the accountant should obtain affirmative acknowledgment, preferably in writing, from the other parties of their understanding of the nature of the engagement, the measurement or disclosure criteria used in the engagement, and the related report. If the other parties are added after the accountant has issued his or her report, the report may be reissued, or the accountant may provide other written acknowledgment that the other parties have been added as specified parties. If the report is reissued, the report date should not be changed. If the accountant provides written acknowledgment that the other parties have been added as specified parties, such written acknowledgment ordinarily should state that no procedures have been performed subsequent to the date of the report.

### **Limiting the Distribution of Reports**

**.38** Because of the reasons presented in paragraph .31, the accountant should consider informing his or her client that restricted use reports are not intended for distribution to nonspecified parties, regardless of whether they are included in a document containing a separate general use report.<sup>7</sup> This section does not preclude the accountant, in connection with establishing the terms of the engagement, from reaching an understanding with the client that the intended use of the report will be restricted and from obtaining the client's agreement that the client and the specified parties will not distribute the report to parties other than those identified in the report. However, the accountant is not responsible for controlling a client's distribution of restricted use reports. Accordingly, a restricted use report should alert readers to the restriction on the use of the report by indicating that the report is not intended to be and should not be used by anyone other than the specified parties.

### **Report Language—Restricted Use**

**.39** An accountant's report that is restricted should contain a separate paragraph at the end of the report that includes the following elements:

- a. A statement indicating that the report is intended solely for the information and use of the specified parties.
- b. An identification of the specified parties to whom use is restricted. The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.
- c. A statement that the report is not intended to be and should not be used by anyone other than the specified parties.

## **An Entity's Ability to Continue as a Going Concern**

**.40** During the performance of compilation procedures, evidence or information may come to the accountant's attention indicating that an uncertainty may exist about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being compiled (hereinafter referred to as a *reasonable period of time*). In those circumstances, the accountant should request that management consider the possible effects of the going concern uncertainty on the financial statements, including the need for related disclosure.

**.41** After management communicates to the accountant the results of its consideration of the possible effects on the financial statements, the accountant should consider the reasonableness of management's conclusions, including the adequacy of the related disclosures, if applicable.

**.42** If the accountant determines that management's conclusions are unreasonable or the disclosure of the uncertainty regarding the entity's ability to continue as a going concern is not adequate, he or she should follow the guidance in paragraphs .27–.29 with respect to departures from an applicable financial reporting framework.

**.43** The accountant may emphasize an uncertainty about an entity's ability to continue as a going concern, provided that the uncertainty is disclosed in the

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<sup>7</sup> In some cases, restricted use reports filed with regulatory agencies are required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency, as part of its oversight responsibility for an entity, may require access to restricted use reports in which they are not named as a specified party.

financial statements. In such circumstances, the accountant should follow the guidance in paragraphs .25–.26.

## Subsequent Events

.44 Evidence or information that a subsequent event that has a material effect on the compiled financial statements has occurred may come to the accountant's attention in the following ways:

- a. During the performance of compilation procedures
- b. Subsequent to the date of the accountant's compilation report but prior to the release of the report<sup>8</sup>

In either case, the accountant should request that management consider the possible effects on the financial statements, including the adequacy of any related disclosure, if applicable.

.45 If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, he or she should follow the guidance in paragraphs .27–.29.

.46 Occasionally, a subsequent event has such a material impact on the entity that the accountant may wish to include in his or her compilation report an explanatory paragraph directing the reader's attention to the event and its effects. Such an emphasis of matter paragraph may be added at the accountant's discretion, provided that the matter is disclosed in the financial statements. See paragraphs .25–.26 for additional guidance with respect to emphasis of matter paragraphs.

## Subsequent Discovery of Facts Existing at the Date of the Report

.47 Subsequent to the date of the report on the financial statements that the accountant has compiled, he or she may become aware that facts may have existed at that date that might have caused him or her to believe that information supplied by the entity was incorrect, incomplete, or otherwise unsatisfactory had the accountant then been aware of such facts.<sup>9</sup> Because of the variety of conditions that might be encountered, some of the procedures contained in this section are necessarily set out only in general terms; the specific actions to be taken in a particular case may vary with the circumstances. The accountant would be well advised to consult with his or her legal counsel when he or she encounters the circumstances to which this section may apply because of legal implications that may be involved in actions contemplated herein.

.48 After the date of the accountant's compilation report, the accountant has no obligation to perform other compilation procedures with respect to the financial statements, unless new information comes to his or her attention. However, when the accountant becomes aware of information that relates to financial statements previously reported on by him or her, but that was not known to the accountant at the date of the report, (and that is of such a nature and from such a source that the accountant would have investigated it had it come to his or her attention during the course of the compilation), the

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<sup>8</sup> For purposes of this section, with respect to compiled financial statements in which the accountant does not report, the submission of the compiled financial statements is the equivalent of the accountant's compilation or review report date.

<sup>9</sup> See footnote 8.

accountant should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of the report. The accountant should discuss the matter with his or her client at whatever management levels the accountant deems appropriate and request cooperation in whatever investigation may be necessary. In addition to management, the accountant may deem it appropriate to discuss the matter with those charged with governance. If the nature and effect of the matter are such that (a) the accountant's report or the financial statements would have been affected if the information had been known to the accountant at the accountant's compilation report date and had not been reflected in the financial statements and (b) the accountant believes that persons are currently using or are likely to use the financial statements, and those persons would attach importance to the information, the accountant should obtain additional or revised information. Consideration should be given to, among other things, the time elapsed since the financial statements were issued.

**.49** When the accountant has concluded that action should be taken to prevent further use of the accountant's report or the financial statements, the accountant should advise his or her client to make appropriate disclosure of the newly discovered facts and their impact on the financial statements to persons who are known to be currently using or who are likely to use the financial statements. When the client undertakes to make appropriate disclosure, the method used and the disclosure made will depend on the circumstances. For example

- a. if the effect of the subsequently discovered information on the accountant's report or the financial statements can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and, when applicable, the accountant's report. The reasons for the revision usually should be described in a note to the financial statements and, when applicable, referred to in the accountant's report. Generally, only the most recently issued compiled financial statements would need to be revised, even though the revision resulted from events that had occurred in prior years.
- b. when issuance of financial statements for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements, pursuant to subparagraph (a).
- c. when the effect on the financial statements of the subsequently discovered information cannot be promptly determined, the issuance of revised financial statements would necessarily be delayed. In this circumstance, when it appears that the information will require a revision of the statements, appropriate disclosure would consist of notification by the client to persons who are known to be using or who are likely to use the financial statements that the statements should not be used; that revised financial statements will be issued; and, when applicable, that the accountant's report will be issued as soon as practicable.

**.50** The accountant should take whatever steps he or she deems necessary to satisfy himself or herself that the client has made the disclosures specified in paragraph .49.

**.51** If the client refuses to make the disclosures specified in paragraph .49, the accountant should notify the appropriate personnel at the highest levels within the entity, such as the manager (owner) or those charged with governance, of such refusal and of the fact that, in the absence of disclosure by the

client, the accountant will take steps as outlined subsequently to prevent further use of the financial statements and, if applicable, the accountant's report. The steps that can appropriately be taken will depend upon the degree of certainty of the accountant's knowledge that persons exist who are currently using or who will use the financial statements and, if applicable, the accountant's report and who would attach importance to the information and the accountant's ability as a practical matter to communicate with them. Unless the accountant's attorney recommends a different course of action, the accountant should take the following steps to the extent applicable:

- a. Notification to the client that the accountant's report must no longer be associated with the financial statements.
- b. Notification to the regulatory agencies having jurisdiction over the client that the accountant's report should no longer be used.
- c. Notification to each person known to the accountant to be using the financial statements that the financial statements and the accountant's report should no longer be used. In many instances, it will not be practicable for the accountant to give appropriate individual notification to stakeholders whose identities ordinarily are unknown to him or her; notification to a regulatory agency having jurisdiction over the client will usually be the only practicable way for the accountant to provide appropriate disclosure. Such notification should be accompanied by a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.

**.52** The following guidelines should govern the content of any disclosure made by the accountant in accordance with paragraph .51, to persons other than his or her client:

- a. The disclosure should include a description of the nature of the subsequently acquired information and its effect on the financial statements.
- b. The information disclosed should be as precise and factual as possible and should not go beyond that which is reasonably necessary to accomplish the purpose mentioned in the preceding subparagraph (a). Comments concerning the conduct or motives of any person should be avoided.

If the client has not cooperated, the accountant's disclosure need not detail the specific information but can merely indicate that the client has not cooperated with the accountant's attempt to substantiate information that has come to the accountant's attention and that, if the information is true, the accountant believes that the compilation report must no longer be used or associated with the financial statements. No such disclosure should be made unless the accountant believes that the financial statements are likely to be misleading and that the accountant's compilation report should not be used.

## Supplementary Information

**.53** When the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should clearly indicate the degree of responsibility, if any, he or she is taking with respect to such information. When the accountant has compiled both the basic financial statements and other data presented only for supplementary analysis purposes, the compilation report should refer to the other data, or the accountant can issue a separate report on the other data. If a separate report is issued, the report

should state that the other data accompanying the financial statements are presented only for the purposes of additional analysis, and that the information has been compiled from information that is the representation of management, without audit or review, and that the accountant does not express an opinion or provide any assurance on such data.

## Communicating to Management and Others

**.54** When evidence or information comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred, that matter should be brought to the attention of the appropriate level of management. The accountant need not report matters regarding illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of such items to be communicated. When matters regarding fraud or an illegal act involve senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or those charged with governance. The communication may be oral or written. If the communication is oral, the accountant should document it. When matters regarding fraud or an illegal act involve an owner of the business, the accountant should consider resigning from the engagement. Additionally, the accountant should consider consulting with his or her legal counsel whenever any evidence or information comes to his or her attention during the performance of compilation procedures that fraud or an illegal act may have occurred, unless such illegal act is clearly inconsequential.

**.55** The disclosure of any evidence or information that comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred to parties other than the client's senior management (or those charged with governance, if applicable) ordinarily is not part of the accountant's responsibility and, ordinarily, would be precluded by the accountant's ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances, a duty to disclose to parties outside of the entity may exist:

- a. To comply with certain legal and regulatory requirements
- b. To a successor accountant when the successor decides to communicate with the predecessor accountant in accordance with section 400, *Communications Between Predecessor and Successor Accountants*, regarding acceptance of an engagement to compile or review the financial statements of a nonissuer
- c. In response to a subpoena

Because potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex, the accountant may wish to consult with legal counsel before discussing matters covered by paragraph .54 with parties outside the client.

## Change in Engagement From Audit or Review to Compilation

**.56** The accountant who has been engaged to audit the financial statements of a nonissuer in accordance with auditing standards generally accepted in the United States of America or the accountant who has been engaged to review the financial statements of a nonissuer in accordance with SSARSs may, before the completion of the audit or review, be requested to change the engagement to a compilation of financial statements. A request to change the engagement may

result from a change in circumstances affecting the entity's requirement for an audit or review; a misunderstanding regarding the nature of an audit, review, or compilation; or a restriction on the scope of the audit or review, whether imposed by the client or caused by circumstances.

**.57** Before the accountant, who was engaged to perform an audit in accordance with auditing standards generally accepted in the United States of America or a review in accordance with SSARs, agrees to change the engagement to a compilation, at least the following should be considered:

- a. The reason given for the client's request, particularly the implications of a restriction on the scope of the audit or review, whether imposed by the client or by circumstances
- b. The additional audit or review effort required to complete the audit or review
- c. The estimated additional cost to complete the audit or review

**.58** A change in circumstances that affects the entity's requirement for an audit or review or a misunderstanding concerning the nature of an audit, review, or compilation would ordinarily be considered a reasonable basis for requesting a change in the engagement.

**.59** In considering the implications of a restriction on the scope of the audit or review, the accountant should evaluate the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. Nevertheless, when the accountant has been engaged to audit an entity's financial statements and has been prohibited by the client from corresponding with the entity's legal counsel, the accountant ordinarily would be precluded from issuing a compilation report on the financial statements. If in an audit or a review engagement, a client does not provide the accountant with a signed representation letter, the accountant would ordinarily be precluded from issuing a compilation report on the financial statements.

**.60** In all circumstances, if the audit or review procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement.

**.61** If the accountant concludes, based upon his or her professional judgment, that reasonable justification exists to change the engagement, and if he or she complies with the standards applicable to a compilation engagement, the accountant should issue an appropriate compilation report. The report should not include reference to (a) the original engagement, (b) any audit or review procedures that may have been performed, or (c) scope limitations that resulted in the changed engagement.

## **Effective Date**

**.62** This section is effective for compilations of financial statements for periods ending on or after December 15, 2010. Early implementation of the requirements and guidance in paragraph .21 is permitted.



## Compilation Exhibit A—Illustrative Engagement Letters

### Standard Engagement Letter for a Compilation

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the annual [*and interim, if applicable*] financial statements of XYZ Company as of and for the year ended December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a compilation is to assist you in presenting financial information in the form of financial statements. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

- a. the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].
- b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- c. preventing and detecting fraud
- d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred.

## 1652 Statements on Standards for Accounting and Review Services

In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

*If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:*

*We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report.*

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services. . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

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[Signature of accountant]

Acknowledged:

XYZ Company

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President

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Date

## Engagement Letter for a Compilation of Financial Statements Not Intended for Third Party Use

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the *[monthly, quarterly, or other frequency]* financial statements of XYZ Company as of and for the year ended December 31, 20XX.

The objective of a compilation is to assist you in presenting financial information in the form of financial statements. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with *[the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]*.

You are responsible for

- a. the preparation and fair presentation of the financial statements in accordance with *[the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]*.
- b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- c. preventing and detecting fraud.
- d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

**1654**      **Statements on Standards for Accounting and Review Services**

The financial statements will not be accompanied by a report and are for management's use only and are not to be used by a third party.

*If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:*

*We are not independent with respect to XYZ Company.*

Our fees for these services. . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

\_\_\_\_\_  
*[Signature of accountant]*

Acknowledged:

XYZ Company

\_\_\_\_\_  
President

\_\_\_\_\_  
Date

## Compilation Exhibit B—Illustrative Compilation Reports

*Standard compilation report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America*

### Accountant's Compilation Report

[*Appropriate Salutation*]

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

*Standard accountant's compilation report on financial statements prepared in accordance with the cash basis of accounting*

### Accountant's Compilation Report

[*Appropriate Salutation*]

I (we) have compiled the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 20XX, and the related statement of revenue collected and expenses paid for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the cash basis of accounting.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the cash basis of accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

*Paragraph the accountant may add after the conclusion paragraph when management has elected to omit substantially all disclosures, but the financial statements are otherwise in conformity with accounting principles generally accepted in the United States of America*

Management has elected to omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, the financial statements are not designed for those who are not informed about such matters.

*Paragraph the accountant may add after the conclusion paragraph when management has elected to omit substantially all disclosures, but the financial statements are otherwise in conformity with the income tax basis of accounting*

Management has elected to omit substantially all of the disclosures ordinarily included in financial statements prepared in accordance with the income tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's assets, liabilities, equity, revenue, and expenses. Accordingly, the financial statements are not designed for those who are not informed about such matters.

*Accountant's compilation report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America when the accountant's independence has been impaired, and the accountant determines to not disclose the reason for the independence impairment*

### **Accountant's Compilation Report**

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

I am (we are) not independent with respect to XYZ Company.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

*Accountant's compilation report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America when the accountant's independence has been impaired due to the accountant having a financial interest in the client, and the accountant decides to disclose the reason for the independence impairment*

### **Accountant's Compilation Report**

[Appropriate Salutation]

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

I am (we are) not independent with respect to XYZ Company as during the year ended December 31, 20XX, I (a member of the engagement team) had a direct financial interest in XYZ Company.

[Signature of accounting firm or accountant, as appropriate]

[Date]

*Accountant's compilation report on financial statements disclosing a departure from accounting principles generally accepted in the United States of America*

### **Accountant's Compilation Report**

[Appropriate Salutation]

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information

in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. During our compilation, I (we) did become aware of a departure (certain departures) from accounting principles generally accepted in the United States of America that is (are) described in the following paragraph.

As disclosed in Note X to the financial statements, accounting principles generally accepted in the United States of America require that land be stated at cost. Management has informed me (us) that the company has stated its land at appraised value and that, if accounting principles generally accepted in the United States of America had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

*or*

A statement of cash flows for the year ended December 31, 20XX, has not been presented. Accounting principles generally accepted in the United States of America require that such a statement be presented when financial statements purport to present financial position and results of operations.<sup>1</sup>

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

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<sup>1</sup> If a statement of cash flows is not presented, the first paragraph of the accountant's compilation report should be modified accordingly.



## AR Section 9080

# ***Compilation of Financial Statements: Accounting and Review Services Interpretations of Section 80***

### **1. Reporting When There Are Significant Departures From the Applicable Financial Reporting Framework**

**.01 Question**—When the financial statements include significant departures from the applicable financial reporting framework, may the accountant modify his or her standard report in accordance with paragraphs .27–.29 of section 80, *Compilation of Financial Statements*, to include a statement that the financial statements are not in conformity with the applicable financial reporting framework?

**.02 Interpretation**—No. Including such a statement in the accountant's compilation report would be tantamount to expressing an adverse opinion on the financial statements as a whole. Such an opinion can be expressed only in the context of an audit engagement.

**.03** However, paragraph .25 of section 80 states that an accountant may emphasize, in any report on financial statements, a matter disclosed in the financial statements. The accountant may wish, therefore, to emphasize the limitations of the financial statements in a separate paragraph of his or her compilation report, depending on his or her assessment of the possible dollar magnitude of the effects of the departures, the significance of the affected items to the entity, the pervasiveness and overall impact of the misstatements, and whether disclosure has been made of the effects of the departures. Such separate paragraph, which would follow the other modifications of his or her report (see illustrations in Compilation Exhibit B, "Illustrative Compilation Reports"), might read as follows (the illustration assumes that the accountant is reporting on financial statements in which there are significant departures from accounting principles generally accepted in the United States of America):

Because the significance and pervasiveness of the matters previously discussed makes it difficult to assess their impact on the financial statements as a whole, users of these financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in conformity with accounting principles generally accepted in the United States of America.

**.04 Interpretation**—Inclusion of such a separate paragraph in the accountant's compilation report is not a substitute for disclosure of the specific departures or the effects of such departures when they have been determined by management or are known as a result of the accountant's procedures.

[Issue Date: August 1981; Revised: November 2002; Revised: May 2004; Revised: July 2005; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 7 to section 100).]

## 2. Reporting on Tax Returns

**.05 Question**—May an accountant comply with a request from a nonissuer to issue a compilation report on financial information contained in a tax return, as in Form 1040, *U.S. Individual Income Tax Return*, or Form 1120, *U.S. Corporation Income Tax Return*, or in an information return, as in Form 990, *Return of Organization Exempt from Income Tax*; Form 1065, *U.S. Partnership Return of Income*; or Form 5500, *Return of Employee Benefit Plan*?

**.06 Interpretation**—Yes. Although paragraph .01 of section 80 states that the section establishes standards and provides guidance on compilations of financial statements and financial information included in a tax return is not included in the definition of financial statements, an accountant may decide to accept an engagement to issue a compilation report on such a return. In that case, the performance and reporting requirements of section 80 would apply.

[Issue Date: November 1982; Revised: February 2008; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 10 to section 100).]

## 3. Additional Procedures Performed in a Compilation Engagement

**.07 Question**—If an accountant performs procedures customarily performed in a review or audit but not in a compilation, is the accountant required to change the engagement to a review or an audit?

**.08 Interpretation**—No. Paragraph .13 of section 80 states that in a compilation engagement the accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant is not precluded from making inquiries or performing additional procedures.

**.09** The wording of confirmation requests or other communications related to additional procedures performed in the course of a compilation engagement should not use phrases such as "as part of an *audit* of the financial statements" (emphasis supplied).

[Issue Date: March 1983; Revised: October 2000; Revised: November 2002; Revised: May 2004; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 13 to section 100).]

## 4. Differentiating a Financial Statement Presentation From a Trial Balance

**.10 Question**—Paragraph .01 of section 80 states that the accountant is required to comply with the provisions of section 80 whenever he or she is engaged to report on compiled financial statements or submits financial statements to a client or third parties. What attributes should an accountant consider when differentiating a financial statement from a trial balance to determine if he or she is required to comply with the provisions of section 80?

**.11 Interpretation**—The accountant may consider, among other matters, the following attributes when determining whether a financial presentation is a financial statement or a trial balance:

- Generally, a financial statement features the combination of similar general ledger accounts to create classifications or account groupings with corresponding subtotals and totals of dollar amounts. Some examples of these classifications or account groupings are current assets, long-term debt, and revenues. In addition, contra accounts are generally netted against the related primary accounts in financial statement presentations (that is, "Accounts

Receivable Net of Allowance for Bad Debts"). In contrast, a trial balance consists of a listing of all of the general ledger accounts and their corresponding debit or credit balances.

- Financial statements generally contain titles that identify the presentation as one intended to present financial position, results of operations, or cash flows. Typical titles for financial statements include the following:
  - Balance Sheet
  - Statement of Income or Statement of Operations
  - Statement of Comprehensive Income
  - Statement of Retained Earnings
  - Statement of Cash Flows
  - Statement of Changes in Owners' Equity
  - Statement of Assets and Liabilities (with or without owners' equity accounts)
  - Statement of Revenue and Expenses
  - Statement of Financial Position
  - Statement of Activities
  - Summary of Operations
  - Statement of Operations by Product Lines
  - Statement of Cash Receipts and Disbursements

Examples of typical titles for trial balance presentations are as follows:

- Trial Balance
  - Working Trial Balance
  - Adjusted Trial Balance
  - Listing of General Ledger Accounts
- The balance sheet in a set of financial statements segregates asset, liability, and owners' equity accounts and presents these three elements based on the following basic example equation:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

The elements of the income statement and their relationship to net income are presented based on the following basic example equation:

$$\text{Revenues} - \text{Expenses} + \text{Gains} - \text{Losses} = \text{Net Income}$$

In a trial balance, no attempt is made to establish a mathematical relationship among the elements except that total debits equal total credits.

- The income statement in a set of financial statements generally contains a caption such as "Net Income" or "Net Revenues Over Expenses" that identifies the net results of operations. Trial balance presentations generally do not contain similar captions.

- The balance sheet in a set of financial statements usually presents assets in the order of their liquidity and liabilities in the order of their maturity. In a trial balance, the accounts are generally listed in account number order as they appear in the general ledger.
- In a set of financial statements, the income statement articulates with the balance sheet because the net results of operations are added to or subtracted from opening retained earnings. In a trial balance, the net results of operations are generally not closed out to retained earnings.

**.12** The accountant's use of judgment is important when considering these attributes to determine whether the financial presentation constitutes a financial statement or a trial balance. When making this determination, the accountant may consider the preponderance of the attributes of the financial presentation. For example, a trial balance that contains one or two attributes of a financial statement may, in the accountant's judgment, still constitute a trial balance. When the presentation is deemed to be a financial statement, the accountant, at a minimum, should compile the financial statements in accordance with section 80 when he or she submits such financial statements to his or her client or third parties.

[Issue Date: September 1990; Revised: October 2000; Revised: February 2008; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 15 to section 100).]

## 5. Submitting Draft Financial Statements

**.13 Question**—Accountants frequently submit draft financial statements (a) because information needed to complete a compilation of the financial statements will not be available until a later date, or (b) to provide the client with the opportunity to read and analyze the financial statements prior to their final issuance. Is it permissible for the accountant to submit draft financial statements without intending to comply with the reporting provisions of section 80?

**.14 Interpretation**—Except in those instances in which the financial statements are not expected to be used by a third party, as permitted under paragraphs .22–.24 of section 80, an accountant is precluded from submitting draft financial statements unless he or she intends to submit those financial statements in final form accompanied by an appropriate compilation report prescribed by section 80. However, as long as the accountant intends to issue a compilation report on the financial statements in final form and labels each page of draft financial statements with words such as "Draft," "Preliminary Draft," "Draft—Subject to Changes," or "Working Draft," the accountant is not required to comply with the reporting provisions of section 80 with respect to those draft financial statements. In the rare circumstance in which the accountant intended to but never submitted final financial statements, the accountant may want to document the reasons why he or she was unable to submit financial statements in final form accompanied by an appropriate compilation report.

[Issue Date: September 1990; Revised: October 2000; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 17 to section 100).]

## 6. Reporting When Financial Statements Contain a Departure From Promulgated Accounting Principles That Prevents the Financial Statements From Being Misleading

**.15 Question**—Rule 203, *Accounting Principles* (ET sec. 203 par. .01), of the AICPA Code of Professional Conduct states

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Paragraphs .27–.29 of section 80 do not address the Rule 203 circumstances. When the circumstances contemplated by Rule 203 are present, how should the accountant report on the information described in the rule?

**.16 Interpretation**—Rule 203 does not apply to engagements to report on a compiled financial statements. Accordingly, when the accountant is reporting on a compiled financial statements and is confronted with the circumstances contemplated by Rule 203, the guidance in paragraphs .27–.29 of section 80 pertaining to departures from generally accepted accounting principles (GAAP) should be followed.

[Issue Date: February 1991; Revised: October 2000; Revised: November 2002; Revised: May 2004; Revised: July 2005; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 19 to section 100).]

## **7. Applicability of Statements on Standards for Accounting and Review Services to Litigation Services**

**.17 Question**—When are litigation services excluded from the applicability of Statements on Standards for Accounting and Review Services (SSARSs)?

**.18 Interpretation**—SSARSs do not apply to financial statements submitted in conjunction with litigation services that involve pending or potential formal legal or regulatory proceedings before a "trier of fact" in connection with the resolution of a dispute between two or more parties when the

- a. service consists of being an expert witness.
- b. service consists of being a "trier of fact" or acting on behalf of one.
- c. accountant's work under the rules of the proceedings is subject to detailed analysis and challenge by each party to the dispute.
- d. accountant is engaged by an attorney to do work that will be protected by the attorney's work product privilege, and such work is not intended to be used for other purposes.

When performing such litigation services, the accountant should comply with Rule 201, *General Standards* (ET sec. 201 par. .01).

**.19 Question**—When do SSARSs apply to litigation service engagements?

**.20 Interpretation**—SSARSs apply to litigation service engagements when the accountant

- a. submits unaudited financial statements of a nonissuer that are the representation of management (owners) to others who,

under the rules of the proceedings, do not have the opportunity to analyze and challenge the accountant's work, or

- b. is specifically engaged to submit, in accordance with SSARSs, financial statements that are the representation of management (owners).

[Issue Date: May 1991; Revised: October 2000; Revised: February 2008; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 20 to section 100).]

## 8. Applicability of Statements on Standards for Accounting and Review Services When Performing Controllership or Other Management Services

**.21 Question**—If the accountant is in the practice of public accounting and provides an entity with controllership or other management services that entail the submission of financial statements, is the accountant required to follow the requirements of section 80?

**.22 Interpretation**—If the accountant is in the practice of public accounting as defined in paragraph .29 of ET section 92, *Definitions*, of the AICPA Code of Professional Conduct and is not a stockholder, partner, director, officer, or employee of the entity, the accountant is required to follow the performance and communication requirements of section 80, including any requirement to disclose a lack of independence.

**.23** If the accountant is in the practice of public accounting and is also a stockholder, partner, director, officer, or employee of the entity, the accountant may either (a) comply with the requirements of section 80, or (b) communicate, preferably in writing, the accountant's relationship to the entity (for example, stockholder, partner, director, officer, or employee). The following is an example of the type of communication that may be used by the accountant:

The accompanying balance sheet of Company X as of December 31, 20XX, and the related statements of income and cash flows for the year then ended have been prepared by [name of accountant], CPA. I have prepared such financial statements in my capacity [describe capacity, for example, as a director] of Company X.

**.24** If an accountant is not in the practice of public accounting, the issuance of a report under SSARSs would be inappropriate; however, the previously mentioned communication may be used.

[Issue Date: July 2002; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 21 to section 100).]

## 9. Use of the Label "Selected Information—Substantially All Disclosures Required by [the applicable financial reporting framework] Are Not Included" in Compiled Financial Statements

**.25 Question**—Can an accountant label notes to the financial statements "Selected Information—Substantially All Disclosures Required by [identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] Are Not Included" when the client includes more than a few required disclosures?

**.26 Interpretation**—No. As discussed in paragraph .20 of section 80, when the entity wishes to include disclosures about only a few matters in the form of notes to the financial statements, such disclosures should be labeled "Selected Information—Substantially All Disclosures Required by [identify the applicable financial reporting framework (for example "accounting principles generally accepted in the United States of America")] Are Not Included."

.27 When the financial statements include more than a few disclosures, this guidance is not appropriate. The omission of one or more notes, when substantially all other disclosures are presented, should be treated in a compilation report like any other departure from the applicable financial reporting framework, and the nature of the departure and its effects, if known, should be disclosed in accordance with paragraphs .27–.29 of section 80. The label "Selected Information—Substantially All Disclosures Required by [*identify the applicable financial reporting framework (for example "accounting principles generally accepted in the United States of America")*] Are Not Included" is not intended to be used for the omission of (intentionally or unintentionally) one or more specific disclosures. In determining whether use of the label is appropriate, the accountant needs to apply professional judgment to all the facts and circumstances.

[Issue Date: December 2002; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 22 to section 100).]

## 10. Omission of the Display of Comprehensive Income in Compiled Financial Statements

.28 *Question*—When an element of comprehensive income is present, can the display of comprehensive income be omitted when issuing a compilation report on financial statements that omit substantially all disclosures required by accounting principles generally accepted in the United States of America?

.29 *Interpretation*—Yes. Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 220, Comprehensive Income*, requires the display of comprehensive income when a full set of financial statements is presented in conformity with accounting principles generally accepted in the United States of America. However, the display of comprehensive income may be omitted by identifying the omission in the compilation report or, if the engagement is to compile financial statements that are not expected to be used by a third party and the accountant does not report on those financial statements, in the engagement letter. The following is suggested modified wording (shown in *italic*) to the paragraph in the compilation report:

Management has elected to omit substantially all the disclosures, (the statement of cash flows, if applicable,) *and the display of comprehensive income* required by accounting principles generally accepted in the United States of America. If the omitted disclosures, (the statement of cash flows, if applicable,) *and the display of comprehensive income* were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

.30 If the accountant compiles financial statements that include substantially all disclosures required by accounting principles generally accepted in the United States of America but omit the display of comprehensive income, the omission is a departure from accounting principles generally accepted in the United States of America.

.31 Additionally, if an element of comprehensive income has not been computed, for example, unrealized gains and losses arising from investments in marketable securities classified as "available for sale," then the accountant should consider a departure from accounting principles generally accepted in the United States of America and follow the guidance in paragraphs .27–.29 of section 80.

[Issue Date: September 2003; Revised: May 2004; Revised: July 2005; Revised: June 2009; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 25 to section 100).]

## 11. Special-Purpose Financial Statements to Comply With Contractual Agreements or Regulatory Provisions

**.32 Question**—An accountant may be asked to compile special-purpose financial statements prepared to comply with a contractual agreement or regulatory provision that specifies a special basis of presentation. In most circumstances, these financial statements are intended solely for the use of the parties to the agreement, regulatory bodies, or other specified parties. How should the accountant modify the standard compilation report when reporting on these compiled special-purpose financial statements?

**.33 Interpretation**—An accountant who is asked to compile special-purpose financial statements prepared to comply with a contractual agreement or a regulatory provision that specifies a special basis of presentation may issue a compilation report on those financial statements in accordance with section 80 as described in this interpretation. This interpretation describes reporting on

- a. special-purpose financial statements prepared in compliance with a contractual agreement or regulatory provision that does not constitute a complete presentation of the entity's assets, liabilities, revenues, and expenses, but is otherwise prepared in conformity with GAAP or an other comprehensive basis of accounting (OCBOA), or
- b. a special-purpose financial presentation (may be a complete set of financial statements or a single financial statement) prepared on a basis of accounting prescribed in an agreement that does not result in a presentation in conformity with GAAP or an OCBOA.

### ***Financial Statements Prepared on a Basis of Accounting Prescribed in a Contractual Agreement or Regulatory Provision That Results in an Incomplete Presentation but One That Is Otherwise in Conformity With GAAP or an OCBOA***

**.34** An entity may engage an accountant to compile a special-purpose financial statement prepared in compliance with a contractual agreement or regulatory provision that does not constitute a complete presentation of the entity's assets, liabilities, revenues, or expenses, but is otherwise prepared in conformity with GAAP or an OCBOA. For example, a governmental agency may require a statement of gross income and certain expenses of an entity's real estate operation in which income and expenses are measured in conformity with GAAP, but expenses are defined to exclude certain items such as interest, depreciation, and income taxes. Such a statement may also present the excess of gross income over defined expenses. Also, a buy-sell agreement may specify a statement of gross assets and liabilities of the entity measured in conformity with GAAP, but limited to the assets to be sold and liabilities to be transferred pursuant to the agreement.

**.35** When the accountant submits compiled special-purpose financial statements prepared on a basis of accounting prescribed in a contractual agreement or regulatory provision that results in an incomplete presentation but one that is otherwise prepared in conformity with GAAP or an OCBOA, the



accountant's report should be modified to include a separate paragraph with the following information:

- An explanation of what the financial statement is intended to present and a reference to the note to the special-purpose financial statement that describes the basis of presentation
- If the basis of presentation is in conformity with GAAP or an OCBOA, a statement that the presentation is not intended to be a complete presentation of the entity's assets, liabilities, revenues, and expenses
- A separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity, the parties to the contract or agreement, the regulatory agency with which the report is being filed, or those with whom the entity is negotiating directly, and is not intended to be and should not be used by anyone other than these specified parties

**.36** The following is an illustrative example of a compilation report on special-purpose financial statements:

I (we) have compiled the accompanying statement of net assets sold of XYZ Company as of December 31, 20X1. I (we) have not audited or reviewed the accompanying statement of net assets sold and, accordingly, do not express an opinion or provide any assurance about whether the statement of net assets sold is in accordance with the purchase agreement described in Note A.

Management (owners) is (are) responsible for the preparation and fair presentation of the statement of net assets sold in accordance with the purchase agreement described in Note A and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the statement of net assets sold.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The accompanying statement was prepared for the purpose of presenting the net assets of XYZ Company sold to ABC Company pursuant to the purchase agreement described in Note A, and is not intended to be a complete presentation of XYZ Company's assets and liabilities.

This report is intended solely for the information and use of [*the specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

***Financial Statements Prepared on a Basis of Accounting Prescribed in an Agreement That Results in a Presentation That Is Not in Conformity With GAAP or an OCBOA***

**.37** An entity may engage an accountant to compile a special-purpose financial statement prepared in conformity with a basis of accounting that departs from GAAP or an OCBOA. A loan agreement, for example, may require the borrower to prepare consolidated financial statements in which assets, such as inventory, are presented on a basis that is not in conformity with GAAP or an OCBOA. Also, an acquisition agreement may require the financial statements of the entity being acquired (or a segment of it) to be prepared in conformity with

GAAP except for certain assets, such as receivables, inventories, and properties for which a valuation basis is specified in the agreement.

**.38** Financial statements prepared under a basis of accounting as discussed in the preceding are not considered to be prepared in conformity with an OCBOA because the criteria used to prepare such financial statements do not meet the requirement of "having substantial support," even though the criteria are definite.

**.39** When the accountant submits compiled special-purpose financial statements prepared on a basis of accounting prescribed in an agreement that results in a presentation that is not in conformity with GAAP or an OCBOA, the accountant's report should be modified to include a separate paragraph with the following information:

- An explanation of what the presentation is intended to present and a reference to the note to the special-purpose financial statements that describes the basis of presentation.
- A statement that the financial statement is not intended to be a presentation in conformity with GAAP or an OCBOA.
- A description and the source of significant interpretations, if any, made by the company's management relating to the provisions of a relevant agreement.
- A separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity, the parties to the contract or agreement, the regulatory agency with which the report is being filed, or those with whom the entity is negotiating directly, and is not intended to be and should not be used by anyone other than these specified parties. For example, if the financial statements have been prepared for the specified purpose of obtaining bank financing, the report's use should be restricted to the various banks with whom the entity is negotiating the proposed financing.

**.40** The following is an illustrative example of a compilation report on special-purpose financial statements:

I (we) have compiled the special-purpose statement of assets and liabilities of XYZ Company as of December 31, 20X1, and the related special-purpose statements of revenue and expenses and of cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the acquisition agreement between ABC Company and XYZ Company as discussed in Note A.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the acquisition agreement between ABC Company and XYZ Company as described in Note A and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The accompanying special-purpose financial statements were prepared for the purpose of complying with the acquisition agreement between ABC Company and XYZ Company as discussed in Note A, and are not intended to be a presentation in conformity with GAAP.

This report is intended solely for the information and use of [*the specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

[Issue Date: December 2006; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 28 to section 100).]

## 12. Reporting on an Uncertainty, Including an Uncertainty About an Entity's Ability to Continue as a Going Concern

**.41 Question**—How should an accountant modify the standard compilation report when, during the performance of compilation procedures, evidence or information comes to the accountant's attention that there may be an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being compiled?

**.42 Interpretation**—Disclosure requirements with respect to uncertainties are included in FASB ASC 275, *Risks and Uncertainties*; FASB ASC 450, *Contingencies*; and other authoritative accounting literature. However, the accounting literature does not provide specific guidance on disclosure of uncertainties caused by concern about an entity's ability to continue as a going concern. Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. The accountant should follow the guidance in paragraphs .40–.43 of section 80 with respect to his or her consideration of the entity's ability to continue as a going concern during the performance of compilation procedures.

**.43** If the accountant concludes that management's disclosure of the uncertainty regarding the entity's ability to continue as a going concern is adequate but further decides to include an emphasis-of-matter paragraph with respect to the uncertainty in the accountant's compilation report, he or she may use the following language:

As discussed in Note X, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

**.44 Question**—If the accountant, while performing a compilation, becomes aware of a material uncertainty other than a going concern uncertainty (for example, an uncertainty regarding pending or threatened litigation), what should the accountant consider in deciding whether a report modification is necessary?

**.45 Interpretation**—Disclosure requirements with respect to uncertainties are included in FASB ASC 275, 450, and other authoritative accounting literature. If the accountant determines that the disclosure of the uncertainty is not in accordance with the applicable financial reporting framework, he or she should follow the guidance in paragraphs .27–.29 of section 80.

**.46** If the accountant concludes that management's disclosure of the uncertainty is in accordance with the applicable financial reporting framework but further decides to include an emphasis-of-matter paragraph with respect to the uncertainty in the accountant's compilation report, he or she may use the following language (the following is assuming that the financial statements

were prepared in accordance with accounting principles generally accepted in the United States of America):

As discussed in Note X, the Company is currently named in a legal action. The Company has determined that it is not possible to predict the eventual outcome of the legal action but has determined that the resolution of the action will not result in an adverse judgment that would materially affect the financial statements. Accordingly, the accompanying financial statements do not include any adjustments related to the legal action under FASB ASC 450.

**.47 Question**—Paragraph .20 of section 80 allows the accountant, when he or she is requested to do so, to compile financial statements that omit substantially all of the disclosures required by an applicable financial reporting framework, provided the omission of substantially all disclosures was not, to the accountant's knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements, and the accountant includes a paragraph in the accountant's compilation report regarding the omission of substantially all disclosures. Should disclosure of an uncertainty be considered so significant that it also could never be omitted?

**.48 Interpretation**—No. The user is adequately warned of the limitations of the financial statements by the report language required by paragraph .20 of section 80.

[Issue date: February 2007; Revised: February 2008; Amended: December 2008; Revised: June 2009; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 29 to section 100)]

### 13. Compilations of Financial Statements Prepared in Accordance With International Financial Reporting Standards

**.49 Question**—The International Accounting Standards Board (IASB) has been designated by the Council of the AICPA as the body to establish international financial reporting standards for both private and public entities pursuant to Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), and Rule 203 of the AICPA Code of Professional Conduct as of May 18, 2008. As a result, how would an accountant apply the reporting guidance in section 80 when engaged to compile financial statements presented in accordance with International Financial Reporting Standards (IFRSs) as issued by the IASB?

**.50 Interpretation**—A report illustration of how an accountant would apply the reporting guidance in section 80 when reporting on financial statements presented in accordance with IFRSs is as follows:

#### Accountant's Compilation Report

[*Appropriate Salutation*]

I (we) have compiled the accompanying statements of financial position of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of comprehensive income, changes in equity, and cash flows for the years then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards

Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

When the accountant compiles financial statements that omit substantially all disclosures but are otherwise in conformity with IFRSs as issued by the IASB, the accountant may wish to modify the third paragraph of the standard report as follows:

Management has elected to omit substantially all disclosures (and the statement of cash flows) required by International Financial Reporting Standards as issued by the International Accounting Standards Board. If the omitted disclosures and statement were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

**.51 Question**—Unlike accounting principles generally accepted in the United States of America as issued by FASB, IFRSs require an entity to disclose comparative information in respect of the previous comparative period for all amounts presented in the current year's financial statements. When the accountant compiles financial statements that omit prior year information, should such omission be disclosed in the accountant's compilation report as a departure from IFRSs as issued by the IASB in accordance with paragraphs .27–.29 of section 80?

**.52 Interpretation**—Yes. Because IFRSs require an entity to disclose comparative information in respect of the previous comparative period for all amounts presented in the current year's financial statements, the failure to include such information in financial statements would be a departure from GAAP. An example of a paragraph that may be added to the accountant's compilation report is as follows:

Comparative information with respect to the year ended December 31, 20XX-1 has not been presented. International Financial Reporting Standards [or *IFRSs for SMEs*] as issued by the International Accounting Standards Board require an entity to disclose comparative information in respect of the previous comparative period for all amounts presented in the current year's financial statements.

When the accountant compiles financial statements that omit substantially all disclosures and comparative information in respect of the previous comparative period but are otherwise in conformity with IFRSs as issued by the IASB, the accountant may wish to modify the third paragraph of the standard report as follows:

Management has elected to omit substantially all disclosures (and the statement of cash flows) and comparative financial information as of and for the year ended December 31, 20XX-1 required by International Financial Reporting Standards [or *IFRSs for SMEs*] as issued by the International Accounting

Standards Board. If the omitted disclosures, statement, and comparative financial information were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Issue Date: May 2008; Revised: June 2010; Revised: August 2010; Revised: December 2010 (formerly Interpretation No. 30 to section 100).]

#### **14. Compilations of Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country**

**.53 Question**—An accountant may be engaged to compile financial statements that have been prepared in conformity with a financial reporting framework generally accepted in another country (including financial statements prepared in accordance with a jurisdictional variation of IFRSs such that the entity's financial statements do not contain an explicit and unreserved statement of compliance with IFRSs as issued by the IASB). How should an accountant apply the reporting requirements of section 80 when reporting on those financial statements?

**.54 Interpretation**—If the financial statements are intended for use only outside of the United States of America, the accountant may report using the standard form of U.S. compilation report modified as appropriate to identify the applicable financial reporting framework, or alternatively, the accountant may report using the standard compilation report form and content of the other country. (See Interpretation No. 15 with respect to Considerations Related to Compilations Performed in Accordance with International Standard on Related Services [ISRS] 4410, *Engagements to Compile Financial Statements*).\*

**.55** The standard compilation report used in another country, even when it appears similar to that used in the United States of America, may convey a different meaning and entail a different responsibility on the part of the accountant due to custom or culture. Issuing a standard compilation report of another country may require an understanding of local laws. When issuing the accountant's standard compilation report of another country, the accountant is required to obtain an understanding of applicable legal responsibilities, in addition to the compilation standards and accounting principles generally accepted in the other country, as indicated in paragraph .11 of section 80. Therefore, depending on the nature and extent of the accountant's knowledge and experience, the accountant may wish to consult with persons having expertise in the reporting practices of the other country and associated legal responsibilities to obtain the understanding needed to issue that country's standard compilation report.

**.56** If the accountant's report is intended for use in the United States of America, the reporting requirements described in paragraphs .16–.19 of section 80 would apply. Additionally, paragraph .31 of section 80 states that a need for restriction on the use of the report may result from a number of circumstances, including, but not limited to, the purpose of the report and the potential for the report to be misunderstood when taken out of context in which it was intended to be used. Because of the nature of the basis of presentation of the financial statements there is a presumption that the report would be misunderstood or taken out of context in which it was intended to be used. In such instances, the accountant may use the following form of report:

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\* In March 2012, the International Auditing and Assurance Standards Board issued International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, ISRS 4410 (Revised) is effective for compilation engagement reports dated on or after July 1, 2013. [Footnote added, December 2012, to reflect conforming changes necessary due to the issuance of ISRS 4410 (Revised).]

Accountant's Compilation Report

[Appropriate Salutation]

I (we) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with [*the financial reporting framework generally accepted in another country, including identification of the nationality of the framework*].

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with [*the financial reporting framework generally accepted in another country, including identification of the nationality of the framework*] and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

This report is intended solely for the information and the use of [*specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[Signature of accounting firm or accountant, as appropriate]

[Date]

**.57** When the financial statements will be used both outside of the United States of America as well as in the United States of America, nothing precludes the accountant from issuing two reports—a report to be used only outside of the United States of America and another report to be used in the United States of America.

[Issue Date: May 2008; Revised: June 2010; Revised: August 2010; Revised: December 2010 (formerly Interpretation No. 30 to section 100); Revised: December 2012.]

## **15. Considerations Related to Compilations Performed in Accordance With International Standard on Related Services 4410, *Engagements to Compile Financial Statements*,\* Issued by the International Auditing and Assurance Standards Board**

**.58 Question**—May a U.S. accountant perform a compilation of historical financial statements of a U.S. entity<sup>1</sup> in accordance with ISRS 4410\* issued by the International Auditing and Assurance Standards Board (IAASB)? The financial statements may have been prepared in accordance with IFRSs or accounting principles generally accepted in the United States of America.

**.59 Interpretation**—Yes. An accountant performing a compilation of historical financial statements of a U.S. entity is required to follow the compilation standards as promulgated by the AICPA's Accounting and Review Services

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\* See footnote \* in paragraph .54.

<sup>1</sup> A U.S. entity is an entity that is either organized or domiciled in the United States of America.

Committee. However, those standards do not prohibit an accountant from indicating that the compilation also was conducted in accordance with another set of compilation standards. In an engagement to compile the historical financial statements in accordance with ISRS 4410,\* the accountant may perform the compilation in accordance with SSARs as well as ISRS 4410.\* Such a compilation report may read as follows:

I (we) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants and in accordance with the International Standard on Related Services (ISRS 4410)\* issued by the International Auditing and Assurance Standards Board applicable to compilation engagements. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

**.60** If the report is for use only outside of the United States of America, the accountant is still required to apply SSARs, except for requirements related to report form and content.

[Issue Date: May 2008; Revised: June 2010; Revised: August 2010; Revised: December 2010 (formerly Interpretation No. 30 to section 100); Revised: December 2012.]

## 16. Preparation of Financial Statements for Use by an Entity's Auditors

**.61 Question**—Paragraph .22 of section 80 states "When the accountant submits compiled financial statements to his or her client that are not expected to be used by a third party, he or she is not required to issue a compilation report." In the situation in which a client engages an accountant, other than its auditor, to prepare unaudited financial statements on behalf of management and those financial statements are provided by management to its outside auditor for the purposes of the annual audit, is the client's outside auditor deemed to be a third party using the financial statements?

**.62 Interpretation**—No. Although the client's outside auditor is a third party, the auditor is not deemed to be using the financial statements. The auditor's role is to apply auditing procedures to those statements in order to obtain sufficient appropriate audit evidence to support his or her opinion on those statements. Accordingly, the requirements in paragraphs .22–.24 of section 80 are applicable.

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\* See footnote \* in paragraph .54.



[Issue Date: December 2008; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 31 to section 100).]

## 17. Required Supplementary Information That Accompanies Compiled Financial Statements

**.63 Question**—Paragraph .53 of section 80 addresses situations when the basic financial statements are accompanied by information presented for supplementary analysis purposes. Certain information presented for supplementary analysis purposes is required by a body designated by the AICPA Council to establish GAAP pursuant to Rule 202 and Rule 203<sup>2</sup> (hereinafter referred to as "required supplementary information"). Examples of required supplementary information that may accompany compiled financial statements include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by FASB ASC 972-235-50-3
- Management's discussion and analysis and budgetary comparison statements as required by Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.

Is the accountant required to apply procedures to required supplementary information that accompanies compiled financial statements?

**.64 Interpretation**—No. SSARSs do not require the accountant to apply procedures to any information presented for supplementary analysis purposes, including required supplementary information. However, nothing precludes the accountant from compiling the required supplementary information if engaged to do so.

**.65 Question**—Paragraph .53 of section 80 states that when the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should indicate the degree of responsibility, if any, he or she is taking with respect to such information. How may an accountant modify the accountant's compilation report to refer to the required supplementary information and explain the circumstances regarding its presentation?

**.66 Interpretation**—The accountant may modify the accountant's compilation report by including a separate paragraph that refers to the required supplementary information and explains the circumstances regarding its presentation. That separate paragraph would be presented after the paragraph describing the accountant's responsibility and may read as follows:

### ***The Required Supplementary Information Is Included and the Accountant Did Not Compile the Required Supplementary Information***

*[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that*

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<sup>2</sup> The bodies designated by the AICPA Council to establish professional standards with respect to financial accounting and reporting principles pursuant to these rules are the Financial Accounting Standards Board, the Governmental Accounting Standards Board, the Federal Accounting Standards Advisory Board, and the International Accounting Standards Board.

[*identify the required supplementary information*] on page XX be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by [*identify the designated accounting standard setter*] who considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context. Such information was not audited, reviewed, or compiled by me (us) and, accordingly, I (we) do not express an opinion or provide any assurance on it.

***The Required Supplementary Information Is Included, the Accountant Compiled the Required Supplemental Information and No Material Departures From the Prescribed Guidelines Regarding the Required Supplementary Information Have Been Identified***

[*Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that [*identify the required supplementary information*] on page XX be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by [*identify the designated accounting standard setter*] who considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context. Such information has been compiled by me (us) without audit or review and, accordingly, I (we) do not express an opinion or provide any assurance on it.

***All Required Supplementary Information Omitted***

Management has omitted [*describe the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by [*identify the designated accounting standard setter*] who considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context.

***Some Required Supplementary Information is Omitted and Some Is Presented in Accordance With the Prescribed Guidelines Regarding the Required Supplementary Information***

[*Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that [*identify the included supplementary information*] be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by [*identify designated accounting standard setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Such information was not audited, reviewed, or compiled by me (us) and, accordingly, I (we) do not express an opinion or provide any assurance on it.

Management has omitted [*describe the missing required supplementary information*] that [*identify the applicable financial reporting framework*] require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standard setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.

***Material Departures From the Prescribed Guidelines Regarding the Required Supplementary Information Were Identified While Compiling the Required Supplementary Information***

*[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that the [identify the supplementary information] on page XX be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by [identify designated accounting standard setter] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Such information was compiled by me (us) without audit or review and, accordingly, I (we) do not express an opinion or provide any assurance on it. However, during my (our) compilation, I (we) did become aware of the following material departures from the prescribed guidelines regarding the required supplementary information [identify the required supplementary information and describe the material departures from the prescribed guidelines regarding the required supplementary information].*

**.67 Question**—When required supplementary information is omitted from financial statements that omit substantially all the disclosures required by accounting principles generally accepted in the United States of America (U.S. GAAP), may the accountant combine the paragraph discussing the omission of substantially all the disclosures, as required by paragraph .20 of section 80, with the paragraph referring to the omission of the required supplementary information?

**.68 Interpretation**—No. Because required supplementary information is not a part of the basic financial statements and the omitted disclosures (and the statement of cash flows, if applicable) are required by U.S. GAAP to be included in the basic financial statements, the report elements required by paragraphs .20 and .53 of section 80 are not compatible.

[Issue Date: October 2011.]

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## AR Section 90

### *Review of Financial Statements*

**Issue date, unless otherwise indicated: December 2009**

**Source: SSARS No. 19; SSARS No. 20.**

**.01** This section establishes standards and provides guidance on reviews of financial statements. The accountant is required to comply with the provisions of this section whenever he or she has been engaged to review financial statements, except for reviews of interim financial information if the following are true:

- a. The entity's latest annual financial statements have been audited by the accountant or a predecessor.
- b. The accountant either
  - i. has been engaged to audit the entity's current year financial statements, or
  - ii. audited the entity's latest annual financial statements and, when it is expected that the current year financial statements will be audited, the appointment of another accountant to audit the current year financial statements is not effective prior to the beginning of the period covered by the review.
- c. The entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

Accountants engaged to perform reviews of interim financial information when the conditions in (a)–(c) are met should perform such reviews in accordance with AU-C section 930, *Interim Financial Information*. [As amended, effective for reviews of financial statements for periods beginning after December 15, 2011, by SSARS No. 20. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

**.02** The accountant is precluded from performing a review engagement if the accountant's independence is impaired for any reason. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA's Code of Professional Conduct.

### **Establishing an Understanding**

**.03** The accountant should establish an understanding with management regarding the services to be performed for review engagements<sup>1</sup> and should document the understanding through a written communication with management. Such an understanding reduces the risk that either the accountant or

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<sup>1</sup> See paragraph .29 of QC section 10, *A Firm's System of Quality Control*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SQCS No. 8.]

management may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or to perform certain functions that are management's responsibility. The accountant should ensure that the understanding includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. In some cases, the accountant may establish such understanding with those charged with governance.

**.04** An understanding with management and, if applicable, those charged with governance regarding a review of financial statements should include the following matters:

- The objective of a review is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.
- Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
- Management is responsible for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- Management is responsible to prevent and detect fraud.
- Management is responsible for identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- Management is responsible for making all financial records and related information available to the accountant.
- Management will provide the accountant, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
- The accountant is responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.
- A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management.
- A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion regarding the financial statements as a whole.

- The engagement cannot be relied upon to disclose errors, fraud,<sup>2</sup> or illegal acts.<sup>3</sup>
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of review procedures that fraud or an illegal act may have occurred.<sup>4</sup> The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

These matters should be communicated in the form of an engagement letter. An example of an engagement letter for a review of financial statements is presented in Review Exhibit A, "Illustrative Engagement Letter."

**.05** An understanding with management or, if applicable, those charged with governance also may include other matters, such as the following:

- Fees and billings
- Any limitation of or other arrangements regarding the liability of the accountant or the client, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements)
- Conditions under which access to review documentation may be granted to others
- Additional services to be provided relating to regulatory requirements

**.06** The engagement letter also should address the following additional matters if applicable:

- Material departures from the applicable financial reporting framework may exist, and the effects of those departures, if any, on the financial statements may not be disclosed.
- Reference to supplementary information.

## Review Performance Requirements

**.07** The performance of a review engagement requires that the accountant perform procedures designed to accumulate review evidence that will provide a reasonable basis for obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting

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<sup>2</sup> For purposes of this section, *fraud* is an intentional act that results in a misstatement in reviewed financial statements.

<sup>3</sup> For purposes of this section, *illegal acts* are violations of laws or government regulations, excluding fraud.

<sup>4</sup> Whether an act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on financial statements, presents himself or herself as one who is proficient in accounting and review services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination as to whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

framework. The accountant should apply professional judgment in determining the specific nature, timing, and extent of review procedures. Such procedures should be tailored based on the accountant's understanding of the industry in which the client operates and the accountant's knowledge of the entity. Review evidence obtained through the performance of analytical procedures and inquiry will ordinarily provide the accountant with a reasonable basis for obtaining limited assurance. However, the accountant should perform additional procedures if the accountant determines such procedures to be necessary to obtain limited assurance that the financial statements are not materially misstated.

## Understanding of the Industry

**.08** The accountant should possess an understanding of the industry in which the client operates, including the accounting principles and practices generally used in the industry sufficient to assist the accountant with determining the specific nature, timing, and extent of review procedures to be performed.

**.09** The requirement that the accountant possess a level of knowledge of the industry in which the entity operates does not prevent the accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals knowledgeable about the industry.

## Knowledge of the Client

**.10** The accountant should obtain knowledge about the client sufficient to assist the accountant with determining the specific nature, timing, and extent of review procedures to be performed. That knowledge should include the following:

- An understanding of the client's business
- An understanding of the accounting principles and practices used by the client

**.11** In obtaining an understanding of the client's business, the accountant should have a general understanding of the client's organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses. The accountant's understanding of an entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of the entity's personnel.

**.12** The accountant should understand the accounting principles and practices used by the client in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements. The accountant may obtain an understanding of the accounting policies and procedures used by management through inquiry, the review of client prepared documents, or experience with the client.

**.13** In obtaining this understanding of the client's accounting policies and practices, the accountant should be alert to unusual accounting policies and procedures that come to the accountant's attention as a result of his or her knowledge of the industry.



## Designing and Performing Review Procedures

### .14 Based on

- a. the accountant's understanding of the industry,
- b. his or her knowledge of the client, and
- c. his or her awareness of the risk that he or she may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated,

the accountant should design and perform analytical procedures and make inquiries and perform other procedures, as appropriate, to accumulate review evidence in obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

.15 The accountant should focus the analytical procedures and inquiries in those areas where the accountant believes there are increased risks of misstatements. The results of the accountant's analytical procedures and inquiries may modify the accountant's risk awareness. For example, the response to an inquiry that cash has not been reconciled for several months may revise the accountant's awareness of risks relative to the cash account.

## Analytical Procedures

.16 Understanding financial and nonfinancial relationships is essential in evaluating the results of analytical procedures, and generally requires knowledge of the client and the industry in which the client operates. An understanding of the purposes of analytical procedures and the limitations of those procedures also is important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires judgment by the accountant.

.17 Analytical procedures involve comparisons of expectations developed by the accountant to recorded amounts or ratios developed from recorded amounts. The accountant develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the accountant's understanding of the industry in which the client operates and knowledge of the client. Following are examples of sources of information for developing expectations:

- a. Financial information for comparable prior period(s), giving consideration to known changes
- b. Anticipated results (for example, budgets or forecasts, including extrapolations from interim or annual data)
- c. Relationships among elements of financial information within the period
- d. Information regarding the industry in which the client operates (for example, gross margin information)
- e. Relationships of financial information with relevant nonfinancial information (for example, payroll costs to number of employees)

Analytical procedures may be performed at the financial statement level or at the detailed account level. The nature, timing, and extent of the analytical procedures are a matter of professional judgment.

.18 If analytical procedures performed identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the accountant should investigate

these differences by inquiring of management and performing other procedures as necessary in the circumstances. Review evidence relevant to management's responses may be obtained by evaluating those responses, taking into account the accountant's understanding of the entity and its environment, along with other review evidence obtained during the course of the review. Although the accountant is not required to corroborate management's responses with other evidence, the accountant may need to perform other procedures when, for example, management is unable to provide an explanation, or the explanation, together with review evidence obtained relevant to management's response, is not considered adequate.

## Inquiries and Other Review Procedures

.19 The accountant should consider performing the following:

- a. Inquire of members of management who have responsibility for financial and accounting matters concerning the following:
  - i. Whether the financial statements have been prepared in conformity with the applicable financial reporting framework
  - ii. The entity's accounting principles and practices and the methods followed in applying them and the entity's procedures for recording, classifying, and summarizing transactions and accumulating information for disclosure in the financial statements
  - iii. Unusual or complex situations that may have an effect on the financial statements
  - iv. Significant transactions occurring or recognized near the end of the reporting period
  - v. The status of uncorrected misstatements identified during the previous engagement
  - vi. Questions that have arisen in the course of applying the review procedures
  - vii. Events subsequent to the date of the financial statements that could have a material effect on the financial statements
  - viii. Their knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements (for example, communications received from employees, former employees, or others)
  - ix. Significant journal entries and other adjustments
  - x. Communications from regulatory agencies

In addition to members of management who have responsibility for financial and accounting matters, the accountant may determine to direct inquiries to others within the entity and those charged with governance, if appropriate.

- b. Inquire concerning actions taken at meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements
- c. Read the financial statements to consider, on the basis of information coming to the accountant's attention, whether the financial statements appear to conform with the applicable financial reporting framework
- d. Obtain reports from other accountants, if any, who have been engaged to audit or review the financial statements of significant components of the reporting entity, its subsidiaries, and other investees<sup>5</sup>

**.20** The accountant ordinarily is not required to corroborate management's responses with other evidence; however, the accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the client's business and the industry in which it operates.

### **Incorrect, Incomplete, or Otherwise Unsatisfactory Information**

**.21** During the performance of review procedures, the accountant may become aware that information coming to his or her attention is incorrect, incomplete, or otherwise unsatisfactory. In such instances, the accountant should request that management consider the effect of these matters on the financial statements and communicate the results of its consideration to the accountant. The accountant should consider the results communicated to the accountant by management and the effect, if any, on the accountant's review report. If the accountant believes the financial statements may be materially misstated, the accountant should perform additional procedures deemed necessary to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. If the accountant concludes that the financial statements are materially misstated, the accountant should follow the guidance in paragraphs .34–.36 with respect to departures from the applicable financial reporting framework.

### **Management Representations**

**.22** Written representations are required from management for all financial statements and periods covered by the accountant's review report. For example, if comparative financial statements are reported on, the representations obtained at the completion of the most recent review should address all periods being reported on. If current management was not present during all periods covered by the accountant's report, the accountant should nevertheless obtain written representations from current management for all such periods. The specific written representations obtained by the accountant will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. Written representations from management ordinarily

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<sup>5</sup> The financial statements of the reporting entity ordinarily include an accounting for all significant components, such as unconsolidated subsidiaries and investees. If other accountants are engaged to audit or review the financial statements of such components, the accountant will require reports from the other accountants as a basis, in part, for the accountant's review report with respect to the review of the financial statements of the reporting entity. The accountant may decide to make reference to the work of other accountants in the accountant's review report on the financial statements. If such reference is made, the report should indicate the magnitude of the portion of the financial statements audited or reviewed by the other accountants.

confirm representations explicitly or implicitly given to the accountant, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations. The accountant should request that management provide a written representation related to the following matters:

- a. Management's acknowledgment of its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework
- b. Management's belief that the financial statements are fairly presented in accordance with the applicable financial reporting framework
- c. Management's acknowledgement of its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements
- d. Management's acknowledgement of its responsibility to prevent and detect fraud
- e. Knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others
- f. Management's full and truthful response to all inquiries
- g. Completeness of information
- h. Information concerning subsequent events

The representation letter ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.<sup>6</sup> An illustrative representation letter is presented in Review Exhibit B, "Illustrative Representation Letter."

**.23** Circumstances exist in which the accountant should consider obtaining an updating representation letter from management (for example, the accountant obtains a management representation letter after completion of inquiry and analytical review procedures, but does not issue the review report for a significant period of time thereafter, or a material subsequent event occurs after the completion of inquiry and analytical review procedures, including obtaining the original management representation letter, but before the issuance of the report on the reviewed financial statements). In addition, if a predecessor accountant is requested to reissue the report on the financial statements of a prior period and those financial statements are to be presented on a comparative basis with reviewed financial statements of a subsequent period, the predecessor accountant should obtain an updating representation letter from the management of the former client.<sup>7</sup> The updating management representation letter should state (a) whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified and (b) whether any events have occurred subsequent to the balance-sheet date of the latest financial statements reported on by the accountant that would require adjustment to or disclosure in those financial statements. An illustrative updating management representation letter is contained in Review Exhibit C, "Illustrative Updating Management Representation Letter."

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<sup>6</sup> The accountant is not precluded from obtaining representations regarding services performed in addition to the review engagement.

<sup>7</sup> See paragraphs .20–.24 of section 200, *Reporting on Comparative Financial Statements*.

**.24** Because the accountant is concerned with events occurring through the date of the report that may require adjustment to or disclosure in the financial statements, management's representations set forth in the management representation letter should be made as of the date of the accountant's review report. The accountant need not be in physical receipt of the management representation letter as of the date of the accountant's review report, provided that management has acknowledged that they will sign the representation letter without modification and it is received prior to the release of the report. The management representation letter should be addressed to the accountant. The letter should be signed by those members of management whom the accountant believes are responsible for and knowledgeable about (directly or through others in the organization) the matters covered in the representation letter. Normally, the chief executive officer and chief financial officer or others with equivalent positions in the entity should sign the representation letter.

## Documentation in a Review Engagement

**.25** The accountant should prepare documentation in connection with each review engagement in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of review procedures performed); the review evidence obtained and its source; and the conclusions reached. Documentation does the following:

- a.* Provides the principal support for the representation in the accountant's review report that the accountant performed the review in accordance with SSARs
- b.* Provides the principal support for the conclusion that the accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the applicable financial reporting framework

**.26** The form, content, and extent of documentation depend on the circumstances of the engagement, the methodology and tools used, and the accountant's professional judgment. The accountant's documentation should include the following:

- The engagement letter documenting the understanding with the client.
- The analytical procedures performed, including the following:
  - The expectations, when the expectations are not otherwise readily determinable from the documentation of the work performed, and the factors considered in the development of the expectations
  - Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts
  - Management's responses to the accountant's inquiries regarding fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount
- Any additional review procedures performed in response to significant unexpected differences arising from analytical procedures and the results of such additional procedures.
- The significant matters covered in the accountant's inquiry procedures and the responses thereto. The accountant may document

the matters covered by the accountant's inquiry procedures and the responses thereto through a memorandum, checklist, or other means.

- Any findings or issues that, in the accountant's judgment, are significant (for example, the results of review procedures that indicate the financial statements could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached).
- Significant unusual matters that the accountant considered during the performance of the review procedures, including their disposition.
- Communications, whether oral or written, to the appropriate level of management regarding fraud or illegal acts that come to the accountant's attention.
- The representation letter.

The accountant is not precluded from supporting the review report by other means in addition to the review documentation. Such other means might include written documentation contained in other engagement files (for example, compilation or nonattest services) or quality control files (for example, consultation files) and, in limited situations, oral explanations. Oral explanations on their own do not represent sufficient support for the work the accountant performed or conclusions the accountant reached but may be used by the accountant to clarify or explain information contained in the documentation.

## Reporting on the Financial Statements

.27 Financial statements reviewed by an accountant should be accompanied by a written report. The accountant's objective in reporting on the financial statements is to prevent misinterpretation of the degree of responsibility the accountant is assuming when his or her name is associated with the financial statements.

.28 The basic elements of the report are as follows:

- a. *Title*. The accountant's review report should have a title that clearly indicates that it is the accountant's review report and includes the word *independent*. An appropriate title would be "Independent Accountant's Review Report."
- b. *Addressee*. The accountant's report should be addressed as required by the circumstances of the engagement.
- c. *Introductory paragraph*. The introductory paragraph in the accountant's report should
  - i. identify the entity whose financial statements have been reviewed;
  - ii. state that the financial statements have been reviewed;
  - iii. identify the financial statements; that have been reviewed;
  - iv. specify the date or period covered by the financial statements;
  - v. include a statement that a review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners); and

- vi. include a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that, accordingly, the accountant does not express such an opinion.
- d. *Management's responsibility for the financial statements.* A statement that management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- e. *Accountant's responsibility.* A statement that the accountant's responsibility is to conduct the review in accordance with SSARSS issued by the AICPA.

A statement that those standards require the accountant to perform the procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements.

A statement that the accountant believes that the results of his or her procedures provide a reasonable basis for his or her report.
- f. *Results of engagement.* A statement that, based on his or her review, the accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the applicable financial reporting framework, other than those modifications, if any, indicated in the report.
- g. *Signature of the accountant.* The manual or printed signature of the accounting firm or the accountant as appropriate.
- h. *Date of the accountant's report.* The date of the review report (the accountant's review report should not be dated earlier than the date on which the accountant has accumulated review evidence sufficient to provide a reasonable basis for concluding that the accountant has obtained limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework).

See Review Exhibit D, "Illustrative Review Reports," for examples of review reports.

**.29** Each page of the financial statements reviewed by the accountant should include a reference, such as "See Independent Accountant's Review Report."

**.30** When the accountant is unable to perform the inquiry and analytical procedures he or she considers necessary to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework, or the client does not provide the accountant with a representation letter, the review will be incomplete. A review that is incomplete does not provide an adequate basis for issuing a review report. In such a situation, the accountant should consider the matters discussed in paragraphs .56–.61 of section 80, *Compilation of Financial Statements*, in deciding whether it is appropriate to issue a compilation report on the financial statements.

**.31** The accountant may be asked to issue a review report on one financial statement, such as a balance sheet, and not on other related financial statements, such as the statements of income, retained earnings, and cash flows. The accountant may do so if the scope of his or her inquiry and analytical procedures has not been restricted.

**.32** Financial statements prepared in accordance with an OCBOA are not considered appropriate in form unless the financial statements include

- a description of the OCBOA, including a summary of significant accounting policies and a description of the primary differences from GAAP. The effects of the differences need not be quantified.
- informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

### Emphasis of a Matter

**.33** The accountant may emphasize, in any report on financial statements, a matter disclosed in the financial statements. Such explanatory information should be presented in a separate paragraph of the accountant's report. Emphasis paragraphs are never required; they may be added solely at the accountant's discretion.

Examples of matters that the accountant may wish to emphasize are

- uncertainties.
- that the entity is a component of a larger business enterprise.
- that the entity has had significant transactions with related parties.
- unusually important subsequent events.
- accounting matters affecting the comparability of the financial statements with those of the preceding period.

### Departures From the Applicable Financial Reporting Framework

**.34** An accountant who is engaged to review financial statements may become aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements. If the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure.

**.35** If the accountant concludes that modification of the standard report is appropriate, the departure should be disclosed in a separate paragraph of the report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the accountant's procedures. The accountant is not required to determine the effects of a departure if management has not done so, provided that the accountant states in the report that such determination has not been made.

See Review Exhibit D for examples of review reports that disclose departures from the applicable financial reporting framework.



**.36** If the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the review engagement and provide no further services with respect to those financial statements. The accountant may wish to consult with his or her legal counsel in those circumstances.

## **Restricting the Use of an Accountant's Review Report**

### ***General Use and Restricted Use Reports***

**.37** The term *general use* applies to accountants' reports that are not restricted to specified parties. Accountants' reports on financial statements prepared in conformity with an applicable financial reporting framework ordinarily are not restricted regarding use. However, nothing in this section precludes the accountant from restricting the use of any report.

**.38** The term *restricted use* applies to accountants' reports intended only for one or more specified third parties. The need for restriction on the use of a report may result from a number of circumstances, including, but not limited to, the purpose of the report and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used.

**.39** The accountant should restrict the use of a report when the subject matter of the accountant's report or the presentation being reported on is based on measurement or disclosure criteria contained in contractual agreements<sup>8</sup> or regulatory provisions that are not in conformity with an applicable financial reporting framework.

### ***Reporting on Subject Matter or Presentations Based on Measurement or Disclosure Criteria Contained in Contractual Agreements or Regulatory Provisions***

**.40** When reports are issued on subject matter or presentations based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions that are not in conformity with an applicable financial reporting framework, the accountant should restrict the report because the basis, assumptions, or purpose of such presentations (contained in such agreements or regulatory provisions) are developed for, and directed only to, the parties to the agreement or regulatory agency responsible for the provisions and because the report, subject matter, or presentation may be misunderstood by those who are not adequately informed of the basis, assumptions, or purpose of the presentation.

### ***Combined Reports Covering Both Restricted Use and General Use Subject Matter or Presentations***

**.41** If the accountant issues a single combined report covering both (a) subject matter or presentations that require a restriction on use to specified parties and (b) subject matter or presentations that ordinarily do not require such a restriction, the use of such a single combined report should be restricted to the specified parties.

### ***Inclusion of a Separate Restricted Use Report in the Same Document With a General-Use Report***

**.42** When required by law or regulation, a separate restricted use report may be included in a document that also contains a general use report. The

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<sup>8</sup> A *contractual agreement*, as discussed in this section, is an agreement between the client and one or more third parties other than the accountant.

inclusion of a separate restricted-use report in a document that contains a general use report does not affect the intended use of either report. The restricted use report remains restricted regarding use, and the general use report continues for general use.

### ***Adding Other Specified Parties***

.43 Subsequent to the completion of an engagement resulting in a restricted use report or in the course of such an engagement, the accountant may be asked to consider adding other parties as specified parties.

.44 If the accountant is reporting on subject matter or a presentation based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions, as described in paragraph .40, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors such as the identity of the other parties, their knowledge of the basis of the measurement or disclosure criteria, and the intended use of the report. If the accountant agrees to add other parties as specified parties, the accountant should obtain affirmative acknowledgment, preferably in writing, from the other parties of their understanding of the nature of the engagement, the measurement or disclosure criteria used in the engagement, and the related report. If the other parties are added after the accountant has issued his or her report, the report may be reissued, or the accountant may provide other written acknowledgment that the other parties have been added as specified parties. If the report is reissued, the report date should not be changed. If the accountant provides written acknowledgment that the other parties have been added as specified parties, such written acknowledgment ordinarily should state that no procedures have been performed subsequent to the date of the report.

### **Limiting the Distribution of Reports**

.45 Because of the reasons presented in paragraph .38, the accountant should consider informing his or her client that restricted use reports are not intended for distribution to nonspecified parties, regardless of whether they are included in a document containing a separate general use report.<sup>9</sup> This section does not preclude the accountant, in connection with establishing the terms of the engagement, from reaching an understanding with the client that the intended use of the report will be restricted, and from obtaining the client's agreement that the client and the specified parties will not distribute the report to parties other than those identified in the report. However, the accountant is not responsible for controlling a client's distribution of restricted use reports. Accordingly, a restricted use report should alert readers to the restriction on the use of the report by indicating that the report is not intended to be and should not be used by anyone other than the specified parties.

### ***Report Language—Restricted Use***

.46 An accountant's report that is restricted should contain a separate paragraph at the end of the report that includes the following elements:

- a. A statement indicating that the report is intended solely for the information and use of the specified parties.

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<sup>9</sup> In some cases, restricted use reports filed with regulatory agencies are required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency as part of its oversight responsibility for an entity may require access to restricted use reports in which they are not named as a specified party.

- b. An identification of the specified parties to whom use is restricted. The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.
- c. A statement that the report is not intended to be and should not be used by anyone other than the specified parties.

## An Entity's Ability to Continue as a Going Concern

**.47** During the performance of review procedures, evidence or information may come to the accountant's attention indicating that there may be an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being reviewed (hereinafter referred to as a *reasonable period of time*). In those circumstances, the accountant should request that management consider the possible effects of the going concern uncertainty on the financial statements, including the need for related disclosure.

**.48** After management communicates to the accountant the results of its consideration of the possible effects on the financial statements, the accountant should consider the reasonableness of management's conclusions, including the adequacy of the related disclosures, if applicable.

**.49** If the accountant determines that management's conclusions are unreasonable or the disclosure of the uncertainty regarding the entity's ability to continue as a going concern is not adequate, he or she should follow the guidance in paragraphs .34–.36 with respect to departures from the applicable financial reporting framework.

**.50** The accountant may emphasize an uncertainty about an entity's ability to continue as a going concern, provided that the uncertainty is disclosed in the financial statements. In such circumstances, the accountant should follow the guidance in paragraph .33.

## Subsequent Events

**.51** Evidence or information that a subsequent event that has a material effect on the reviewed financial statements has occurred may come to the accountant's attention in the following ways:

- a. During the performance of review procedures
- b. Subsequent to the date of the accountant's review report but prior to the release of the report

In either case, the accountant should request that management consider the possible effects on the financial statements, including the adequacy of any related disclosure, if applicable.

**.52** If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, he or she should follow the guidance in paragraphs .34–.36.

**.53** Occasionally, a subsequent event has such a material impact on the entity that the accountant may wish to include in his or her review report an explanatory paragraph directing the reader's attention to the event and its effects. Such an emphasis of matter paragraph may be added at the accountant's discretion, provided that the matter is disclosed in the financial statements. See paragraph .33 for additional guidance with respect to emphasis of matter paragraphs.

## Subsequent Discovery of Facts Existing at the Date of the Report

**.54** Subsequent to the date of the report on the financial statements that the accountant has reviewed, he or she may become aware that facts may have existed at that date that might have caused him or her to believe that information supplied by the entity was incorrect, incomplete, or otherwise unsatisfactory had the accountant then been aware of such facts. Because of the variety of conditions that might be encountered, some of the procedures contained in this section are necessarily set out only in general terms; the specific actions to be taken in a particular case may vary with the circumstances. The accountant would be well advised to consult with his or her legal counsel when he or she encounters the circumstances to which this section may apply because of legal implications that may be involved in actions contemplated herein.

**.55** After the date of the accountant's review report, the accountant has no obligation to perform other review procedures with respect to the financial statements unless new information comes to his or her attention. However, when the accountant becomes aware of information that relates to financial statements previously reported on by him or her but that was not known to the accountant at the date of the report (and that is of such a nature and from such a source that the accountant would have investigated it had it come to his or her attention during the course of the review), the accountant should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of the report. The accountant should discuss the matter with his or her client at whatever management levels the accountant deems appropriate and request cooperation in whatever investigation may be necessary. In addition to management, the accountant may deem it appropriate to discuss the matter with those charged with governance. If the nature and effect of the matter are such that (a) the accountant's report or the financial statements would have been affected if the information had been known to the accountant at the accountant's review report date and had not been reflected in the financial statements and (b) the accountant believes that persons currently using or likely to use the financial statements exist who would attach importance to the information, the accountant should perform the additional procedures deemed necessary to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. Consideration should be given to, among other things, the time elapsed since the financial statements were issued.

**.56** When the accountant has concluded that action should be taken to prevent further use of the accountant's report or the financial statements, the accountant should advise his or her client to make appropriate disclosure of the newly discovered facts and their impact on the financial statements to persons who are known to be currently using or who are likely to use the financial statements. When the client undertakes to make appropriate disclosure, the method used and the disclosure made will depend on the circumstances. For example

- a. if the effect of the subsequently discovered information on the accountant's report or the financial statements can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and, when applicable, the accountant's report. The reasons for the revision usually should be described in a note to the financial statements and, when applicable, referred to in the accountant's report. Generally, only the

most recently issued reviewed financial statements would need to be revised, even though the revision resulted from events that had occurred in prior years.

- b. when issuance of financial statements for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements, pursuant to subparagraph (a).
- c. when the effect on the financial statements of the subsequently discovered information cannot be promptly determined, the issuance of revised financial statements would necessarily be delayed. In this circumstance, when it appears that the information will require a revision of the statements, appropriate disclosure would consist of notification by the client to persons who are known to be using or who are likely to use the financial statements that the statements should not be used; that revised financial statements will be issued; and, when applicable, that the accountant's report will be issued as soon as practicable.

**.57** The accountant should take whatever steps he or she deems necessary to satisfy himself or herself that the client has made the disclosures specified in paragraph .56.

**.58** If the client refuses to make the disclosures specified in paragraph .56, the accountant should notify the appropriate personnel at the highest levels within the entity, such as the manager (owner) or those charged with governance, of such refusal and of the fact that, in the absence of disclosure by the client, the accountant will take steps as outlined here to prevent further use of the financial statements and the accountant's report. The steps that can appropriately be taken will depend upon the degree of certainty of the accountant's knowledge that persons exist who are currently using or who will use the financial statements and the accountant's report and who would attach importance to the information. The steps that can be taken also will depend on the accountant's ability as a practical matter to communicate with these persons. Unless the accountant's attorney recommends a different course of action, the accountant should take the following steps to the extent applicable:

- a. Notification to the client that the accountant's report must no longer be associated with the financial statements.
- b. Notification to the regulatory agencies having jurisdiction over the client that the accountant's report should no longer be used.
- c. Notification to each person known to the accountant to be using the financial statements that the financial statements and the accountant's report should no longer be used. In many instances, it will not be practicable for the accountant to give appropriate individual notification to stakeholders whose identities ordinarily are unknown to him or her; notification to a regulatory agency having jurisdiction over the client will usually be the only practicable way for the accountant to provide appropriate disclosure. Such notification should be accompanied by a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.

**.59** The following guidelines should govern the content of any disclosure made by the accountant, in accordance with paragraph .58, to persons other than his or her client:

- a. The disclosure should include a description of the nature of the subsequently acquired information and its effect on the financial statements.

- b. The information disclosed should be as precise and factual as possible and should not go beyond that which is reasonably necessary to accomplish the purpose mentioned in the preceding subparagraph (a). Comments concerning the conduct or motives of any person should be avoided.

If the client has not cooperated, the accountant's disclosure need not detail the specific information but can merely indicate that the client has not cooperated with the accountant's attempt to substantiate information that has come to the accountant's attention and that, if the information is true, the accountant believes that the review report must no longer be used or associated with the financial statements. No such disclosure should be made unless the accountant believes that the financial statements are likely to be misleading and that the accountant's review report should not be used.

## Supplementary Information

**.60** When the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should clearly indicate the degree of responsibility, if any, he or she is taking with respect to such information.

When the accountant has reviewed the basic financial statements, an explanation should be included in the review report or in a separate report on the other data. The report should state that the review has been made for the purpose of expressing a conclusion that there are no material modifications that should be made to the financial statements in order for them to be in conformity with the applicable financial reporting framework and that either

- the other data accompanying the financial statements are presented only for purposes of additional analysis and have been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and the accountant did not become aware of any material modifications that should be made to such data, or
- the other data accompanying the financial statements are presented only for purposes of additional analysis and have not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements but were compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or provide any assurance on such data.

## Communicating to Management and Others

**.61** When evidence or information comes to the accountant's attention during the performance of review procedures that fraud or an illegal act may have occurred, that matter should be brought to the attention of the appropriate level of management. The accountant need not report matters regarding illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of such items to be communicated. When matters regarding fraud or an illegal act involve senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or those charged with governance. The communication may be oral or written. If the communication is oral, the accountant should document it. When matters regarding fraud or an illegal act involve an owner of the business, the accountant should consider resigning from the

engagement. Additionally, the accountant should consider consulting with his or her legal counsel whenever any evidence or information comes to his or her attention during the performance of review procedures that fraud or an illegal act may have occurred, unless such illegal act is clearly inconsequential.

**.62** The disclosure of any evidence or information that comes to the accountant's attention during the performance of review procedures that fraud or an illegal act may have occurred to parties other than the client's senior management (or those charged with governance, if applicable) ordinarily is not part of the accountant's responsibility and, ordinarily, would be precluded by the accountant's ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances, a duty to disclose to parties outside of the entity may exist:

- a. To comply with certain legal and regulatory requirements
- b. To a successor accountant when the successor decides to communicate with the predecessor accountant, in accordance with section 400, *Communications Between Predecessor and Successor Accountants*, regarding acceptance of an engagement to compile or review the financial statements of a nonissuer
- c. In response to a subpoena

Because potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex, the accountant may wish to consult with legal counsel before discussing matters covered by paragraph .61 with parties outside the client.

## Change in Engagement From Audit to Review

**.63** The accountant who has been engaged to audit the financial statements of a nonissuer in accordance with auditing standards generally accepted in the United States of America may, before the completion of the audit, be requested to change the engagement to a review of financial statements. A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit, a misunderstanding regarding the nature of an audit or review, or a restriction.

**.64** Before the accountant, who was engaged to perform an audit in accordance with auditing standards generally accepted in the United States of America, agrees to change the engagement to a review, at least the following should be considered:

- a. The reason given for the client's request, particularly the implications of a restriction on the scope of the audit, whether imposed by the client or by circumstances
- b. The additional audit effort required to complete the audit
- c. The estimated additional cost to complete the audit

**.65** A change in circumstances that affects the entity's requirement for an audit, or a misunderstanding concerning the nature of an audit or review would ordinarily be considered a reasonable basis for requesting a change in the engagement.

**.66** In considering the implications of a restriction on the scope of the audit, the accountant should evaluate the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. Nevertheless, when the accountant has been engaged to audit an entity's financial statements and has been prohibited by the client from corresponding with

the entity's legal counsel, the accountant ordinarily would be precluded from issuing a review report on the financial statements.

**.67** In all circumstances, if the audit procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement.

**.68** If the accountant concludes, based upon his or her professional judgment, that there is reasonable justification to change the engagement and if he or she complies with the standards applicable to a review engagement, the accountant should issue an appropriate review report. The report should not include reference to (a) the original engagement, (b) any audit procedures that may have been performed, or (c) scope limitations that resulted in the changed engagement.

## Effective Date

**.69** This section is effective for reviews of financial statements for periods ending on or after December 15, 2010.



## Review Exhibit A—Illustrative Engagement Letter

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the financial statements of XYZ Company as of and for the year ended December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a review is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

- a. the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].
- b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- c. preventing and detecting fraud.
- d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- e. making all financial records and related information available to us.
- f. providing us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.

We are responsible for conducting the engagement in accordance with SSARs issued by the AICPA.

A review includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion regarding the financial statements as a whole.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our

attention during the performance of our review procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services. . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

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*[Signature of accountant]*

Acknowledged:

XYZ Company

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President

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Date

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## Review Exhibit B—Illustrative Representation Letter

The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of the review engagement or the industry in which the entity operates, that other matters should be specifically included in the letter or that some of the representations included in the illustrative letter are not necessary.

[Date]<sup>1</sup>

To [the Accountant]

We are providing this letter in connection with your review of the [identification of financial statements] of [name of entity] as of [dates (for example, December 31, 20X1, and December 31, 20X2)] and for the [periods of review (for example, for the years then ended)] for the purpose of obtaining limited assurance that that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]. We confirm that we are responsible for the fair presentation of the financial statements in accordance with [the applicable financial reporting framework] and the selection and application of the accounting policies.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person using the information would be changed or influenced by the omission or misstatement.<sup>2</sup>

We confirm, to the best of our knowledge and belief, (as of [the date of the accountant's review report]) the following representations made to you during your review:

1. The financial statements referred to previously are fairly presented in accordance with [the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)].
2. We have made the following available to you
  - a. financial records and related data.
  - b. minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. No material transactions exist that have not been properly recorded in the accounting records underlying the financial statements.
4. We acknowledge our responsibility for the preparation and fair presentation of the financial statements in accordance with [the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)].

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<sup>1</sup> This date should be the date that the client presents and signs the letter. In no event should the letter be presented and signed prior to the date of the accountant's review report.

<sup>2</sup> The qualitative discussion of materiality used in this letter is adapted from Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*.

5. We acknowledge our responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
6. We acknowledge our responsibility to prevent and detect fraud.
7. We have no knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others.
8. We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
9. No material losses exist (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
10. None of the following exist:
  - a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency
  - b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion that must be disclosed in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*.<sup>3</sup>
  - c. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450.
11. The company has satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
12. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
13. The following have been properly recorded or disclosed in the financial statements:
  - a. Related party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
  - b. Guarantees, whether written or oral, under which the company is contingently liable.
  - c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with FASB ASC 275, *Risks and Uncertainties*. [*Significant estimates are estimates at the balance sheet date*]

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<sup>3</sup> If management has not consulted a lawyer regarding litigation, claims, and assessments, the representation might be worded as follows:

We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that are required to be accrued or disclosed in the financial statements in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*, and we have not consulted a lawyer concerning litigation, claims, or assessments.

*that could change materially with the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]*

*[Add additional representations that are unique to the entity's business or industry. See the following for additional illustrative representations.]*

14. We are in agreement with the adjusting journal entries you have recommended, and they have been posted to the company's accounts (if applicable).
15. To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.<sup>4</sup>
16. We have responded fully and truthfully to all inquiries made to us by you during your review.

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*[Name of Owner or Chief Executive Officer and Title]*

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*[Name of Chief Financial Officer and Title, where applicable]*

Representation letters ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry. The following is a list of additional representations that may be appropriate in certain situations. This list is not intended to be all-inclusive. The accountant should consider the effects of pronouncements issued subsequent to the issuance of this section.

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<sup>4</sup> If the accountant dual dates his or her report, the accountant should consider whether obtaining additional representations relating to the subsequent event is appropriate.

*General*

<i>Condition</i>	<i>Illustrative Examples</i>
The effect of a new accounting principle is not known.	We have not completed the process of evaluating the impact that will result from adopting Financial Accounting Standards Board (FASB) <i>Accounting Standards Codification</i> (ASC) [XXX, Title], as discussed in note [X]. The company is therefore unable to disclose the impact that adopting FASB ASC XXX will have on its financial position and the results of operations when such statement is adopted.
Justification exists for a change in accounting principles.	We believe that [ <i>describe the newly adopted accounting principle</i> ] is preferable to [ <i>describe the former accounting principle</i> ] because [ <i>describe management's justification for the change in accounting principles</i> ].
Financial circumstances are strained, with disclosure of management's intentions and the entity's ability to continue as a going concern.	Note [X] to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans.
The possibility exists that the value of specific significant long lived assets or certain identifiable intangibles may be impaired.	We have reviewed long lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.
The entity has a variable interest in another entity.	<p>Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with accounting principles generally accepted in the United States of America.</p> <p>We have considered both implicit and explicit variable interests in (a) determining whether potential VIEs should be considered VIEs, (b) calculating expected losses and residual returns, and (c) determining which party, if any, is the primary beneficiary.</p> <p>We have provided you with lists of all identified variable interests in (a) VIEs, (b) potential VIEs that we considered but judged not to be VIEs, and (c) entities that were afforded the scope exceptions of FASB ASC 810, <i>Consolidation</i>.</p>

*General*

<i>Condition</i>	<i>Illustrative Examples</i>
	<p>We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FASB ASC 810.</p> <p>We have made available all relevant information about financial interests and contractual arrangements with related parties, de facto agents, and other entities, including but not limited to, their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements.</p> <p>The information we provided about financial interests and contractual arrangements with related parties, de facto agents, and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements.</p> <p>Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes.</p> <p>Regarding entities in which the company has variable interests (implicit and explicit), we have provided all information about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the company is the primary beneficiary or has a significant variable interest in the entity.</p> <p>We have made and continue to make exhaustive efforts to obtain information about entities in which the company has an implicit or explicit interest, but that were excluded from complete analysis under FASB ASC 810 due to lack of essential information to determine one or more of the following:</p> <ul style="list-style-type: none"> <li>• Whether the entity is a VIE</li> <li>• Whether the company is the primary beneficiary</li> <li>• The accounting required to consolidate the entity</li> </ul>
The work of a specialist has been used by the entity.	<p>We agree with the findings of specialists in evaluating the [<i>describe assertion</i>] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.</p>

*(continued)*

*Assets*

<i>Condition</i>	<i>Illustrative Examples</i>
<p><i>Cash</i></p> <p>Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements.</p>	<p>Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements have been properly disclosed.</p>
<p><i>Financial Instruments</i></p> <p>Management intends to and has the ability to hold to maturity debt securities classified as held-to-maturity.</p> <p>Management considers the decline in value of debt or equity securities to be temporary.</p> <p>Management has determined the fair value of significant financial instruments that do not have readily determinable market values.</p>	<p>Debt securities that have been classified as held-to-maturity have been so classified due to the company's intent to hold such securities to maturity and the company's ability to do so. All other debt securities have been classified as available-for-sale or trading.</p> <p>We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.</p> <p>The methods and significant assumptions used to determine fair values of financial instruments are as follows: [<i>describe methods and significant assumptions used to determine fair values of financial instruments</i>]. The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.</p>
<p>Financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk exist.</p>	<p>The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements:</p> <ol style="list-style-type: none"> <li>1. The extent, nature, and terms of financial instruments with off-balance-sheet risk</li> <li>2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments</li> <li>3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments</li> </ol>



**Assets**

<b>Condition</b>	<b>Illustrative Examples</b>
<p><i>Receivables</i> Receivables have been recorded in the financial statements.</p>	<p>Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.</p>
<p><i>Inventories</i> Excess or obsolete inventories exist.</p>	<p>Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.</p>
<p><i>Investments</i> Unusual considerations are involved in determining the application of equity accounting.</p>	<p>[For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:]</p> <ul style="list-style-type: none"> <li>• The equity method is used to account for the company's investment in the common stock of [investee] because the company has the ability to exercise significant influence over the investee's operating and financial policies.</li> <li>• The cost method is used to account for the company's investment in the common stock of [investee] because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.</li> </ul>
<p><i>Deferred Charges</i> Material expenditures have been deferred.</p>	<p>We believe that all material expenditures that have been deferred to future periods will be recoverable.</p>
<p><i>Deferred Tax Assets</i> A deferred tax asset exists at the balance sheet date.</p>	<p>The valuation allowance has been determined pursuant to the provisions of FASB ASC 740, <i>Income Taxes</i>, including the company's estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized. [Complete with appropriate wording detailing how the entity determined the valuation allowance against the deferred tax asset.]</p> <p>or</p> <p>A valuation allowance against deferred tax assets at the balance-sheet date is not considered necessary because it is more likely than not that the deferred tax asset will be fully realized.</p>

(continued)

*Liabilities*

<i>Condition</i>	<i>Illustrative Examples</i>
<p><i>Debt</i> Short term debt could be refinanced on a long term basis and management intends to do so.</p>	<p>The company has excluded short-term obligations totaling \$[<i>amount</i>] from current liabilities because it intends to refinance the obligations on a long-term basis. [<i>Complete with appropriate wording detailing how amounts will be refinanced as follows:</i>]</p> <ul style="list-style-type: none"> <li>• The company has issued a long term obligation [<i>debt security</i>] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short-term obligations on a long term basis.</li> <li>• The company has the ability to consummate the refinancing, by using the financing agreement referred to in note [X] to the financial statements.</li> </ul>
<p>Tax-exempt bonds have been issued.</p>	<p>Tax-exempt bonds issued have retained their tax-exempt status.</p>
<p><i>Taxes</i> Management intends to reinvest undistributed earnings of a foreign subsidiary.</p>	<p>We intend to reinvest the undistributed earnings of [<i>name of foreign subsidiary</i>].</p>
<p><i>Contingencies</i> Estimates and disclosures have been made of environmental remediation liabilities and related loss contingencies.</p>	<p>Provision has been made for any material loss that is probable from environmental remediation liabilities associated with [<i>name of site</i>]. We believe that such estimate is reasonable based on available information and that the liabilities and related loss contingencies and the expected outcome of uncertainties have been adequately described in the company's financial statements.</p>
<p>Agreements may exist to repurchase assets previously sold.</p>	<p>Agreements to repurchase assets previously sold have been properly disclosed.</p>
<p><i>Pension and Postretirement Benefits</i> An actuary has been used to measure pension liabilities and costs.</p>	<p>We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.</p>

*Liabilities*

<i>Condition</i>	<i>Illustrative Examples</i>
Involvement with a multiemployer plan exists.	We are unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan. or We have determined that there is the possibility of a withdrawal liability in a multiemployer plan in the amount of \$[XX].
Postretirement benefits have been eliminated.	We do not intend to compensate for the elimination of postretirement benefits by granting an increase in pension benefits. or We plan to compensate for the elimination of postretirement benefits by granting an increase in pension benefits in the amount of \$[XX].
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	We plan to continue to make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost. or We do not plan to make frequent amendments to its pension or other postretirement benefit plans.

*Equity*

<i>Condition</i>	<i>Illustrative Example</i>
Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements exist.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

*(continued)*

*Income Statement*

<i>Condition</i>	<i>Illustrative Examples</i>
There may be a loss from sales commitments.	Provisions have been made for losses to be sustained in the fulfillment of or from inability to fulfill any sales commitments.
There may be losses from purchase commitments.	Provisions have been made for losses to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of prevailing market prices.
Nature of the product or industry indicates the possibility of undisclosed sales terms.	We have fully disclosed to you all sales terms, including all rights of return or price adjustments and all warranty provisions.

## Review Exhibit C—Illustrative Updating Management Representation Letter

The following letter is presented for illustrative purposes only. It may be used in the circumstances described in paragraph .23. Management need not repeat all of the representations made in the previous representation letter.

If matters exist that should be disclosed to the accountant, they may be indicated by listing them following the representation. For example, if an event subsequent to the date of the accountant's review report is disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in note X to the financial statements, no events have occurred..."

[Date]<sup>1</sup>

To [Accountant]

In connection with your review(s) of the [*identification of financial statements*] of [*name of entity*] as of [*dates*] and for the [*periods of review*] for the purpose of obtaining limited assurance that that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*], you were previously provided with a representation letter under date of [*date of previous representation letter*]. No information has come to our attention that would cause us to believe that any of those previous representations should be modified.

To the best of our knowledge and belief, no events have occurred subsequent to [*date of latest balance sheet reported on by the accountant or date of previous representation letter*] and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

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[*Name of Owner or Chief Executive Officer and Title*]

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[*Name of Chief Financial Officer and Title, when applicable*]

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<sup>1</sup> The accountant has two methods available for dating the report when a subsequent event requiring disclosure occurs after the completion of the review but before issuance of the report on the related financial statements. The accountant may use dual dating (for example, "February 16, 20XX, except for note Y, as to which the date is March 1, 20XX,") or may date the report as of the later date.

## Review Exhibit D—Illustrative Review Reports

*Standard accountant's review report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America*

### Independent Accountant's Review Report

[*Appropriate Salutation*]

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

*Standard accountant's review report on financial statements prepared in accordance with the income tax basis of accounting*

### Independent Accountant's Review Report

[*Appropriate Salutation*]

I (We) have reviewed the accompanying statement of assets, liabilities, and equity—income tax basis of XYZ Company as of December 31, 20XX, and the related statement of revenue and expenses—income tax basis for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis for accounting and for designing, implementing, and maintaining

internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provides a reasonable basis for our report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting, as described in note X.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

*Accountant's review report disclosing a departure from accounting principles generally accepted in the United States of America*

### **Independent Accountant's Review Report**

*[Appropriate Salutation]*

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) review, with the exception of the matter(s) described in the following paragraph(s), I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

As disclosed in note X to the financial statements, accounting principles generally accepted in the United States of America require that inventory cost consist of material, labor, and overhead. Management has informed (me) us that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from accounting principles generally

accepted in the United States of America on financial position, results of operations, and cash flows have not been determined.

*or*

As disclosed in note X to the financial statements, the company has adopted [*description of newly adopted method*], whereas it previously used [*description of previous method*]. Although the [*description of newly adopted method*] is in conformity with accounting principles generally accepted in the United States of America, the company does not appear to have reasonable justification for making a change as required by Financial Accounting Standards Board *Accounting Standards Codification 250, Accounting Changes and Error Corrections*.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

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## AR Section 9090

# ***Review of Financial Statements: Accounting and Review Services Interpretations of Section 90***

### **1. Reporting When There Are Significant Departures From the Applicable Financial Reporting Framework**

**.01 Question**—When the financial statements include significant departures from the applicable financial reporting framework, may the accountant modify his or her standard report in accordance with paragraphs .34–.36 of section 90, *Review of Financial Statements*, to include a statement that the financial statements are not in conformity with the applicable financial reporting framework?

**.02 Interpretation**—No. Including such a statement in the accountant's review report would be tantamount to expressing an adverse opinion on the financial statements as a whole. Such an opinion can be expressed only in the context of an audit engagement. Furthermore, such a statement in a review report would confuse users because it would contradict the results of engagement as required by paragraph .28(f) of section 90.

**.03** However, paragraph .33 of section 90 states that an accountant may emphasize, in any report on financial statements, a matter disclosed in the financial statements. The accountant may wish, therefore, to emphasize the limitations of the financial statements in a separate paragraph of his or her review report, depending on his or her assessment of the possible dollar magnitude of the effects of the departures, the significance of the affected items to the entity, the pervasiveness and overall impact of the misstatements, and whether disclosure has been made of the effects of the departures. Such separate paragraph, which would follow the other modifications of his or her report (see illustrations in Review Exhibit D, "Illustrative Review Reports"), might read as follows (the illustration assumes that the accountant is reporting on financial statements in which there are significant departures from accounting principles generally accepted in the United States of America):

Because the significance and pervasiveness of the matters previously discussed makes it difficult to assess their impact on the financial statements as a whole, users of these financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in conformity with accounting principles generally accepted in the United States of America.

**.04** Inclusion of such a separate paragraph in the accountant's review report is not a substitute for disclosure of the specific departures or the effects of such departures when they have been determined by management or are known as a result of the accountant's procedures.

[Issue Date: August 1981; Revised: November 2002; Revised: May 2004; Revised: July 2005; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 7 to section 100).]

## 2. Reporting on Tax Returns

**.05 Question**—May an accountant comply with a request from a nonissuer to issue a review report on financial information contained in a tax return, as in Form 1040, *U.S. Individual Income Tax Return*, or Form 1120, *U.S. Corporation Income Tax Return*, or in an information return, as in Form 990, *Return of Organization Exempt from Income Tax*; Form 1065, *U.S. Partnership Return of Income*; or Form 5500, *Return of Employee Benefit Plan*?

**.06 Interpretation**—Yes. Although paragraph .01 of section 90 states that the section establishes standards and provides guidance on reviews of financial statements and financial information contained in a tax return is not included in the definition of financial statements, an accountant may decide to accept an engagement to issue a review report on such a return. In that case, the performance and reporting requirements of section 90 would apply.

[Issue Date: November 1982; Revised: February 2008;  
Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 10 to section 100).]

## 3. Additional Procedures Performed in a Review Engagement

**.07 Question**—If an accountant performs procedures customarily performed in an audit but not in a review, is the accountant required to change the engagement to an audit?

**.08 Interpretation**—No. Paragraph .07 of section 90 states that review evidence obtained through the performance of analytical procedures and inquiry will ordinarily provide the accountant with a reasonable basis for obtaining limited assurance. However, paragraph .07 further states that the accountant should perform additional procedures if the accountant determines such procedures to be necessary to obtain limited assurance that the financial statements are not materially misstated.

**.09** The wording of confirmation requests or other communications related to additional procedures performed in the course of a review engagement should not use phrases such as "as part of an *audit* of the financial statements" (emphasis supplied).

[Issue Date: March 1983; Revised: October 2000; Revised: November 2002;  
Revised: May 2004; Revised: December 2010 to conform to SSARS No. 19  
(formerly Interpretation No. 13 to section 100).]

## 4. Submitting Draft Financial Statements

**.10 Question**—Accountants frequently submit draft financial statements (a) because information needed to complete a review of the financial statements will not be available until a later date or (b) to provide the client with the opportunity to read and analyze the financial statements prior to their final issuance. Is it permissible for the accountant to submit draft financial statements to management without intending to comply with the reporting provisions of section 90?

**.11 Interpretation**—No. An accountant is precluded from submitting draft financial statements unless he or she intends to submit those financial statements in final form accompanied by an appropriate review report prescribed by section 90. However, as long as the accountant intends to issue a review report on the financial statements in final form and labels each page of draft financial statements with words such as "Draft," "Preliminary Draft," "Draft—Subject to Changes," or "Working Draft," the accountant is not required to comply with

the reporting provisions of section 90 with respect to those draft financial statements. In the rare circumstance in which the accountant intended to but never submitted final financial statements, the accountant may want to document the reasons why he or she was unable to submit financial statements in final form accompanied by an appropriate review report.

[Issue Date: September 1990; Revised: October 2000; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 17 to section 100).]

## **5. Reporting When Financial Statements Contain a Departure From Promulgated Accounting Principles That Prevents the Financial Statements From Being Misleading**

**.12 Question**—Rule 203, *Accounting Principles* (ET sec. 203 par. .01), of the AICPA Code of Professional Conduct states

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Paragraphs .34–.36 of section 90 do not address the Rule 203 circumstances. When the circumstances contemplated by Rule 203 are present, how should the accountant report on the information described in the rule?

**.13 Interpretation**—When the circumstances contemplated by Rule 203 are present in a review engagement, the accountant's review report should include, in a separate paragraph or paragraphs, the information required by Rule 203. In such a case, the accountant would not modify the standard review report, except for the addition of the separate paragraph(s) that contains the information required by Rule 203, unless there are other reasons to do so that are not associated with the departure from a promulgated principle.

[Issue Date: February 1991; Revised: October 2000; Revised: November 2002; Revised: May 2004; Revised: July 2005; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 19 to section 100).]

## **6. Special-Purpose Financial Statements to Comply With Contractual Agreements or Regulatory Provisions**

**.14 Question**—An accountant may be asked to review special purpose financial statements prepared to comply with a contractual agreement or regulatory provision that specifies a special basis of presentation. In most circumstances, these financial statements are intended solely for the use of the parties to the agreement, regulatory bodies, or other specified parties. How should the accountant modify the standard review report when reporting on these special-purpose financial statements?

**.15 Interpretation**—An accountant who is asked to review special-purpose financial statements prepared to comply with a contractual agreement or a regulatory provision that specifies a special basis of presentation may issue a review report on those financial statements in accordance with section 90 as described in this interpretation. This interpretation describes reporting on

- a. special-purpose financial statements prepared in compliance with a contractual agreement or regulatory provision that does not constitute a complete presentation of the entity's assets, liabilities, revenues, and expenses, but is otherwise prepared in conformity with generally accepted accounting principles (GAAP) or an other comprehensive basis of accounting (OCBOA), or
- b. a special-purpose financial presentation (may be a complete set of financial statements or a single financial statement) prepared on a basis of accounting prescribed in an agreement that does not result in a presentation in conformity with GAAP or an OCBOA.

***Financial Statements Prepared on a Basis of Accounting Prescribed in a Contractual Agreement or Regulatory Provision That Results in an Incomplete Presentation but One That Is Otherwise in Conformity With GAAP or an OCBOA***

**.16** An entity may engage an accountant to review a special-purpose financial statement prepared in compliance with a contractual agreement or regulatory provision that does not constitute a complete presentation of the entity's assets, liabilities, revenues, or expenses, but is otherwise prepared in conformity with GAAP or an OCBOA. For example, a governmental agency may require a statement of gross income and certain expenses of an entity's real estate operation in which income and expenses are measured in conformity with accounting principles generally accepted in the United States of America, but expenses are defined to exclude certain items such as interest, depreciation, and income taxes. Such a statement may also present the excess of gross income over defined expenses. Also, a buy-sell agreement may specify a statement of gross assets and liabilities of the entity measured in conformity with GAAP, but limited to the assets to be sold and liabilities to be transferred pursuant to the agreement.

**.17** The accountant's report on reviewed special-purpose financial statements prepared in accordance with a basis of accounting prescribed in a contractual agreement or regulatory provision but that is otherwise prepared in conformity with GAAP or an OCBOA should be modified to include a separate paragraph with the following information:

- An explanation of what the financial statement is intended to present and a reference to the note to the special-purpose financial statement that describes the basis of presentation.
- If the basis of presentation is in conformity with GAAP or an OCBOA, a statement that the presentation is not intended to be a complete presentation of the entity's assets, liabilities, revenues, and expenses.
- A separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity, the parties to the contract or agreement, the regulatory agency with which the report is being filed, or those with whom the entity is negotiating directly, and is not intended to be and should not be used by anyone other than these specified parties.

**.18** The following is an illustrative example of a review report on special purpose financial statements:

I (we) have reviewed the accompanying statement of gross income and direct operating expenses of XYZ Company for the year ended December 31, 20X1. A review includes primarily applying analytical procedures to management (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the statement of gross income and direct operating expenses as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the statement of gross income and direct operating expenses in accordance with the regulatory provision described in Note A and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the statement of gross income and direct operating expenses.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the statement of gross income and direct operating expenses. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

The accompanying statement was prepared for the purpose of presenting gross income and direct operating expenses of XYZ Company pursuant to the regulatory provision described in Note A, and is not intended to be a complete presentation of XYZ Company's income and expenses.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying statement of gross income and direct operating expenses in order for it to be in conformity with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of [*the specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

***Financial Statements Prepared on a Basis of Accounting Prescribed in an Agreement That Results in a Presentation That Is Not in Conformity With GAAP or an OCBOA***

**.19** An entity may engage an accountant to review a special-purpose financial statement prepared in conformity with a basis of accounting that departs from GAAP or an OCBOA. A loan agreement, for example, may require the borrower to prepare consolidated financial statements in which assets, such as inventory, are presented on a basis that is not in conformity with GAAP or an OCBOA. Also, an acquisition agreement may require the financial statements of the entity being acquired (or a segment of it) to be prepared in conformity with GAAP except for certain assets, such as receivables, inventories, and properties for which a valuation basis is specified in the agreement.

**.20** Financial statements prepared under a basis of accounting as discussed in the preceding are not considered to be prepared in conformity with an OCBOA because the criteria used to prepare such financial statements do not meet the requirement of "having substantial support," even though the criteria are definite.

**.21** The accountant's report on reviewed special-purpose financial statements prepared on a basis of accounting prescribed in an agreement that results in a presentation that is not in conformity with GAAP or an OCBOA should be modified to include a separate paragraph with the following information:

- An explanation of what the presentation is intended to present and a reference to the note to the special-purpose financial statements that describes the basis of presentation.
- A statement that the financial statement is not intended to be a presentation in conformity with GAAP or an OCBOA.
- A description and the source of significant interpretations, if any, made by the Company's management relating to the provisions of a relevant agreement.
- A separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity, the parties to the contract or agreement, the regulatory agency with which the report is being filed, or those with whom the entity is negotiating directly, and is not intended to be and should not be used by anyone other than these specified parties. For example, if the financial statements have been prepared for the specified purpose of obtaining bank financing, the report's use should be restricted to the various banks with whom the entity is negotiating the proposed financing.

**.22** The following is an illustrative example of a review report on special-purpose financial statements:

I (we) have reviewed the accompanying special-purpose statement of assets and liabilities of XYZ Company as of December 31, 20X1. A review includes primarily applying analytical procedures to management (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the statement of assets and liabilities as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the statement of assets and liabilities in accordance with Section 4 of a loan agreement between DEF Bank and the Company as discussed in Note A and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the statement of assets and liabilities.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the statement of assets and liabilities. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

The accompanying special-purpose statement of assets and liabilities was prepared for the purpose of complying with Section 4 of a loan agreement between DEF Bank and the Company as discussed in Note A and is not intended to be a presentation in conformity with accounting principles generally accepted in the United States of America.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying special-purpose statement of assets and liabilities in order for it to be in conformity with the basis of accounting described in Note A.

This report is intended solely for the information and use of the [specified parties]

[Issue Date: December 2006; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 28 to section 100).]

## **7. Reporting on an Uncertainty, Including an Uncertainty About an Entity's Ability to Continue as a Going Concern**

**.23 Question**—How should an accountant modify the standard review report when, during the performance of review procedures, evidence or information comes to the accountant's attention that there may be an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being compiled or reviewed?

**.24 Interpretation**—Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. The accountant should follow the guidance in paragraphs .47–.50 of section 90 with respect to his or her consideration of the entity's ability to continue as a going concern during the performance of review procedures.

**.25** If the accountant concludes that management's disclosure of the uncertainty regarding the entity's ability to continue as a going concern is adequate but further decides to include an emphasis-of-matter paragraph with respect to the uncertainty in the accountant's review report, he or she may use the following language:

As discussed in Note X, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

**.26 Question**—If the accountant, while performing a review, becomes aware of a material uncertainty other than a going concern uncertainty (for example, an uncertainty regarding pending or threatened litigation), what should the accountant consider in deciding whether a report modification is necessary?

**.27 Interpretation**—If the accountant determines that the disclosure of the uncertainty is not in accordance with the applicable financial reporting framework, he or she should follow the guidance in paragraphs .34–.36 of section 90.

**.28** If the accountant concludes that management's disclosure of the uncertainty is in accordance with the applicable financial reporting framework but further decides to include an emphasis-of-matter paragraph with respect to the uncertainty in the accountant's review report, he or she may use the following language (the following is assuming that the financial statements were prepared in accordance with accounting principles generally accepted in the United States of America):

As discussed in Note X, the Company is currently named in a legal action. The Company has determined that it is not possible to predict the eventual outcome of the legal action but has determined that the resolution of the action will not result in an adverse judgment that would materially affect the financial statements. Accordingly, the accompanying financial statements do not include any adjustments related to the legal action under FASB ASC 450.

[Issue date: February 2007; Revised: February 2008; Amended: December 2008; Revised: June 2009; Revised: December 2010 to conform to SSARS No. 19 (formerly Interpretation No. 29 to section 100)]

## 8. Reviews of Financial Statements Prepared in Accordance With International Financial Reporting Standards

**.29 Question**—The International Accounting Standards Board (IASB) has been designated by the Council of the AICPA as the body to establish international financial reporting standards for both private and public entities pursuant to Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), and Rule 203 of the AICPA Code of Professional Conduct as of May 18, 2008. As a result, how would an accountant apply the reporting guidance in section 90 when engaged to review financial statements presented in accordance with International Financial Reporting Standards (IFRSs) as issued by the IASB?

**.30 Interpretation**—A report illustration of how an accountant would apply the reporting guidance in section 90 when reporting on financial statements presented in accordance with IFRSs is as follows:

### Independent Accountant's Review Report

*[Appropriate Salutation]*

I (We) have reviewed the accompanying statements of financial position of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of comprehensive income, changes in equity, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

**.31 Question**—Unlike accounting principles generally accepted in the United States of America as issued by the Financial Accounting Standards Board (FASB), IFRSs require an entity to disclose comparative information in respect of the previous comparative period for all amounts presented in the current year's financial statements. When the accountant reviews financial statements that omit prior year information, should such omission be disclosed in the accountant's review report as a departure from IFRSs as issued by the IASB in accordance with paragraphs .34–.36 of section 90?

**.32 Interpretation**—Yes. Because IFRSs require an entity to disclose comparative information in respect of the previous comparative period for all amounts presented in the current year's financial statements, the failure to include such information in financial statements would be a departure from



generally accepted accounting principles. An example of a paragraph that may be added to the accountant's review report is as follows:

Comparative information with respect to the year ended December 31, 20XX-1 has not been presented. International Financial Reporting Standards [or *IFRSs for SMEs*] as issued by the International Accounting Standards Board require an entity to disclose comparative information in respect of the previous comparative period for all amounts presented in the current year's financial statements.

[Issue Date: May 2008; Revised: June 2010; Revised: August 2010; Revised: December 2010 (formerly Interpretation No. 30 to section 100).]

## 9. Reviews of Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country

**.33 Question**—An accountant may be engaged to review financial statements that have been prepared in conformity with a financial reporting framework generally accepted in another country (including financial statements prepared in accordance with a jurisdictional variation of IFRSs such that the entity's financial statements do not contain an explicit and unreserved statement of compliance with IFRSs as issued by the IASB). How should an accountant apply the reporting requirements in section 90 when reporting on those financial statements?

**.34 Interpretation**— If the financial statements are intended for use only outside of the United States of America, the accountant may report using the standard form of U.S. review report modified as appropriate to identify the applicable financial reporting framework; or alternatively, the accountant may report using the standard review report form and content of the other country. (See Interpretation No. 10 with respect to Considerations Related to Reviews Performed in Accordance with International Standard on Review Engagements [ISRE] 2400, *Engagements to Review Financial Statements*)\*.

**.35** The standard review report used in another country, even when it appears similar to that used in the United States of America, may convey a different meaning and entail a different responsibility on the part of the accountant due to custom or culture. Issuing a standard review report of another country may require an understanding of local laws. When issuing the accountant's standard review report of another country, the accountant is required to obtain an understanding of applicable legal responsibilities, in addition to the review standards and accounting principles generally accepted in the other country, as indicated in paragraph .13 of section 90. Therefore, depending on the nature and extent of the accountant's knowledge and experience, the accountant may wish to consult with persons having expertise in the reporting practices of the other country and associated legal responsibilities to obtain the understanding needed to issue that country's standard review report.

**.36** If the accountant's report is intended for use in the United States of America, the reporting requirements described in paragraphs .27–.32 of section 90 would apply. Additionally, paragraph .38 of section 90 states that a need for restriction on the use of the report may result from a number of circumstances, including, but not limited to, the purpose of the report and the potential for the report to be misunderstood when taken out of context in which it was intended to be used. Because of the nature of the basis of presentation of the financial

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\* In September 2012, the International Auditing and Assurance Standards Board issued International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. ISRE 2400 (Revised) is effective for reviews of financial statements for periods ending on or after December 31, 2013. [Footnote added, December 2012, to reflect conforming changes necessary due to the issuance of ISRE 2400 (Revised).]

statements, there is a presumption that the report would be misunderstood or taken out of context in which it was intended to be used. In such instances, the accountant may use the following form of report:

Independent Accountant's Review Report

[*Appropriate Salutation*]

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with [*the financial reporting framework generally accepted in another country, including identification of the nationality of the framework*] and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with [*the financial reporting framework generally accepted in another country, including identification of the nationality of the framework*].

This report is intended solely for the information and the use of [*specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

**.37** When the financial statements will be used both outside of the United States of America as well as in the United States of America, nothing precludes the accountant from issuing two reports—a report to be used only outside of the United States of America and another report to be used in the United States of America.

[Issue Date: May 2008; Revised: June 2010; Revised: August 2010; Revised: December 2010 (formerly Interpretation No. 30 to section 100); Revised: December 2012.]

## **10. Considerations Related to Reviews Performed in Accordance with International Standard on Review Engagements 2400, *Engagements to Review Financial Statements*, Issued by the International Auditing and Assurance Standards Board**

**.38** *Question*—May a U.S. accountant perform a review of historical financial statements of a U.S. entity<sup>1</sup> in accordance with ISRE 2400, *Engagements to*

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<sup>1</sup> A U.S. entity is an entity that is either organized or domiciled in the United States of America.

*Review Financial Statements*,\* issued by the International Auditing and Assurance Standards Board? The financial statements may have been prepared in accordance with IFRS or accounting principles generally accepted in the United States of America.

**.39 Interpretation**—An accountant performing a review of historical financial statements of a U.S. entity is required to follow the review standards as promulgated by the AICPA's Accounting and Review Services Committee. However, those standards do not prohibit an accountant from indicating that the review also was conducted in accordance with another set of review standards. In an engagement to review the historical financial statements in accordance with ISRE 2400,\* the accountant may perform the review in accordance with Statements on Standards for Accounting and Review Services (SSARSs) as well as ISRE 2400.\* Such a review report may read as follows:

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants and in accordance with International Standard on Review Engagements (ISRE 2400)\* issued by the International Auditing and Assurance Standards Board. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with or International Financial Reporting Standards as issued by the International Accounting Standards Board.

**.40** If the report is for use only outside of the United States of America, the accountant is still required to apply SSARSs, except for requirements related to report form and content.

[Issue Date: May 2008; Revised: June 2010; Revised: August 2010; Revised: December 2010 (formerly Interpretation No. 30 to section 100); Revised: December 2012.]

## 11. Required Supplementary Information That Accompanies Reviewed Financial Statements

**.41 Question**—Paragraph .60 of section 90 addresses situations when the basic financial statements are accompanied by information presented for supplementary analysis purposes. Certain information presented for supplementary analysis purposes may be required by a body designated by the AICPA

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\* See footnote \* in paragraph .34.

Council to establish GAAP pursuant to Rule 202 and Rule 203<sup>2</sup> (hereinafter referred to as "required supplementary information"). Examples of required supplementary information that may accompany reviewed financial statements include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by FASB *Accounting Standards Codification* 972-235-50-3
- Management's discussion and analysis and budgetary comparison statements as required by Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

Is the accountant required to apply procedures to required supplementary information that accompanies reviewed financial statements?

**.42 Interpretation**—No. SSARs do not require the accountant to apply procedures to any information presented for supplementary analysis purposes, including required supplementary information.

**.43 Question**—Paragraph .60 of section 90 states that when the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should indicate the degree of responsibility, if any, he or she is taking with respect to such information. How may an accountant modify the accountant's review report to refer to the required supplementary information and explain the circumstances regarding its presentation?

**.44 Interpretation**—The accountant may modify the accountant's review report by including a separate paragraph that refers to the required supplementary information and explains the circumstances regarding its presentation. That separate paragraph would be presented after the paragraph that reports the results of the engagement and may read as follows:

### ***The Required Supplementary Information Is Included***

[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that [identify the required supplementary information] on page XX be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by [identify the designated accounting standard setter] who considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context. Such information was not audited, reviewed, or compiled by me (us) and, accordingly, I (we) do not express an opinion or provide any assurance on it.

### ***All Required Supplementary Information Omitted***

Management has omitted [describe the missing required supplementary information] that [identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by [identify the designated accounting standard setter] who considers

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<sup>2</sup> The bodies designated by the AICPA Council to establish professional standards with respect to financial accounting and reporting principles pursuant to these rules are the Financial Accounting Standards Board, the Governmental Accounting Standards Board, the Federal Accounting Standards Advisory Board, and the International Accounting Standards Board.

it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context. The results of our review of the basic financial statements are not affected by this missing information.

***Some Required Supplementary Information Is Omitted and Some Is Presented in Accordance With the Prescribed Guidelines Regarding the Required Supplementary Information***

*[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require that *[identify the included supplementary information]* be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by *[identify designated accounting standard setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Such information was not audited, reviewed, or compiled by me (us) and, accordingly, I (we) do not express an opinion or provide any assurance on it.

Management has omitted *[describe the missing required supplementary information]* that *[identify the applicable financial reporting framework]* require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standard setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. The results of our review of the basic financial statements are not affected by this missing information.

[Issue Date: October 2011.]

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## **AR Section 100**

# ***Compilation and Review of Financial Statements***

Superseded, December 2010, by the issuance of SSARS No. 19.

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## AR Section 110

# ***Compilation of Specified Elements, Accounts, or Items of a Financial Statement***

**Issue date, unless otherwise indicated: July 2005**

**Source: SSARS No. 13; SSARS No. 17**

**.01** Statements on Standards for Accounting and Review Services (SSARSs) provide guidance concerning the standards and procedures applicable when an accountant is engaged to report on compiled financial statements or submits financial statements to his or her client or to third parties. By definition, presentations of specified elements, accounts, or items of a financial statement are not financial statements. This statement expands SSARSs to apply when an accountant is engaged to report or issues a report on one or more compiled specified elements, accounts, or items of a financial statement. If, however, the specified element, account, or item of a financial statement is included as supplementary information, the accountant should refer to paragraph .53 of section 80, *Compilation of Financial Statements*. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.02** A compilation of one or more specified elements, accounts, or items of a financial statement is limited to assisting management (owners) in presenting financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to that information. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.03** Examples of specified elements, accounts, or items of a financial statement that an accountant may compile include schedules of rentals, royalties, profit participation, or provision for income taxes.

## **Conditions for Compiling Specified Elements, Accounts, or Items of a Financial Statement**

**.04** Nothing in this statement is intended to preclude an accountant from assisting management (owners) in presenting one or more specified elements, accounts, or items of a financial statement and submitting such specified elements, accounts, or items of a financial statement to the client or to third parties without the issuance of a compilation report, unless the accountant has been engaged to report on such compiled specified elements, accounts, or items of a financial statement. If an accountant assists management (owners) in presenting a schedule of one or more specified elements, accounts, or items of a financial statement,<sup>[1]</sup> the accountant should consider how such a presentation of specified elements, accounts, or items will be used. The accountant should consider the potential of being associated with the schedule and the likelihood that the user may inappropriately infer, through that association, an unintended level

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<sup>[1]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19.]

of reliance on the information. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer an unintended level of reliance on the information. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.05** An engagement to report on one or more compiled specified elements, accounts, or items of a financial statement may be undertaken as a separate engagement or in conjunction with a compilation, review, or audit of financial statements. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## **Understanding With the Entity**

**.06** When an accountant is engaged to report on one or more compiled specified elements, accounts, or items of a financial statement, the accountant should establish an understanding with management regarding the services to be performed and should document the understanding through a written communication with management. Such an understanding reduces the risks that either the accountant or management may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or perform certain functions that are management's responsibility. The accountant should ensure that the understanding includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. In some cases, the accountant may establish such understanding with those charged with governance. An understanding with management and, if applicable, those charged with governance, regarding a compilation of specified elements, accounts, or items of a financial statement should include the following matters:

- The objective of a compilation of specified elements, accounts, or items of a financial statement is to assist management in presenting such financial information.
- The accountant utilizes information that is the representation of management (owners) without undertaking to obtain any assurance that there are no material modifications that should be made to the specified element, account, or item of a financial statement in order for the specified element, account, or item to be in conformity with the applicable financial reporting framework.
- Management is responsible for the preparation and fair presentation of the specified element, account, or item of a financial statement in accordance with the applicable financial reporting framework.
- Management is responsible for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the specified element, account, or item of a financial statement.
- Management is responsible for the prevention and detection of fraud.
- Management is responsible for identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

- Management is responsible for making all financial records and related information available to the accountant.
- The accountant is responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.
- A compilation differs significantly from a review or an audit of specified elements, accounts, or items of a financial statement. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion or provide any assurance regarding the specified element, account, or item of a financial statement.
- The engagement cannot be relied upon to disclose errors, fraud,<sup>2</sup> or illegal acts.<sup>3</sup>
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation procedures<sup>4</sup> that fraud or an illegal act may have occurred.<sup>5</sup> The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.
- The effect of any independence impairments on the expected form of the accountant's compilation report, if applicable.

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.07** When the accountant is engaged to report on one or more compiled specified elements, accounts, or items of a financial statement and evidence or information comes to his or her attention during the engagement that fraud or an illegal act may have occurred, the accountant should adhere to the communication requirements contained in paragraphs .54–.55 of section 80. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>2</sup> For purposes of this statement, *fraud* is an intentional act that results in a misstatement in compiled specified elements, accounts, or items of a financial statement.

<sup>3</sup> For purposes of this statement, illegal acts are violations of laws or government regulations, excluding fraud.

<sup>4</sup> Performance requirements with respect to an engagement to compile one or more specified elements, accounts, or items of a financial statement are contained in paragraphs .08 and .09.

<sup>5</sup> Whether the act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on one or more specified elements, accounts, or items of a financial statement, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination about whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

## Performance Requirements

**.08** When the accountant is engaged to report on one or more compiled specified elements, accounts, or items of a financial statement, he or she should adhere to the compilation performance requirements contained in paragraphs .06–.13 of section 80. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.09** Before issuance of a compilation report on one or more specified elements, accounts, or items of a financial statement, the accountant should read such compiled specified elements, accounts, or items of a financial statement and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the specified elements, accounts, or items of a financial statement, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Documentation Requirements

**.10** When the accountant is engaged to report on one or more compiled specified elements, accounts, or items of a financial statement, he or she should adhere to the documentation requirements contained in paragraphs .14–.15 of section 80. [Paragraph added, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Reporting Requirements

**.11** The accountant's objective in reporting on one or more compiled specified elements, accounts, or items of a financial statement is to prevent misunderstanding of the degree of responsibility the accountant is assuming when his or her name is associated with the elements, accounts, or items of a financial statement. When the accountant issues a compilation report on one or more specified elements, accounts, or items of a financial statement, the basic elements of the report are as follows:

- a. *Title.* The accountant's compilation report should have a title that clearly indicates that it is the accountant's compilation report. The accountant may indicate that he or she is independent in the title, if applicable. Appropriate titles would be "Accountant's Compilation Report" or "Independent Accountant's Compilation Report."
- b. *Addressee.* The accountant's report should be addressed as appropriate in the circumstances of the engagement.
- c. *Introductory paragraph.* The introductory paragraph in the accountant's report should
  - i. identify the entity whose elements, accounts, or items of a financial statement have been compiled;
  - ii. state that the specified element(s), account(s), or item(s) have been compiled;
  - iii. identify the specified element(s), account(s), or item(s) that have been compiled;
  - iv. specify the date or period covered by the specified element(s), account(s), or items;

- v. include a statement that the accountant has not audited or reviewed the specified element(s), account(s), or item(s) and, accordingly, does not express an opinion or provide any assurance about whether the specified element(s), account(s), or item(s) are in accordance with the applicable financial reporting framework; and
  - vi. if the compilation was performed in conjunction with a compilation of the entity's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the specified element(s), account(s), or item(s).
- d. *Management's responsibility for the specified element(s), account(s), or item(s) and for internal control over financial reporting.* A statement that management (owners) is (are) responsible for the preparation and fair presentation of the specified element(s), account(s), or item(s) in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the specified element(s), account(s), or item(s).
  - e. *Accountant's responsibility.* A statement that the accountant's responsibility is to conduct the compilation in accordance with SSARSs issued by the AICPA.
  - f. A statement that the objective of a compilation is to assist management in presenting financial information in the form of specified element(s), account(s), or item(s) of a financial statement without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the specified element(s), account(s), or item(s) of a financial statement.
  - g. *Signature of the accountant.* The manual or printed signature of the accounting firm or the accountant, as appropriate.
  - h. *Date of the accountant's report.* The date of the compilation report (the date of completion of the compilation should be used as the date of the accountant's report).

Procedures that the accountant might have performed as part of the compilation engagement should not be described in the report.

See exhibit B, "Illustrative Accountant's Compilation Reports on Specified Elements, Accounts, or Items of a Financial Statement," for illustrative compilation reports.

[Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.12** Each page of the specified elements, accounts, or items of a financial statement compiled by the accountant should include a reference, such as "See accountant's compilation report" or "See independent accountant's compilation report." [Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**[.13]** [Paragraph renumbered and deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Reporting When the Accountant Is Not Independent

**.14** When the accountant is issuing a report with respect to a compilation of specified element(s), account(s), or item(s) of a financial statement for an entity, with respect to which the accountant is not independent, the accountant's report should be modified. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct. The accountant should indicate his or her lack of independence in a final paragraph of the accountant's compilation report. An example of such a disclosure would be<sup>[6]</sup>

I am (we are) not independent with respect to XYZ Company.

The accountant is not precluded from disclosing a description about the reason(s) that his or her independence is impaired. The following are examples of descriptions the accountant may use:

- a. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.
- b. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.
- c. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.

[Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.15** This section is effective for engagements entered into after December 15, 2005. Early application is permitted. [Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>[6]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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## Exhibit A

### Illustrative Engagement Letter for a Compilation of Specified Elements, Accounts, or Items of a Financial Statement

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, *[identify specified element, account, or item of the financial statement, schedule of accounts receivable or schedule of depreciation – income tax basis]* of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

The objective of a compilation is to assist you in presenting financial information in the form of *[identify specified element, account, or item of the financial statement]*. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the *[identify specified element, account, or item of the financial statement]* in order for *[identify specified element, account, or item of the financial statement]* to be in conformity with *[the applicable financial accounting framework (for example, accounting principles generally accepted in the United States of America)]*.

You are responsible for

- a. the preparation and fair presentation of *[identify specified element, account, or item of the financial statement]* in accordance with *[the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]*.
- b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of *[identify specified element, account, or item of the financial statement]*.
- c. preventing and detecting fraud.
- d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the

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examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the [*identify specified element, account, or item of the financial statement*] being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report.

If, for any reason, we are unable to complete the compilation of your [*identify specified element, account, or item of the financial statement*], we will not issue a report on such schedule as a result of this engagement.

Our fees for these services . . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.<sup>[\*]</sup>

Sincerely yours,

\_\_\_\_\_  
[*Signature of accountant*]

Acknowledged:  
XYZ Company

\_\_\_\_\_  
President

\_\_\_\_\_  
Date

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17. Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>[\*]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]



.17

## Exhibit B

### Illustrative Compilation Reports on Specified Elements, Accounts, or Items of a Financial Statement

#### Standard Compilation Report on a Schedule of Accounts Receivable Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

##### Accountant's Compilation Report

*[Appropriate Salutation]*

I (we) have compiled the accompanying schedule of accounts receivable of XYZ Company as of December 31, 20XX. I (we) have not audited or reviewed the accompanying schedule of accounts receivable and, accordingly, do not express an opinion or provide any assurance about whether the schedule of accounts receivable is in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the schedule of accounts receivable in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the schedule of accounts receivable.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of a schedule of accounts receivable without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the schedule of accounts receivable.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

#### Standard Compilation Report on a Schedule of Depreciation Prepared in Accordance With the Basis of Accounting the Entity Uses for Federal Income Tax Purposes

##### Accountant's Compilation Report

*[Appropriate Salutation]*

I (we) have compiled the accompanying schedule of depreciation of XYZ Company as of December 31, 20XX. I (we) have not audited or reviewed the accompanying schedule of depreciation and, accordingly, do not express an opinion or provide any assurance about whether the schedule of depreciation is in accordance with the basis of accounting the Company uses for federal income tax purposes.

Management (owners) is (are) responsible for the preparation and fair presentation of the schedule of depreciation in accordance with the basis of accounting the Company uses for federal income tax purposes and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the schedule of depreciation.

**1740**      **Statements on Standards for Accounting and Review Services**

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of a schedule of depreciation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the schedule of depreciation.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

[Paragraph added, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

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## AR Section 120

# Compilation of Pro Forma Financial Information

Issue date, unless otherwise indicated: July 2005

Source: SSARS No. 14; SSARS No. 17

**.01** Statements on Standards for Accounting and Review Services (SSARSS) provide guidance concerning the standards and procedures applicable when an accountant is engaged to report on compiled financial statements or submits financial statements to his or her client or third parties. By definition, presentations of pro forma financial information are not financial statements. This statement expands SSARSS to apply when an accountant is engaged to report or issues a report on compiled pro forma financial information. If, however, the pro forma financial information is included as supplementary information, the accountant should refer to paragraph .53 of section 80, *Compilation of Financial Statements*. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.02** A compilation of pro forma financial information is limited to assisting management (owners) in presenting financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to that information. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.03** The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Pro forma financial information is commonly used to show the effects of transactions such as the following:

- Business combination
- Change in capitalization
- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

**.04** This objective is achieved primarily by applying pro forma adjustments to historical financial information. Pro forma adjustments should be based on management's assumptions and give effect to all significant effects directly attributable to the transaction (or event).

**.05** Pro forma financial information should be labeled as such to distinguish it from historical financial information. This presentation should describe the transaction (or event) that is reflected in the pro forma financial information, the source of the historical financial information on which it is based, the significant assumptions used in developing the pro forma adjustments, and any significant uncertainties about those assumptions. The presentation should

also indicate that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

## **Conditions for Compiling Pro Forma Financial Information**

**.06** Nothing in this statement is intended to preclude an accountant from assisting management (owners) in presenting pro forma financial information and submitting such pro forma financial information to the client or to third parties without the issuance of a compilation report, unless the accountant has been engaged to report on such compiled pro forma financial information. If an accountant assists management (owners) in presenting pro forma financial information,<sup>[1]</sup> the accountant should consider how such a presentation of pro forma financial information will be used. The accountant should consider the potential of being associated with pro forma financial information and the likelihood that the user may inappropriately infer, through that association, an unintended level of reliance on the information. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer an unintended level of reliance on the information. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.07** An engagement to report on compiled pro forma financial information may be undertaken as a separate engagement or in conjunction with a compilation of financial statements. The accountant may agree to compile pro forma financial information only if the document that contains the pro forma financial information includes (or incorporates by reference) the historical financial statements of the entity on which the pro forma financial information is based. Historical interim financial information may be presented in condensed form. In the case of a business combination, the document should include (or incorporate by reference) the appropriate historical financial information for the significant constituent parts of the combined entity. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.08** Additionally, the historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based must have been compiled, reviewed, or audited. The accountant's compilation or review report or the auditor's report on the historical financial statements should be included (or incorporated by reference) in the document containing the pro forma financial information.

## **Understanding With the Entity**

**.09** When an accountant is engaged to report on compiled pro forma financial information, the accountant should establish an understanding with

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<sup>[1]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19.]

management regarding the services to be performed and should document the understanding through a written communication with management. Such an understanding reduces the risks that either the accountant or management may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or perform certain functions that are management's responsibility. The accountant should ensure that the understanding includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. In some cases, the accountant may establish such understanding with those charged with governance. An understanding with management and, if applicable, those charged with governance regarding a compilation of pro forma financial information should include the following matters:

- The objective of a compilation of pro forma information is to assist management in presenting such financial information.
- The accountant utilizes information that is the representation of management (owners) without undertaking to obtain any assurance that there are no material modifications that should be made to the pro forma financial information in order for the pro forma financial information to be in conformity with the applicable financial reporting framework.
- Management is responsible for the preparation and fair presentation of the pro forma financial information in accordance with the applicable financial reporting framework.
- Management is responsible for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.
- Management is responsible for the prevention and detection of fraud.
- Management is responsible for identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- Management is responsible for making all financial records and related information available to the accountant.
- The accountant is responsible for conducting the engagement in accordance with SSARs issued by the AICPA.
- A compilation differs significantly from a review or an audit of pro forma financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion or provide any assurance regarding the pro forma financial information.

- The engagement cannot be relied upon to disclose errors, fraud,<sup>2</sup> or illegal acts.<sup>3</sup>
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation procedures<sup>4</sup> that fraud or an illegal act may have occurred.<sup>5</sup> The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.
- The effect of any independence impairments on the expected form of the accountant's compilation report, if applicable.

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.10** When the accountant is engaged to report on compiled pro forma financial information and evidence or information comes to his or her attention during the engagement that fraud or an illegal act may have occurred, the accountant should adhere to the communication requirements contained in paragraphs .54–.55 of section 80. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Performance Requirements

**.11** When the accountant is engaged to report on compiled pro forma financial information, he or she should adhere to the compilation performance requirements contained in paragraphs .06–.13 of section 80. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.12** Before issuance of a compilation report on pro forma financial information, the accountant should read such compiled pro forma financial information, including the summary of significant assumptions,<sup>6</sup> and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the pro forma financial information, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate

<sup>2</sup> For purposes of this statement, *fraud* is an intentional act that results in a misstatement in compiled pro forma financial information.

<sup>3</sup> For purposes of this statement, *illegal* acts are violations of laws or government regulations, excluding fraud.

<sup>4</sup> Performance requirements with respect to an engagement to compile pro forma financial information are contained in paragraphs .11–.12.

<sup>5</sup> Whether the act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on pro forma financial information, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination about whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

<sup>6</sup> The accountant may not report on compiled pro forma financial information if the summary of significant assumptions is not presented. Nothing in this statement should be interpreted to preclude the accountant from reporting on compiled pro forma financial information when management elects to omit substantially all disclosures. In that situation, the accountant should follow the guidance in paragraph .20 of section 80, *Compilation of Financial Statements*. [Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

disclosures. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Documentation Requirements

**.13** When the accountant is engaged to report on compiled pro forma financial information, he or she should adhere to the documentation requirements contained in paragraphs .14–.15 of section 80. [Paragraph added, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Reporting Requirements

**.14** The accountant's objective in reporting on compiled pro forma financial information is to prevent misunderstanding of the degree of responsibility the accountant is assuming when his or her name is associated with the pro forma financial information. When the accountant issues a compilation report on pro forma financial information, the basic elements of the report are as follows:

- a. *Title.* The accountant's compilation report should have a title that clearly indicates that it is the accountant's compilation report. The accountant may indicate that he or she is independent in the title, if applicable. Appropriate titles would be "Accountant's Compilation Report" or "Independent Accountant's Compilation Report."
- b. *Addressee.* The accountant's report should be addressed as appropriate in the circumstances of the engagement.
- c. *Introductory paragraph.* The introductory paragraph in the accountant's report should
  - i. identify the entity whose pro forma financial information has been compiled.
  - ii. state that the pro forma financial information has been compiled.
  - iii. identify the pro forma financial information that has been compiled.
  - iv. specify the date or period covered by the pro forma financial information.
  - v. reference the financial statements from which the historical financial information is derived and include a statement on whether such financial statements were compiled, reviewed, or audited. (The report on pro forma financial information should refer to any modifications in the accountant's or auditor's report on historical financial statements.)
  - vi. include a statement that the accountant has not audited or reviewed the pro forma financial information and, accordingly, does not express an opinion or provide any assurance about whether pro forma financial information is in accordance with the applicable financial reporting framework.
  - vii. if the compilation was performed in conjunction with a compilation of the entity's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on

those statements should also be disclosed if considered relevant to the presentation of the pro forma financial information.

- d. *Management's responsibility for the pro forma financial information and for internal control over financial reporting.* A statement that management (owners) is (are) responsible for the preparation and fair presentation of the pro forma financial information in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.
- e. *Accountant's responsibility.* A statement that the accountant's responsibility is to conduct the compilation in accordance with SSARSs issued by the AICPA.
- f. A statement that the objective of a compilation is to assist management in presenting financial information in the form of pro forma financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information.
- g. A separate paragraph explaining the objective of pro forma financial information and its limitations.
- h. *Signature of the accountant.* The manual or printed signature of the accounting firm or the accountant, as appropriate.
- i. *Date of the accountant's report.* The date of the compilation report (the date of completion of the compilation should be used as the date of the accountant's report).

Procedures that the accountant might have performed as part of the compilation engagement should not be described in the report.

See exhibit B, "Illustrative Accountant's Compilation Report on Pro Forma Financial Information," for an illustrative compilation report.

[Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.15** Each page of the pro forma financial information compiled by the accountant should include a reference, such as "See accountant's compilation report" or "See independent accountant's compilation report." [Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

[.16] [Paragraph renumbered and deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]<sup>[7-8]</sup>

## Reporting When the Accountant Is Not Independent

**.17** When the accountant is issuing a report with respect to a compilation of pro forma financial information for an entity, with respect to which the accountant is not independent, the accountant's report should be modified. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct. The accountant

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<sup>[7-8]</sup> [Footnotes deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]



should indicate his or her lack of independence in a final paragraph of the accountant's compilation report. An example of such a disclosure would be<sup>[9]</sup> If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

The accountant is not precluded from disclosing a description about the reason(s) that his or her independence is impaired. The following are examples of descriptions the accountant may use:

- a. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.
- b. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.
- c. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.

[Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.18** This section is effective for engagements entered into after December 15, 2005. Early application is permitted. [Paragraph renumbered, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>[9]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Exhibit A

### Illustrative Engagement Letter for a Compilation of Pro Forma Financial Information

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the pro forma financial information of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

The objective of a compilation is to assist you in presenting financial information in the form of pro forma financial information. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information in order for the pro forma financial information to be in conformity with *[the applicable financial accounting framework (for example, accounting principles generally accepted in the United States of America)]*.

You are responsible for

- a. the preparation and fair presentation of the pro forma financial information in accordance with *[the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]*.
- b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.
- c. preventing and detecting fraud.
- d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the pro forma financial information being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material

errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report.

If, for any reason, we are unable to complete the compilation of your pro forma financial information, we will not issue a report on such schedule as a result of this engagement.

Our fees for these services . . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.<sup>[\*]</sup>

Sincerely yours,

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[*Signature of accountant*]

Acknowledged:

XYZ Company

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President

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Date

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17. Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>[\*]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Exhibit B

### Illustrative Compilation Report on Pro Forma Financial Information

Compilation report on pro forma financial information reflecting a business combination prepared in accordance with accounting principles generally accepted in the United States of America

#### Accountant's Compilation Report

*[Appropriate Salutation]*

I (we) have compiled the accompanying pro forma financial information of XYZ Company as of December 31, 20XX, reflecting the business combination of the Company and ABC Company. The historical condensed financial statements are derived from the historical unaudited financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were compiled by another (other) accountant(s).<sup>1</sup> I (we) have not audited or reviewed the accompanying pro forma financial information and, accordingly, do not express an opinion or provide any assurance about whether the pro forma financial information is in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the pro forma financial information in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of pro forma financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction (or event) occurred at an earlier date. However, the pro forma financial information is not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the transaction (or event) actually occurred earlier.

*Paragraph the accountant may add after the previous paragraph when management has elected to omit substantially all disclosures, but the pro forma financial*

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<sup>1</sup> When one set of historical financial statements is audited or reviewed and the other is audited, reviewed, or compiled, wording similar to the following would be appropriate:

The historical condensed financial statements are derived from the historical financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were reviewed by another (other) accountant(s), appearing elsewhere herein (or incorporated by reference).

If either accountant's review report or auditor's report includes an explanatory paragraph or is modified, that fact should be referred to within the report.

*information is otherwise in conformity with accounting principles generally accepted in the United States of America.*

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

[Paragraph added, December 2010, to reflect the presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

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**AR Section 200****Reporting on Comparative Financial Statements**

Issue date, unless  
otherwise indicated:  
October 1979

Source: SSARS No. 2;  
SSARS No. 3; SSARS No. 4;  
SSARS No. 5; SSARS No. 7;  
SSARS No. 11; SSARS No. 12;  
SSARS No. 15; SSARS No. 17

**.01** This section establishes standards for reporting on comparative financial statements<sup>[1]</sup> of a nonissuer when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with section 80, *Compilation of Financial Statements*, or section 90, *Review of Financial Statements*, respectively.<sup>2</sup> [Revised, October 2000, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 8. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.02** When comparative financial statements are presented, the accountant should issue an appropriate report(s) covering each period presented in accordance with the provisions of this section. Exhibit A, "Illustrative Compilation Reports on Comparative Financial Statements," and exhibit B, "Illustrative Review Reports on Comparative Financial Statements," provide illustrative reports on comparative financial statements, including how the title of the report may be modified when the level of service between the years is different.<sup>[3]</sup>

**.03** Client-prepared financial statements of some periods that have not been audited, reviewed, or compiled may be presented on separate pages of a document that also contains financial statements of other periods on which the accountant has reported if they are accompanied by an indication by the client that the accountant has not audited, reviewed, or compiled those financial statements and that the accountant assumes no responsibility for them. Whenever the accountant becomes aware that financial statements of other periods that have not been audited, reviewed, or compiled have been presented in columnar form in a document with financial statements on which he or she has

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<sup>[1]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19.]

<sup>2</sup> The terms *nonissuer* and *financial statements* are defined in paragraph .04 of section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17. Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

<sup>[3]</sup> [Footnote deleted to reflect the conforming changes necessary due to the issuance of SSARS No. 8.]

compiled or reviewed and that his or her name has been used or his or her report included in the document, he or she should advise his or her client that the use of his or her name or report is inappropriate and should consider what other actions might be appropriate, including consultation with his or her attorney.

**.04** An accountant may modify his or her report with respect to one or more financial statements for one or more periods while issuing an unmodified report on the other financial statements presented.

**.05** Compiled financial statements that omit substantially all of the disclosures required by an applicable financial reporting framework<sup>[4]</sup> are not comparable to financial statements that include such disclosures. Accordingly, the accountant should not issue a report on comparative financial statements when statements for one or more, but not all, of the periods presented omit substantially all of the disclosures required by an applicable financial reporting framework. (See paragraphs .30–.31 for guidance on reporting on financial statements that previously did not omit substantially all of the disclosures required by an applicable financial reporting framework.) [As amended by the issuance of SSARS No. 15, July 2007. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.06** Each page of the comparative financial statements compiled or reviewed by the accountant should include a reference such as "See Accountant's Compilation Report" or "See Independent Accountant's Review Report." [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Definitions

**.07** The following definitions apply for purposes of this section:

**Comparative financial statements.** Financial statements of two or more periods presented in columnar form.

**Continuing accountant.** An accountant who has been engaged to audit, review, or compile and report on the financial statements of the current period and one or more consecutive periods immediately prior to the current period.

**Updated report.** A report issued by a continuing accountant that takes into consideration information that he or she becomes aware of during his or her current engagement and that re-expresses his or her previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period as of the date of his or her current report.<sup>5</sup>

**Reissued report.** A report issued subsequent to the date of the original report that bears the same date as the original report. A reissued report may need to be revised for the effects of specific events; in these circumstances, the report should be dual-dated with the original date and a separate date that applies to the effects of such events.

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<sup>[4]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19]

<sup>5</sup> See paragraph .17 of section 80, *Compilation of Financial Statements*, and paragraph .28 of section 90, *Review of Financial Statements*. [Footnote revised, November 2002, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 9. Footnote revised, May 2004, to reflect the conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 10. Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]



## Continuing Accountant's Standard Report

**.08** A continuing accountant who performs the same or a higher level of service with respect to the financial statements of the current period should update his or her report on the financial statements of a prior period presented with those of the current period.<sup>6</sup> A continuing accountant who performs a lower level of service with respect to the financial statements of the current period should either (a) include as a separate paragraph of his or her report a description of the responsibility assumed for the financial statements of the prior period (see paragraphs .11–.12) or (b) reissue his or her report on the financial statements of the prior period.

**.09** [Paragraph deleted, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

**.10** [Paragraph deleted, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

**.11** A continuing accountant who performs a compilation of the current-period financial statements and has previously reviewed one or more prior-period financial statements should report as indicated in either (a) or (b) that follow:

- a. Issue a compilation report on the current-period financial statements that includes a description of the responsibility assumed for the financial statements of the prior period. The description should include the original date of the accountant's report and should also state that he or she has not performed any procedures in connection with that review engagement after that date.
- b. Combine his or her compilation report on the financial statements of the current period with his or her reissued review report on the financial statements of the prior period or present them separately. The combined report should state that the accountant has not performed any procedures in connection with that review engagement after the date of his or her review report.

**.12** See exhibit A and exhibit B for examples of a continuing accountant's standard report on comparative financial statements when

- the same level of service has been performed for both periods.
- the financial statements of the current period have been reviewed and those of the prior period have been compiled.
- the financial statements of the current period have been compiled and those of the prior period have been reviewed.

[Revised, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

## Continuing Accountant's Changed Reference to a Departure From the Applicable Financial Reporting Framework

**.13** During his or her current engagement, the accountant should be aware that circumstances or events may affect the prior-period financial statements

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<sup>6</sup> For purposes of this section, a *review* is a higher level of service and a *compilation* is a lower level of service. When one of the periods is audited, see paragraphs .28–.29.

presented, including the adequacy of informative disclosures. The accountant should consider the effects on his or her report on the prior-period financial statements of circumstances or events coming to his or her attention.

**.14** When the accountant's report on the financial statements of the prior period contains a changed reference to a departure from the applicable financial reporting framework,<sup>7</sup> his or her report should include a separate explanatory paragraph indicating

- a. the date of the accountant's previous report.
- b. the circumstances or events that caused the reference to be changed.
- c. when applicable, that the financial statements of the prior period have been changed.

[Revised, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

**.15** See exhibit A and exhibit B for examples of reports which include an explanatory paragraph when an accountant's report contains a changed reference to a departure from accounting principles generally accepted in the United States of America. [Revised, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

## **Predecessor's Compilation or Review Report**

**.16** A predecessor may reissue his or her report at the client's request if he or she is able to make satisfactory arrangements with his or her former client and if he or she complies with the provisions of paragraphs .20–.24. However, a predecessor is not required to reissue his or her compilation or review report on the financial statements of a prior period. If he or she does not reissue his or her compilation or review report on the financial statements of a prior period, a successor should either (a) make reference to the report of the predecessor in accordance with the provisions of paragraphs .17–.19 or (b) perform a compilation or review of the financial statements of the prior period and report on them accordingly.<sup>[8]</sup>

## **Predecessor's Compilation or Review Report Not Presented**

**.17** When the financial statements of a prior period have been compiled or reviewed by a predecessor whose report is not presented and the successor has not compiled or reviewed those financial statements, the successor should make reference in an additional paragraph(s) of his or her report on the current-period financial statements to the predecessor's report on the prior-period financial statements. This reference should include the following matters:

- a. A statement that the financial statements of the prior period were compiled or reviewed by another accountant (other accountants).<sup>9</sup>
- b. The date of his or her (their) report.

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<sup>7</sup> A changed reference includes the removal of a prior reference or the inclusion of a new reference.

<sup>[8]</sup> [Footnote deleted by the issuance of SSARS No. 4, December 1981.]

<sup>9</sup> The successor accountant should not name the predecessor accountant in his or her report unless the predecessor accountant if the predecessor accountant's practice was acquired by, or merged with, that of the successor accountant. [Footnote amended, effective May 2004, by SSARS No. 11. Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

- c. If the financial statements of the prior period were compiled, a statement that the other accountant(s) did not audit or review the financial statements and, accordingly, did not express an opinion or provide any assurance about whether the financial statements are in accordance with the applicable financial reporting framework.
- d. If the financial statements of the prior period were reviewed, a statement that, based on his or her review, the other accountant(s) are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the applicable financial reporting framework, other than those modifications, if any, indicated in the report.
- e. A description or a quotation of any modifications of the standard report and of any paragraphs emphasizing a matter regarding the financial statements.

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.18** See exhibit A and exhibit B for examples of reports when the predecessor compiled or reviewed the financial statements of the prior period, respectively. [Revised, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

**[.19]** [Paragraph deleted, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

## Predecessor's Compilation or Review Report Reissued

**.20** Before reissuing a compilation or review report on the financial statements of a prior period, a predecessor should consider whether his or her report is still appropriate. In making this determination, the predecessor should consider (a) the current form and manner of presentation of the prior-period financial statements, (b) subsequent events not previously known, and (c) changes in the financial statements that require the addition or deletion of modifications to the standard report.

**.21** A predecessor should perform the following procedures before reissuing his or her compilation or review report on the financial statements of a prior period:

- a. Read the financial statements of the current period and the successor's report.
- b. Compare the prior-period financial statements with those previously issued and with those of the current period.
- c. Obtain a letter from the successor that indicates whether he or she is aware of any matter that, in his or her opinion, might have a material effect on the financial statements, including disclosures, reported on by the predecessor. The predecessor should not refer in his or her reissued report to this letter or to the report of the successor.

**.22** If a predecessor becomes aware of information, including information about events or transactions occurring subsequent to the date of his or her previous report, that he or she believes may affect the prior-period financial statements or his or her report on them, he or she should (a) make inquiries or perform analytical procedures similar to those he or she would have performed if he or she had been aware of such information at the date of his or her report on the prior-period financial statements and (b) perform any other procedures he or

she considers necessary in the circumstances. For example, the predecessor may wish to discuss this information with the successor or to review the engagement documentation of the successor as it relates to the matters affecting the prior-period financial statements. If the predecessor decides, based on the information obtained, that his or her report on the prior-period financial statements should be revised, he or she should follow the guidance in paragraphs .14-.15 and .23-.24. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.23** A predecessor's knowledge of the current affairs of his or her former client is obviously limited in the absence of a continuing relationship. Consequently, when reissuing his or her report on the prior-period financial statements, a predecessor should use the date of his or her previous report to avoid any implication that he or she has performed procedures after that date other than those described in paragraphs .20-.22. If the predecessor revises his or her report or if the financial statements are restated, he or she should dual-date his or her report (for example, "March 1, 20X1, except for note X, as to which the date is March 15, 20X2"). The predecessor's responsibility for events occurring subsequent to the completion of his or her engagement is limited to the specific event referred to in the note or otherwise disclosed. He or she should also obtain a written statement from the former client setting forth the information currently acquired and its effect on the prior-period financial statements and, if applicable, expressing an understanding of its effect on the predecessor's reissued report.

**.24** If a predecessor is unable to complete the procedures described in paragraphs .20-.23, he or she should not reissue his or her report and may wish to consult with his or her attorney regarding the appropriate course of action.

## **Restated Prior-Period Financial Statements**

**.25** When prior-period financial statements have been restated,<sup>10</sup> the predecessor accountant would normally reissue his or her report following the guidance in paragraph .22. If the predecessor decides not to reissue his or her report, the successor accountant may be engaged to report on the financial statements for the prior year. If the predecessor accountant does not reissue his or her report and the successor accountant is not engaged to report on the prior year financial statements, the successor accountant should indicate in the introductory paragraph of his or her compilation or review report that a predecessor accountant reported on the financial statements of the prior period before restatement. In addition, if the successor accountant is engaged to compile or review the restatement adjustment(s), he or she may also indicate in the accountant's report that he or she compiled or reviewed the adjustment(s) that was (were) applied to restate prior-year financial statements. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

**.26** See exhibit A and exhibit B for examples of reports when the predecessor accountant's report is not presented and the successor accountant is

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<sup>10</sup> See paragraphs .10-.11 of section 400, *Communications Between Predecessor and Successor Accountants*, for guidance regarding communication to the predecessor accountant with respect to information that leads the successor accountant to believe that the financial statements reported on by the predecessor accountant may require revision. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

engaged to compile or review the restatement adjustment(s), respectively.<sup>[11]</sup> [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Revised, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

[.27] [Paragraph deleted, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]<sup>[12]</sup>

## Reporting When One Period Is Audited

[.28] [Paragraph deleted, December 2010, to remove reference to auditing literature.]

**.29** When the current-period financial statements of a nonissuer have been compiled or reviewed and those of the prior period have been audited, the accountant should issue an appropriate compilation or review report on the current-period financial statements and, if the auditor's report on the prior period financial statements is not reissued, the report on the current period should include as a separate paragraph an appropriate description of the responsibility assumed for the financial statements of the prior period. The separate paragraph should indicate (a) that the financial statements of the prior period were audited previously, (b) the date of the previous report, (c) the type of opinion expressed previously, (d) if the opinion was other than unmodified, the substantive reasons therefor, and (e) that no auditing procedures were performed after the date of the previous report. See exhibit A and exhibit B for examples of compilation and review reports, respectively, when the prior year financial statements were audited. [Paragraph renumbered by the issuance of SSARS No. 12, July 2005. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17. Revised, December 2010, to reflect the presentation style and conforming changes necessary due to the issuance of SSARS No. 19. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

## Reporting on Financial Statements That Previously Did Not Omit Substantially All Disclosures

**.30** An accountant who has compiled, reviewed, or audited financial statements that did not omit substantially all of the disclosures required by an applicable financial reporting framework may subsequently be requested to compile statements for the same period that do omit substantially all of those disclosures when they are to be presented in comparative financial statements. In these circumstances the accountant may report on comparative compiled financial statements that omit such disclosures if he or she includes in his or her report an additional paragraph indicating the nature of the previous service rendered with respect to those financial statements and the date of his or her previous report. [Paragraph renumbered by the issuance of SSARS No. 12, July 2005. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>[11]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

<sup>[12]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.31** See exhibit A for an example of a report appropriate when prior-period financial statements that omit substantially all disclosures have been compiled from previously reviewed financial statements for the same period. [As amended, effective for periods ending after December 15, 1993, by SSARS No. 7. Paragraph renumbered by the issuance of SSARS No. 12, July 2005. Revised, December 2010, to reflect the presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

**[.32–.33]** [Paragraphs deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]<sup>[13–14]</sup>

## **Transition**

**[.34–.36]** [Paragraphs deleted to reflect conforming changes necessary due to the issuance of SSARS No. 8. Paragraphs renumbered by the issuance of SSARS No. 12, July 2005.]

## **Effective Date**

**.37** This section will be effective for reports on comparative financial statements for periods ending on or after November 30, 1979. However, earlier application is encouraged for periods ending on or after July 1, 1979. [Paragraph renumbered by the issuance of SSARS No. 12, July 2005.]

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<sup>[13–14]</sup> [Footnotes deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Exhibit A

### Illustrative Compilation Reports on Comparative Financial Statements

#### Compilation Report on Comparative Financial Statements When a Compilation Has Been Performed for Both Periods

##### Accountant's Compilation Report

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

#### Compilation Report When the Financial Statements of the Current Year Have Been Compiled and Those of The Prior Year Have Been Reviewed

##### Accountant's Compilation Report<sup>1</sup>

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the 20X2 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles

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<sup>1</sup> Alternatively, an accountant may use a title that does not describe the level of service such as "Accountant's Report" or "Report of Certified Public Accountants" because the report refers to different levels of service.

generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The accompanying 20X1 financial statements were previously reviewed by me (us) and I (we) stated that I was (we were) not aware of any material modifications that should be made to those financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America in my (our) report dated March 31, 20X2, but I (we) have not performed any procedures in connection with that review engagement since that date.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

**Compilation Report on Comparative Financial Statements When the Accountant's Report Includes a Changed Reference to a Departure From Accounting Principles Generally Accepted in the United States of America**

**Accountant's Compilation Report**

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

In my (our) report dated March 1, 20X2 with respect to the 20X1 financial statements, we referred to a departure from accounting principles generally accepted in the United States of America because the company carried its land at appraised values. As described in Note X, the Company has changed its method of accounting for land and restated its 20X1 financial statements to conform with accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*



**Compilation Report on Comparative Financial Statements When the Prior Period Financial Statements Were Compiled By a Predecessor Accountant and the Predecessor's Report Is Not Presented****Accountant's Compilation Report**

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America. The financial statements of XYZ Company as of December 31, 20X1, were compiled by other accountants whose report dated February 1, 20X2 stated that they have not audited or reviewed the 20X1 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the 20X2 compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

**Compilation Report on Comparative Financial Statements When the Predecessor Accountant's Report Is Not Presented, and the Successor Accountant Is Engaged to Compile the Restatement Adjustment(s)****Accountant's Compilation Report**

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America. The financial statements prior to adjustment of XYZ Company as of and for the year ended December 31, 20X1, were compiled by other accountants whose report dated February 1, 20X2, stated that they have not audited or reviewed the 20X1 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles

generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

I (We) also compiled the adjustments described in Note X that were applied to restate the 20X1 financial statements. I (we) have not audited or reviewed the adjustments described in Note X that were applied to restate the 20X1 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the adjustments described in Note X that were applied to restate the 20X1 financial statements are in accordance with accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

### **Compilation Report on Comparative Financial Statements When the Prior Period Financial Statements Were Audited**

#### **Accountant's Compilation Report<sup>2</sup>**

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The 20X1 financial statements were audited by me (us) (other accountants) and I (we) (they) expressed an unmodified opinion on them in my (our) (their) report dated March 1, 20X2, but I (we) (they) have not performed any auditing procedures since that date.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

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<sup>2</sup> Alternatively, an accountant may use a title that does not describe the level of service such as "Accountant's Report" or "Report of Certified Public Accountants" because the report refers to different levels of service.

**Compilation Report on Comparative Financial Statements When Prior Period Financial Statements That Omit Substantially All Disclosures Have Been Compiled From Previously Reviewed Financial Statements of the Same Period**

**Accountant's Compilation Report**

*[Appropriate Salutation]*

I (we) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

Management has elected to omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, the financial statements are not designed for those who are not informed about such matters.

The 20X1 financial statements were compiled by me (us) from financial statements that did not omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America and that I (we) previously reviewed as indicated in my (our) report dated March 1, 20X2.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

[Paragraph added, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

## Exhibit B

### Illustrative Review Reports on Comparative Financial Statements

#### Review Report on Comparative Financial Statements When a Review Has Been Performed for Both Periods

##### Independent Accountant's Review Report

*[Appropriate Salutation]*

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

#### Review Report on Comparative Financial Statements When the Financial Statements of the Current Period Have Been Reviewed and Those of The Prior Period Have Been Compiled

##### Independent Accountant's Review Report<sup>1</sup>

*[Appropriate Salutation]*

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making

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<sup>1</sup> Alternatively, an accountant may use a title that does not describe the level of service such as "Accountant's Report" or "Report of Certified Public Accountants" because the report refers to different levels of service.

inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

The accompanying 20X1 financial statements of XYZ Company were compiled by me (us). The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. Accordingly, I (we) do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

### **Review Report on Comparative Financial Statements When the Accountant's Report Includes a Changed Reference to a Departure From Accounting Principles Generally Accepted in the United States Of America**

#### **Independent Accountant's Review Report**

*[Appropriate Salutation]*

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform

procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

In my (our) report dated March 1, 20X2, with respect to the 20X1 financial statements, we referred to a departure from accounting principles generally accepted in the United States of America because the company carried its land at appraised values. As described in Note X, the Company has changed its method of accounting for land and restated its 20X1 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, my (our) present statement on the 20X1 financial statements, as presented herein, that I am (we are) not aware of any material modifications that should be made to the accompanying financial statements is different from that expressed in our previous report.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

**Review Report on Comparative Financial Statements When the Prior Period Financial Statements Were Reviewed by a Predecessor Accountant, and the Predecessor's Report Is Not Presented**

**Independent Accountant's Review Report**

*[Appropriate Salutation]*

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion. The financial statements of XYZ Company as of December 31, 20X1, were reviewed by other accountants whose report dated February 1, 20X2, stated that based on their procedures, they are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in

conformity with accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

**Review Report on Comparative Financial Statements When the Predecessor Accountant's Report Is Not Presented, and the Successor Accountant Is Engaged to Review the Restatement Adjustments**

**Independent Accountant's Review Report**

*[Appropriate Salutation]*

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion. The financial statements of XYZ Company as of December 31, 20X1 prior to adjustment were reviewed by other accountants whose report dated February 1, 20X2, stated that based on their procedures, they are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

I (We) also reviewed the adjustments described in Note X that were applied to restate the 20X1 financial statements. Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the adjustments described in Note X that were applied to restate the 20X1 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

**Review Report on Comparative Financial Statements When the Prior Period Financial Statements Were Audited**

**Independent Accountant's Review Report<sup>2</sup>**

*[Appropriate Salutation]*

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

The 20X1 financial statements were audited by me (us) (other accountants) and I (we) (they) expressed an unmodified opinion on them in my (our) (their) report dated March 1, 20X2, but I (we) (they) have not performed any auditing procedures since that date.

[Paragraph added, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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<sup>2</sup> Alternatively, an accountant may use a title that does not describe the level of service such as "Accountant's Report" or "Report of Certified Public Accountants" because the report refers to different levels of service.



## AR Section 9200

# Reporting on Comparative Financial Statements: Accounting and Review Services Interpretations of Section 200

### 1. Reporting on Financial Statements That Previously Did Not Omit Substantially All Disclosures

**.01 Question**—Paragraph .30 of section 200, *Reporting on Comparative Financial Statements*, states that an accountant who has compiled, reviewed, or audited financial statements that do not omit substantially all of the disclosures required by an applicable financial reporting framework may subsequently compile financial statements for the same period that do omit substantially all of those disclosures when they are to be presented in comparative financial statements. In these circumstances, section 200 requires the accountant's compilation report to include an additional paragraph indicating (a) the nature of the service rendered with respect to the financial statements that previously did not omit substantially all disclosures and (b) the date of the accountant's previous report.

**.02** When the accountant has previously audited such financial statements, the accountant may have issued a modified opinion on the financial statements (a qualified opinion, an adverse opinion, or a disclaimer of opinion; see AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*). What effect, if any, should this have on the accountant's compilation report on the comparative financial statements? Also, when the accountant has previously compiled or reviewed such financial statements, what effect should a modification to the accountant's compilation or review report have on the accountant's compilation report on the comparative financial statements?

**.03 Interpretation**—If financial statements that omit substantially all disclosures are compiled from financial statements that the accountant has previously audited, the accountant's compilation report on the comparative financial statements should indicate whether the accountant modified the opinion on the audited financial statements, and the substantive reasons therefor. Similarly, if the accountant issued a modified compilation or review report or a report containing any paragraphs emphasizing a matter regarding the financial statements on financial statements that previously did not omit substantially all disclosures, the accountant's reference to that report in the accountant's compilation report on the comparative financial statements should include a description or a quotation of any modifications of the standard report and of any paragraphs emphasizing a matter regarding the financial statements.

**.04** Statements on Standards for Accounting and Review Services do not require an accountant to modify the standard compilation report for an uncertainty or an inconsistency in the application of an applicable financial reporting framework. When the accountant's compilation report on comparative financial statements that omit substantially all of the disclosures required by the applicable financial reporting framework includes a reference to a previous audit report that includes an emphasis-of-matter paragraph describing an uncertainty, users may assume, in the absence of an indication to the contrary,

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that the uncertainty has been resolved. Thus, in such circumstances, in accordance with paragraph .25 of section 80, *Compilation of Financial Statements*, the accountant may emphasize the uncertainty in a separate paragraph of that portion of the accountant's report that relates to the financial statements for the current period.

[Issue Date: November, 1980; Revised: November, 2002;  
Revised: May, 2004; Revised: July, 2005; Revised: December, 2012.]

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## AR Section 300

**Compilation Reports on Financial Statements  
Included in Certain Prescribed Forms**

Issue date, unless  
otherwise indicated:  
December 1981

Source: SSARS No. 3; SSARS No. 5;  
SSARS No. 7; SSARS No. 15; SSARS No. 17

**.01** The requirements of section 80, *Compilation of Financial Statements*, and section 200, *Reporting on Comparative Financial Statements*, are applicable when the unaudited financial statements of a nonissuer are included in a prescribed form. This section provides reporting guidance when the accountant is engaged to compile financial statements included in a prescribed form and the prescribed form or related instructions call for departure from the applicable financial reporting framework by specifying a measurement principle not in conformity with the applicable financial reporting framework or by failing to request the disclosures or presentation required by applicable financial reporting framework.<sup>1</sup> This section also provides additional guidance applicable to reports on financial statements included in a prescribed form.<sup>[2]</sup> [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services (SSARS) No. 17. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.02** For purposes of this section, a *prescribed form* is any standard preprinted form designed or adopted by the body to which it is to be submitted, for example, forms used by industry trade associations, credit agencies, banks, and governmental and regulatory bodies other than those concerned with the sale or trading of securities. A form designed or adopted by the entity whose financial statements are to be compiled is not considered to be a prescribed form. The terms *applicable financial reporting framework*, *financial statements*, and *nonissuer* are defined in paragraph .04 of section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.03** There is a presumption that the information required by a prescribed form is sufficient to meet the needs of the body that designed or adopted the form and that there is no need for that body to be advised of departures from the

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<sup>1</sup> See paragraphs .04 and .37–.39 of section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*, for guidance with respect to applicable financial reporting frameworks. [Footnote amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of Statements on Standards for Accounting and Review Services (SSARS) No. 15. Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

<sup>[2]</sup> [Footnote deleted to reflect the incorporation of material into relevant sections of the Statements on Standards for Accounting and Review Services.]

applicable financial reporting framework required by the prescribed form or related instructions. See the exhibit, "Illustrative Compilation Reports When the Financial Statements Are Included in a Prescribed Form That Calls for a Departure From Accounting Principles Generally Accepted in the United States of America," for an illustrative example of a standard compilation report that may be used when the compiled financial statements are included in a prescribed form that calls for a departure from accounting principles generally accepted in the United States of America. [As amended, effective for periods ending after December 15, 1993, by SSARS No. 7. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17. Revised, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

**.04** If the accountant becomes aware of a departure from an applicable financial reporting framework other than departures that may be called for by the prescribed form or related instructions (see paragraph .01), he or she should follow the guidance in paragraphs .27–.29 of section 80 regarding such departures. If the accountant becomes aware of a departure from the requirements of the prescribed form or related instructions, he or she should consider that departure as the equivalent of a departure from an applicable financial reporting framework in determining its effect on his or her report. See the exhibit for an illustration of a report containing a departure from the prescribed form or related instructions. [Revised, November 2002, to reflect conforming changes necessary due to the issuance of SSARS No. 9. Revised, May 2004, to reflect conforming changes necessary due to the issuance of SSARS No. 10. Revised, July 2005, to reflect conforming changes necessary due to the issuance of SSARS No. 12. Revised, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

**.05** The accountant should not sign a preprinted report form that does not conform to the guidance in this section or section 80, whichever is applicable. In such circumstances, the accountant should append an appropriate report to the prescribed form. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

.06

## Exhibit

### Illustrative Compilation Reports on Financial Statements Included in Certain Prescribed Forms

#### Standard Compilation Report When the Compiled Financial Statements Are Included in a Prescribed Form That Calls for a Presentation Departure From Accounting Principles Generally Accepted in the United States of America

##### Accountant's Compilation Report

*[Appropriate Salutation]*

I (we) have compiled the (identification of financial statements, including period covered and the name of entity) included in the accompanying prescribed form. I (we) have not audited or reviewed the financial statements included in the accompanying prescribed form and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements included in the form prescribed by (name of body) in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The financial statements included in the accompanying prescribed form are presented in accordance with the requirements of *[name of body]*, and are not intended to be a presentation in accordance with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of *[the specified parties]* and is not intended to be and should not be used by anyone other than these specified parties.

*[Signature of accounting firm or accountant, as appropriate]*

*[Date]*

**Compilation Report When the Compiled Financial Statements Are Prepared in Accordance With a Special Purpose Framework Prescribed by Contract or Regulation and That Framework Prescribes a Format for the Financial Information<sup>3</sup>**Accountant's Compilation Report

[Appropriate Salutation]

I (we) have compiled the [identification of financial statements, including period covered and the name of entity] included in the accompanying prescribed form. I (we) have not audited or reviewed the financial statements included in the accompanying prescribed form and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the basis of accounting prescribed by [describe contract or regulation].

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements included in the form in accordance with the basis of accounting prescribed by [describe contract or regulation] and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The financial statements included in the accompanying prescribed form are presented in accordance with the requirements of [describe contract or regulation], and are not intended to be a complete presentation of [name of entity's] assets and liabilities.

This report is intended solely for the information and use of [the specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature of accounting firm or accountant, as appropriate]

[Date]

[Paragraph added, December 2010, to reflect presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>3</sup> See Interpretation No. 11, "Special-Purpose Financial Statements to Comply With Contractual Agreements or Regulatory Provisions," of section 80, *Compilation of Financial Statements* (sec. 9080 par. .32-.40).

## AR Section 9300

# ***Compilation Reports on Financial Statements Included in Certain Prescribed Forms: Accounting and Review Services Interpretations of Section 300***

### **1. Omission of Disclosures in Financial Statements Included in Certain Prescribed Forms**

**.01 Question**—The accountant may have reviewed financial statements including disclosures required by accounting principles generally accepted in the United States of America and be asked to compile financial statements included in a prescribed form which does not request such disclosures. If the measurement principles to be used do not cause the compiled financial statements in the prescribed form to be materially different from the reviewed statements, can the accountant's compilation report on the prescribed form refer to the accountant's report on the reviewed financial statements?

**.02 Interpretation**—Yes. An accountant who has reviewed the financial statements of a nonissuer may issue a compilation report on financial statements for the same period that are included in a prescribed form that calls for a departure from accounting principles generally accepted in the United States of America. When the difference between the previously reviewed financial statements and the financial statements included in the prescribed form is limited to the omission of disclosures not requested by the form, the accountant may wish to refer to his review report in his report on the compiled financial statements included in the prescribed form. This might be accomplished by adding a sentence such as the following to the introductory paragraph of the report or as a separate paragraph: "These financial statements were compiled by me (us) from financial statements for the same period which I (we) previously reviewed, as indicated in my (our) report dated \_\_\_\_."<sup>[\*]</sup> The reference to a previous review report should include a description or a quotation of any modifications of the standard review report previously issued and of any paragraphs emphasizing a matter regarding the financial statements.

**.03** If the measurement principles used in the compiled financial statements in the prescribed form cause such financial statements to be materially different from the previously reviewed financial statements, no reference should be made to the review engagement.

[Issue Date: May, 1982. Revised: February, 2008; Revised: December, 2012.]

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[\*] [Footnote deleted, December 2012, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 19.]





## AR Section 400

# Communications Between Predecessor and Successor Accountants

Issue date, unless  
otherwise indicated:  
December 1981

Source: SSARS No. 4; SSARS No. 7;  
SSARS No. 9; SSARS No. 15; SSARS No. 17

**.01** This section provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant regarding acceptance of an engagement to compile or review the financial statements of a nonissuer.<sup>[1]</sup> This section also provides guidance on inquiries a successor accountant may wish to make of a predecessor, and the predecessor's responses, to facilitate the conduct of the successor's compilation or review engagement. It also requires a successor accountant who becomes aware of information that leads him or her to believe the financial statements reported on by the predecessor accountant may require revision to request that the client communicate this information to the predecessor accountant. [As amended, effective for periods ending after December 15, 1993, by Statement on Standards for Accounting and Review Services (SSARS) No. 7. As amended, effective November 2002, by SSARS No. 9.]

**.02** The following definitions apply for purposes of this section:

**Successor accountant.** An accountant who has been invited to make a proposal for an engagement to compile or review financial statements and is considering accepting the engagement or an accountant who has accepted such an engagement.

**Predecessor accountant.** An accountant who (a) has reported on the most recent compiled or reviewed financial statements or was engaged to perform, but did not complete, a compilation or review of the financial statements, and (b) has resigned, declined to stand for reappointment, or been notified that his or her services have been or may be terminated.

[As amended, effective November 2002, by SSARS No. 9.]

## Inquiries Regarding Acceptance of an Engagement

**.03** A successor accountant is not required to communicate with a predecessor accountant in connection with acceptance of a compilation or review engagement, but he or she may believe it is beneficial to obtain information that will assist in determining whether to accept the engagement. The successor

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<sup>[1]</sup> [Footnote deleted, November 2002, by the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 9.]

accountant may consider making inquiries of the predecessor accountant when circumstances such as the following exist:<sup>[2]</sup>

- a. The information obtained about the prospective client and its management and principals is limited or appears to require special attention.
- b. The change in accountants takes place substantially after the end of the accounting period for which statements are to be compiled or reviewed.
- c. There have been frequent changes in accountants.

The successor accountant should bear in mind that the predecessor accountant and the client may have disagreed about accounting principles, procedures applied by the predecessor accountant, or similarly significant matters. [As amended, effective November 2002, by SSARS No. 9.]

**.04** The successor accountant should request permission from the prospective client to make any inquiries of the predecessor accountant. Except as permitted by the AICPA Code of Professional Conduct, an accountant is precluded from disclosing any confidential information obtained in the course of an engagement unless the client specifically consents. Accordingly, if the successor accountant decides to communicate with the predecessor, the successor accountant should request the client to (a) permit the successor accountant to make inquiries of the predecessor accountant and (b) authorize the predecessor accountant to respond fully to those inquiries.<sup>3</sup> If the prospective client refuses to permit the predecessor accountant to respond or limits the response, the successor accountant should inquire about the reasons and consider the implications of that refusal in connection with acceptance of the engagement. [As amended, effective November 2002, by SSARS No. 9.]

**.05** When the successor accountant decides to communicate with the predecessor accountant, the inquiries may be oral or written. The inquiries should be specific and reasonable regarding matters that will assist the successor accountant in determining whether to accept the engagement. Matters subject to inquiry would include (a) information that might bear on the integrity of management (owners), (b) disagreements with management (owners) about accounting principles or the necessity for the performance of certain procedures or similarly significant matters, (c) the cooperation of management (owners) in providing additional or revised information, if necessary, (d) the predecessor's knowledge of any fraud or illegal acts perpetrated within the client, and (e) the predecessor's understanding of the reason for the change of accountants. [As amended, effective November 2002, by SSARS No. 9.]

**.06** The predecessor accountant should respond promptly and fully to the inquiries, on the basis of known facts. However, if the predecessor accountant decides, due to unusual circumstances<sup>4</sup> such as impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to respond fully to the inquiries, the predecessor accountant should indicate that the response is limited. The successor accountant should consider the implications of a limited response in connection with acceptance of the engagement. [As amended, effective November 2002, by SSARS No. 9.]

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<sup>[2]</sup> [Footnote deleted, November 1992, by the issuance of SSARS No. 7.]

<sup>3</sup> The successor accountant is not precluded from making these inquiries before making a proposal for the engagement.

<sup>4</sup> Unpaid fees, as discussed in paragraph .08, are not considered to be an unusual circumstance for purposes of this paragraph; however, see paragraph .08.

## Other Inquiries

[.07] [Paragraph deleted, November 2002, by the issuance of SSARS No. 9.]

.08 The successor accountant also may wish to review the predecessor's engagement documentation (terms such as *working papers* or *workpapers* are also sometimes used).<sup>[5]</sup> In these circumstances, the successor accountant should request the client to authorize the predecessor accountant to allow access. It is customary in such circumstances for the predecessor accountant to make himself or herself available to the successor accountant for consultation and to make available for review certain engagement documentation. The predecessor accountant should determine which documentation is to be made available for review and which may be copied. Ordinarily, the predecessor accountant should provide the successor accountant access to documentation relating to matters of continuing accounting significance and those relating to contingencies. Valid business reasons (including but not limited to unpaid fees), however, may lead the predecessor to decide not to allow access to the documentation.<sup>6</sup> The predecessor accountant may decide to reach an understanding with the successor accountant about the use of the documentation.<sup>7</sup> Further, when more than one accountant is considering acceptance of an engagement, the predecessor accountant should not be expected to make himself or herself or his or her documentation available until the client has designated one of those accountants as the successor accountant. [As amended, effective November 2002, by SSARS No. 9. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Successor Accountant's Use of Communications

.09 The successor accountant should not make reference to the report or work of a predecessor accountant in his or her own report, except as specifically permitted by section 200, *Reporting on Comparative Financial Statements*, with respect to the financial statements of a prior period. [As amended, effective November 2002, by SSARS No. 9. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15.]

## Financial Statements Reported on by Predecessor Accountant

.10 If, during the engagement, the successor accountant becomes aware of information that leads him or her to believe that financial statements reported on by the predecessor accountant may require revision, the successor accountant should request the client to communicate this information to the

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<sup>[5]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19].

<sup>6</sup> See Interpretation No. 501-1, "Response to requests by clients and former clients for records," under Rule 501, *Acts Discreditable* (ET sec. 501 par. .02), for guidance on what constitutes an accountant's working papers. [Footnote added, April 30, 1982, by the Accounting and Review Services Committee.]

<sup>7</sup> Before permitting access to the documentation, the predecessor accountant may wish to obtain a written communication from the successor accountant regarding the use of the documentation. The exhibit contains an illustrative successor accountant acknowledgment letter. [Footnote added, effective November 2002, by SSARS No. 9. Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

predecessor accountant. Paragraphs .47–.52 of section 80, *Compilation of Financial Statements*, and paragraphs .54–.59 of section 90, *Review of Financial Statements*, provide guidance to the predecessor accountant in determining an appropriate course of action with respect to compilation and review engagements, respectively. [As amended, effective November 2002, by SSARS No. 9. Revised, May 2004, to reflect conforming changes necessary due to the issuance of SSARS No. 10. Revised, July 2005, to reflect conforming changes necessary due to the issuance of SSARS No. 12. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.11** If the client refuses to communicate with the predecessor accountant or if the successor accountant is not satisfied with the predecessor accountant's course of action, the successor accountant should evaluate (a) possible implications for the current engagement and (b) whether to resign from the engagement. Furthermore, the successor accountant may decide to consult with legal counsel in determining an appropriate course of further action. [Paragraph added, effective November 2002, by SSARS No. 9.]

.12

## Exhibit

### Illustrative Successor Accountant Acknowledgment Letter

Paragraph .08 footnote 7 states, "Before permitting access to the documentation, the predecessor accountant may wish to obtain a written communication from the successor accountant regarding the use of the documentation." The following letter is presented for illustrative purposes only and is not required by professional standards.

[Date]

[Successor Accountant]

[Address]

We have previously [reviewed or compiled], in accordance with Statements on Standards for Accounting and Review Services the December 31, 20X1, financial statements of ABC Enterprises (ABC). In connection with your [review or compilation] of ABC's 20X2 financial statements, you have requested access to our documentation prepared in connection with that engagement. ABC has authorized our firm to allow you to review that documentation.

Our [review or compilation], and the documentation prepared in connection therewith, of ABC's financial statements was not planned or conducted in contemplation of your [review or compilation]. Therefore, items of possible interest to you may not have been specifically addressed. Our use of professional judgment for the purpose of this engagement means that matters may have existed that would have been assessed differently by you. We make no representation about the sufficiency or appropriateness of the information in our documentation for your purposes.

We understand that the purpose of your review of our documentation is to obtain information about ABC and our 20X1 [compilation or review] procedures to assist you in planning your 20X2 [compilation or review] of the financial statements of ABC. For that purpose only, we will provide you access to our documentation that relate to that objective.

Upon request, we will provide copies of the documentation that provide factual information about ABC. You agree to subject any such copies, or information otherwise derived from our documentation, to your normal policy for retention of documentation and protection of confidential client information. Furthermore, in the event of a third-party request for access to your documentation prepared in connection with your (reviews or compilations) of ABC, you agree to obtain our permission before voluntarily allowing any such access to our documentation or information otherwise derived from our documentation, and to obtain on our behalf any releases that you obtain from such third party. You agree to advise us promptly and provide us a copy of any subpoena, summons, or other court order for access to your documentation that include copies of our documentation or information otherwise derived therefrom.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Very truly yours,

[Predecessor Accountant]

By: \_\_\_\_\_

Accepted:

[Successor Accountant]

By: \_\_\_\_\_ Date: \_\_\_\_\_

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Even with the client's consent, access to the predecessor accountant's documentation may still be limited. Experience has shown that the predecessor accountant may be willing to grant broader access if given additional assurance concerning the use of the documentation. Accordingly, the successor accountant might consider agreeing to the following limitations on the review of the predecessor accountant's documentation in order to obtain broader access:

- The successor accountant will not comment, orally or in writing, to anyone as a result of the review about whether the predecessor accountant's engagement was performed in accordance with Statements on Standards for Accounting and Review Services.
- The successor accountant will not provide expert testimony or litigation services or otherwise accept an engagement to comment on issues relating to the quality of the predecessor accountant's engagement.

The following paragraph illustrates the above:

Because your review of our documentation is undertaken solely for the purpose described above and may not entail a review of all our documentation, you agree that (1) the information obtained from the review will not be used by you for any other purpose, (2) you will not comment, orally or in writing, to anyone as a result of that review about whether our engagement was performed in accordance with Statements on Standards for Accounting and Review Services, (3) you will not provide expert testimony or litigation services or otherwise accept an engagement to comment on issues relating to the quality of our engagement.

[Paragraph added, effective November 2002, by SSARS No. 9. Revised, September 2005, to reflect conforming changes necessary due to the Accounting and Review Services Committee. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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## AR Section 9400

# ***Communications Between Predecessor and Successor Accountants: Accounting and Review Services Interpretations of Section 400***

### **1. Reports on the Application of Accounting Principles**

**.01 Question**—Section 400, *Communications Between Predecessor and Successor Accountants*, provides guidance on communication between a successor accountant and a predecessor accountant. The guidance provided concerns only the situation in which one accountant succeeds another in a compilation or review engagement.

**.02** In other situations, an accountant in public practice may be requested by an entity that has not engaged that accountant to report on its financial statements to provide advice about the application of accounting principles or about the type of report to be issued on its financial statements (compilation, review, or audit report). Such requests are often made to obtain a second opinion about these matters from another accountant. What guidance should be followed by the accountant who is requested to provide advice on these matters?

**.03 Interpretation**—AU-C section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*, addresses the reporting accountant's responsibilities when requested to issue a written report on the application of the requirements of an applicable financial reporting framework to a specific transaction or the type of report that may be issued on a specific entity's financial statements.

**.04** AU-C section 915 also applies to oral advice provided by the reporting accountant that the reporting accountant concludes is intended to be used by a principal to the transaction as an important factor considered in reaching a decision on the application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements.

**.05** Paragraph .13 of AU-C section 915 states that the reporting accountant should consult with the continuing accountant to determine whether the reporting accountant has obtained the available facts relevant to form a conclusion. The reporting accountant should follow AU-C section 915 for such engagements.

[Issue Date: August, 1987; Revised: November, 2002; Revised: December, 2012.]

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## AR Section 500

### *Reporting on Compiled Financial Statements*

Deleted, November 1992, by the issuance of SSARS No. 7.

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**AR Section 600****Reporting on Personal Financial Statements  
Included in Written Personal Financial Plans**

Issue date, unless  
otherwise indicated:  
September 1986

Source: SSARS No. 6

**.01** This section provides an exemption from section 80, *Compilation of Financial Statements*, for personal financial statements that are included in written personal financial plans prepared by an accountant, and specifies the form of written report required under the exemption.<sup>1</sup> However, this statement does not preclude an accountant from complying with section 80 in such engagements. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.02** Because the purpose of such financial statements is solely to assist in developing the client's personal financial plan, they frequently omit disclosures required by an applicable financial reporting framework. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.03** An accountant may submit a written personal financial plan containing unaudited personal financial statements to a client without complying with the requirements of section 80 when all of the following conditions exist:

- a. The accountant establishes an understanding with the client and documents the understanding through a written communication with the client that the financial statements
  - i. will be used solely to assist the client and the client's advisers to develop the client's personal financial goals and objectives.
  - ii. will not be used to obtain credit or for any purposes other than developing these goals and objectives.
- b. Nothing comes to the accountant's attention during the engagement that would cause the accountant to believe that the financial statements will be used to obtain credit or for any purposes other than developing the client's financial goals and objectives.

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.04** An accountant using the exemption provided by this section should issue a written report stating that the unaudited financial statements

- a. are designed solely to help develop the financial plan.

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<sup>1</sup> For purposes of this statement, personal financial statements are those financial statements of an individual that meet the definition of *financial statements* in paragraph .04 of section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*. [Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19]

## **1790**      **Statements on Standards for Accounting and Review Services**

- b.*    may be incomplete or contain other departures from the applicable financial reporting framework and should not be used to obtain credit or for any purposes other than developing the personal financial plan.
- c.*    have not been audited, reviewed, or compiled.

**.05** See the exhibit, "Illustrative Report When the Accountant Submits a Written Financial Plan Containing Unaudited Personal Financial Statements That the Accountant Did Not Compile," for an illustration. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.06** Each of the personal financial statements should include a reference to the accountant's report.

### **Effective Date**

**.07** This section is effective on September 30, 1986.

.08

**Exhibit****Illustrative Report When the Accountant Submits a Written Financial Plan Containing Unaudited Personal Financial Statements That the Accountant Did Not Compile****Accountant's Report**

The accompanying Statement of Financial Condition of X, as of December 31, 20XX, was prepared solely to help you develop your personal financial plan. Accordingly, it may be incomplete or contain other departures from accounting principles generally accepted in the United States of America and should not be used to obtain credit or for any purposes other than developing your financial plan. We have not audited, reviewed, or compiled the statement.

[Paragraph added, December 2010, to reflect the presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

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## AR Section 9600

# ***Reporting on Personal Financial Statements Included in Written Personal Financial Plans: Accounting and Review Services Interpretation of Section 600***

### **1. Submitting a Personal Financial Plan to a Client's Advisers**

**.01 Question**—Paragraph .03 of section 600, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans*, states that an accountant may submit a written personal financial plan containing unaudited personal financial statements to a client without complying with the requirements of section 80, *Compilation of Financial Statements*, when, among other conditions, the accountant establishes an understanding with the client that the financial statements will be used solely to assist the client and the client's advisers to develop the client's personal financial goals and objectives. Does developing the client's personal financial goals and objectives encompass implementing the personal financial plan by the client or the client's advisers?

**.02 Interpretation**—Yes. Developing a client's personal financial goals and objectives includes implementing the personal financial plan by the client or the client's advisers because implementing the plan may be considered the culmination of the process of developing personal financial goals and objectives. Therefore, an accountant may submit a written personal financial plan containing unaudited personal financial statements to a client, to be used by the client or the client's advisers to implement the personal financial plan, without complying with the requirements of section 80, provided the conditions in paragraph .03 of section 600 exist.

**.03** Examples of implementation of a personal financial plan by the client's advisers include use of the plan by

- an insurance broker who will identify specific insurance products.
- an investment adviser who will provide specific recommendations about the investment portfolio.
- an attorney who will draft a will or trust documents.

[Issue Date: May 1991; Revised: December 2012.]

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## EXHIBITS

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## AR Exhibit A

# ***Analytical Procedures in a Review Engagement***

### **Notice to Readers**

The purpose of the documentation guidance contained in this exhibit is to illustrate how an accountant might document expectations in a review engagement. The examples are presented for illustrative purposes only and should not be considered to represent either minimum or maximum documentation requirements.

This exhibit is an other compilation and review publication as defined in AR section 50, *Standards for Accounting and Review Services*. Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply Statements on Standards for Accounting and Review Services (SSARSs). If an accountant applies the guidance included in an other compilation and review publication, the accountant should be satisfied that, in his or her judgment, it is both appropriate and relevant to the circumstances of the subject engagement. This publication was reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate.

### **Expectations**

Forming an expectation is an integral phase of the analytical procedure process. Expectations are the accountant's predictions of recorded amounts or ratios developed from recorded amounts. In performing analytical procedures, the accountant develops the expectation in such a way that a material difference between the expectation and the recorded amount or ratio is indicative of a possible misstatement and, therefore, the accountant should obtain explanations for the difference (for example, an unusual event occurred). Expectations are developed by identifying plausible relationships (for example, store square footage and retail sales) that are reasonably expected to exist based on the accountant's understanding of the client and the industry in which the client operates. The accountant selects from a variety of data sources to form expectations. For example, the accountant may use prior-period information (adjusted for expected changes), management's budgets or forecasts, industry data, or nonfinancial data. Additionally, information that is developed when an accountant compiles interim financial statements can be utilized by the accountant in developing expectations associated with the review of financial statements.

An accountant cannot, under any circumstances, perform effective analytical procedures without first developing expectations related to the results of those analytical procedures. Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit.

Pursuant to paragraph .26 of AR section 90, *Review of Financial Statements*, the accountant should document expectations and factors considered in the development of those expectations when the expectations are not otherwise readily determinable from the documentation of the work performed. [Revised, September 2012, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

The following are examples of how an accountant can document expectations. These examples are not intended to be all inclusive.

### Example 1—Expected Increase in Revenue

An accountant is engaged to review the financial statements of a company that manufactures components that are utilized by other companies in customizing vehicles for use by the United States military. Because of various conflicts occurring in the world and the United States' role in those conflicts, the accountant reasonably expects sales to increase. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 10 percent to 15 percent increase in sales. Further, the accountant concludes that receivables should increase and that loans payable and interest expense would also increase because the client would need to borrow money to fund the additional production.

#### *Sample documentation*

Teemickmag Military Supply Company  
Analytical Procedures  
For the year ended December 31, 20XX

#### *Expectations*

The following are factors that should affect the relationship between current and prior year amounts:

- Increase in military spending by the government due to world events should result in an increase in sales. Expected increase is between 10 percent and 15 percent. The accountant expects a similar increase in accounts receivable.
- Because of an increase in production of military vehicles, the company had to borrow additional funds. Therefore, expected increase in loans payable and interest expense is between 10 percent and 15 percent.
- No significant change in either days sales in inventory or inventory turnover is expected. Although a build-up in inventory is expected, that build-up is not expected to correspond with the increase in sales because the vehicles are expected to be sold near the date of completion. Any change greater than 5 percent will be subjected to additional inquiries.

Balance sheets and income statements are available for the current year and the two years prior to the current year.

#### *Trend analysis*

	<u>Current Year</u>	<u>Prior Year</u>	<u>Change</u>	<u>% Change</u>
Sales	\$2,500,000	\$2,175,000	\$325,000	14.94%
Cost of goods sold	1,780,000	1,566,000	214,000	13.67%
Gross margin	720,000	609,000		
Gross margin as a % of sales	28.80%	28.00%		
Selling expenses	230,000	184,000	46,000	25.00%
Interest expense	48,000	42,000	6,000	14.29%

*Balance sheet ratio analysis*

	<u>Current Year</u>	<u>Prior Year</u>	<u>Two Years Prior</u>
Accounts receivable, net	\$1,100,000	\$843,000	\$703,000
Inventory	1,000,000	832,000	694,000
Loans payable	498,000	437,000	418,000

*Days sales in receivables*

Days sales in receivables = Accounts receivable, net at end of period / (Net sales/365)

Current year days sales in receivables = \$1,100,000 / (\$2,500,000 / 365) = 161 days

Prior year days sales in receivables = \$843,000 / (\$2,175,000 / 365) = 141 days

The increase of 20 days sales in receivables (161 days – 141 days) represents a 14 percent increase. Because this increase is within the expected range, no further inquiry is necessary.

*Days sales in inventory*

Days sales in inventory = Inventory at the end of period / (Total cost of goods sold / 365)

Current year days sales in inventory = \$1,000,000 / (\$1,780,000 / 365) = 205 days

Prior year days sales in inventory = \$832,000 / (\$1,566,000 / 365) = 194 days

The increase of 11 days sales in inventory (205 days – 194 days) represents a 6 percent increase. Because this increase is greater than expected, the accountant should inquire of the client and document the reason for the unexpected increase.

*Inventory turnover*

Inventory turnover = Cost of goods sold / Average inventory

Current year inventory turnover = \$1,780,000 / ((\$1,100,000 + 832,000) / 2) = 1.84 times

Prior year inventory turnover = \$1,566,000 / ((\$832,000 + 694,000) / 2) = 2.05 times

The inventory turnover decreased 10 percent; therefore, because this decrease is greater than expected, the accountant should inquire of the client and document the reason for the unexpected decrease.

The preceding documentation would be adequate. Further, after performing the trend analysis, the accountant concludes that sales, costs of goods sold, and interest expense are all "reasonable" given the expectations associated with these amounts. In addition, with respect to balance sheet accounts, the increase in loans payable is also reasonable (14 percent increase) when considered with the corresponding increase in interest expense and the expectation associated with the loan payable account; however, because selling expenses increased by 25 percent, the accountant should inquire of the client and document the reason for that unexpected increase (actual increase does not correspond to expected increase).

## Example 2—Expected Decrease in Revenue

An accountant is engaged to review the financial statements of a client that either owns or manages, or both owns and manages, a shopping mall. Due to a poor economy, the mall lost tenants during the year; as such, the accountant reasonably expects revenue to decrease. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 5 percent to 10 percent decrease in revenue during the year. Further, the accountant expects that general and administrative expenses should increase due to an increase in leasing and sales expenses and that management fees should decrease due to a decrease in tenants in the building.

### *Sample documentation*

Pearl River Mall  
Analytical Procedures  
For the year ended December 31, 20XX

### *Expectations*

The following are factors that should affect the relationship between current and prior year amounts:

- Loss of tenants due to poor economy should result in a decrease in revenue. Expected decrease is between 5 percent and 10 percent.
- Because of the increased number of vacancies, general and administrative expenses are expected to increase because of an increase in leasing and sales expenses. Expected increase is between 5 percent and 10 percent (corresponds with the decrease in revenue).
- Because of the decrease in the number of tenants in the building, management fees are expected to decrease between 5 percent and 10 percent (corresponds with decrease in revenue).

Balance sheets and income statements are available for the current year and the two years prior to the current year.

### *Trend analysis*

	<u>Current</u> <u>Year</u>	<u>Prior Year</u>	<u>Change</u>	<u>% Change</u>
Tenant revenue	\$7,223,000	\$8,603,000	\$(1,380,000)	(16.04)%
Costs and expenses:				
Management fees	339,000	387,000	(48,000)	(12.40)%
General and administrative	583,000	511,000	72,000	14.09 %

Similar balance sheet analytics should be performed as those performed in Example 1 above.

The preceding documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations associated with those procedures. Therefore, the accountant should inquire and document why the decrease in tenant revenue, the decrease in management fees, and the increase in general and administrative expenses exceeded expectations.

### Example 3—No significant change in revenue or expenses expected

An accountant is engaged to review the financial statements of a small, privately held client in the candy store business. The accountant has performed a review of the financial statements of the candy store for each of the past five years with no significant change in revenue or expenses in any of those years. The accountant expects that trend to continue.

#### *Sample documentation*

Mom and Pop Candy Store  
Analytical Procedures  
For the year ended December 31, 20XX

#### *Expectations*

- Based on discussions with the owner and manager, no significant changes from prior year amounts are expected.
- All increases and decreases greater than 5 percent will be subjected to additional inquiries.

#### *Trend analysis*

	<u>Current Year</u>	<u>Prior Year</u>	<u>Change</u>	<u>% Change</u>
Sales	\$44,000	\$39,000	\$5,000	12.82%
Cost of goods sold	32,500	31,000	1,500	4.84%
Gross margin	11,500	8,000		
Gross margin as a % of sales	26.14%	20.51%		
Operating expenses	5,200	4,500	700	15.56%
Net income	6,300	3,500		

Similar balance sheet analytics should be performed as those performed in Example 1 above.

The preceding documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations associated with those procedures. Therefore, the accountant may deem it appropriate to inquire and document why sales increased by an amount greater than expected. In addition, the accountant should inquire as to why there was not a comparable increase in cost of goods sold. Also, the accountant should discuss with the owner and manager why there is a greater than expected increase in operating expenses and document the results of the discussion.

### Example 4—Expected Changes in Construction Contracts

An accountant is engaged to review the financial statements of a general construction contractor primarily engaged in the construction of commercial office buildings. The accountant has performed the review of this company's financial statements for several years and expects that the current project in process should yield a 5 percent gross profit margin consistent with similar projects in the past and in accordance with the initial project estimate.

*Sample documentation*

ABC Construction Contractors  
 Analytical Procedures  
 For the year ended December 31, 20XX

*Expectations*

- Based upon discussions with the project manager, it is believed that the gross margin will be consistent with the 5 percent margin achieved in the past and in accordance with the initial project estimate.
- Any deviation in the margin greater than 1 percent will be subjected to additional inquiries.

*Trend analysis*

<u>Building Contract</u>	<u>Current Year</u>	<u>Prior Year</u>	<u>\$ Change</u>	<u>% Change</u>
Contract value	\$5.0 million	\$5.0 million		
Estimated costs at completion	4.9 million	4.75 million	\$150,000	3.15%
Planned profit	100,000	250,000	150,000	60.00%
Costs incurred	2.5 Million	1.0 million		
Profit recognized contract to date	50,000	50,000		

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## AR Exhibit B

# Going Concern Considerations

### Notice to Readers

The purpose of this nonauthoritative exhibit is to help practitioners better understand the accounting concepts of going concern in performing a compilation or review engagement. This exhibit has been prepared and reviewed by AICPA staff; however, it has not been approved, disapproved, or otherwise acted upon by the Accounting and Review Service Committee or any senior committee of the AICPA.

### Going Concern Consideration

Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Ordinarily, information that indicates an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, typically not to exceed one year beyond the date of the financial statements, relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions.

Certain conditions or events, when considered in the aggregate, may indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others. The following are examples of such conditions and events:

- *Negative trends.* For example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, adverse key financial ratios.
- *Other indications of possible financial difficulties.* For example, default on loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, noncompliance with statutory capital requirements, need to seek new sources or methods of financing or to dispose of substantial assets.
- *Internal matters.* For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, need to significantly revise operations.
- *External matters that have occurred.* For example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; uninsured or underinsured catastrophe such as a drought, earthquake, or flood.

After identifying adverse conditions and events, management's plans for dealing with the conditions or events may include the following:

- Plans to dispose of assets
  - Restrictions on disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
  - Apparent marketability of assets that management plans to sell
  - Possible direct or indirect effects of disposal of assets
- Plans to borrow money or restructure debt
  - Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
  - Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
  - Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- Plans to reduce or delay expenditures
  - Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
  - Possible direct or indirect effects of reduced or delayed expenditures
- Plans to increase ownership equity
  - Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  - Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors

## Financial Statement Effects

When management concludes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, management should consider disclosing the following:

- Pertinent conditions and events giving rise to the assessment of the uncertainty about the entity's ability to continue as a going concern for a reasonable period of time
- The possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events and any mitigating factors
- Possible discontinuance of operations
- Management's plans (including relevant prospective financial information)
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

When management concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is alleviated, management should consider the need for disclosure of the principal conditions and events that initially caused it to believe there was an uncertainty. The consideration of disclosure may include the possible effects of such conditions and events, and any mitigating factors, including management's plans.

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## AR Exhibit C

[Exhibit deleted, October 2009, to reflect conforming changes necessary due to the issuance of FASB ASC 855, which provides authoritative accounting guidance for subsequent events.]

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**AR****APPENDIXES**

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## AR Appendix A

*[Reserved.]*

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## AR Appendix B

*[Reserved.]*

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## AR Appendix C

## ***Schedule of Changes in Statements on Standards for Accounting and Review Services***

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
20		SSARS No. 16 added	December 2007
20		Superseded by SSARS No. 19	December 2009
50		Added by SSARS No. 11	May 2004
50		Superseded by SSARS No. 19	December 2009
50	.01	Amended by SSARS No. 17	December 2008
60		Added by SSARS No. 19	December 2009
80		Added by SSARS No. 19	December 2009
90		Added by SSARS No. 19	December 2009
90	.01	Amended by SSARS No. 20	February 2011
100		Superseded by SSARS No. 19	December 2009
100	.01	Amended by SSARS No. 8	October 2000
100	.01	Amended by SSARS No. 15	July 2007
100	.01	Amended by SSARS No. 17	February 2008
100	.01	Amended by SSARS No. 18	February 2009
100	.02	Amended by SSARS No. 3	December 1981
100	.02	Amended by SSARS No. 8	October 2000
100	.02	Amended by SSARS No. 17	December 2008
100	.03	Amended by SSARS No. 8	October 2000
100	.03	Amended by SSARS No. 9	November 2002
100	.03	Amended by SSARS No. 17	February 2008
100	.04	Amended by SSARS No. 2	October 1979
100	.04	Amended by SSARS No. 8	October 2000
100	.04	Amended by SSARS No. 9	November 2002
100	.04	Amended by SSARS No. 15	July 2007
100	.04	Amended by SSARS No. 17	February 2008
100	.05	Amended by SSARS No. 8	October 2000
100	.05	Amended by SSARS No. 12	July 2005
100	.06	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.07	Amended by SSARS No. 8	October 2000
100	.08	Amended by SSARS No. 8	October 2000
100	.09	Amended by SSARS No. 8	October 2000
100	.10	Amended by SSARS No. 8	October 2000
100	.10	Amended by SSARS No. 9	November 2002
100	.10	Amended by SSARS No. 12	July 2005

(continued)

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
100	.11	Amended by SSARS No. 8	October 2000
100	.12	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.13	Amended by SSARS No. 8	October 2000
100	.13	Amended by SSARS No. 9	November 2002
100	.14	Amended by SSARS No. 8	October 2000
100	.14	Deleted by SSARS No. 9	November 2002
100	.15–.16	Amended by SSARS No. 8	October 2000
100	.16	Amended by SSARS No. 15	July 2007
100	.17	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.18–.19	Amended by SSARS No. 3	December 1981
100	.20–.21	Amended by SSARS No. 8	October 2000
100	.21	Amended by SSARS No. 15	July 2007
100	.22	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.23–.27	Amended by SSARS No. 8	October 2000
100	.28	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.29	Amended by SSARS No. 9	November 2002
100	.29	Amended by SSARS No. 10	May 2004
100	.29	Amended by SSARS No. 17	February 2008
100	.30	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.31	Amended by SSARS No. 9	November 2002
100	.31	Amended and transferred, from former 100.32, by SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.31	Amended by SSARS No. 12	July 2005
100	.31	Amended by SSARS No. 17	February 2008
100	.32	New paragraphs added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.33	Amended by SSARS No. 10	May 2004
100	.36	New paragraphs added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
100	.36	Amended by SSARS No. 17	February 2008
100	.37-.38	New paragraphs added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.38	Amended by SSARS No. 10	May 2004
100	.39	New paragraph added by issuance of SSARS No. 9; subsequent paragraphs renumbered	November 2002
100	.39	Amended by SSARS No. 10	May 2004
100	.40	New paragraph added by issuance of SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.41	Amended by SSARS No. 9	November 2002
100	.41	Amended by SSARS No. 17	February 2008
100	.42	Amended by SSARS No. 10	May 2004
100	.43	New paragraph added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.44	Amended by SSARS No. 10	May 2004
100	.45	New paragraph added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.45	Amended by SSARS No. 12	July 2005
100	.46	Amended by SSARS No. 9	November 2002
100	.47	Deleted by SSARS No. 9	November 2002
100	.49	Amended by SSARS No. 15	July 2007
100	.50	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.51	Amended by SSARS No. 9	November 2002
100	.53	Amended by SSARS No. 3	December 1981
100	.54-.55	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.56	Amended by SSARS No. 5	July 1982
100	.56	Amended by SSARS No. 3	December 1981
100	.56-.58	Amended by SSARS No. 15	July 2007
100	.59-.68	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.69-.76	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	February 2008

(continued)

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
100	.77	Amended by SSARS No. 9	November 2002
100	.77	Amended by SSARS No. 15	July 2007
100	.78–.82	New paragraphs added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.83	Amended by SSARS No. 17	February 2008
100	.84–.85	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.85–.86	Amended by SSARS No. 17	February 2008
100	.92	Superseded by SSARS No. 2	October 1979
100	.93–.95	New paragraphs added by issuance of SSARS No. 9; subsequent paragraphs renumbered	November 2002
100	.94	Amended by SQCS 7	December 2008
100	.97	New paragraph added by issuance of SSARS No. 8; subsequent paragraphs renumbered	October 2000
100	.98	Amended by SSARS No. 10	May 2004
100	.98	Revised	December 2008
100	.99	Amended by SSARS No. 5	July 1982
100	.99	Amended by SSARS No. 17	February 2008
100	.100	New paragraph added by issuance of SSARS No. 8; subsequent paragraphs renumbered	October 2000
100	.100–.101	Amended by SSARS No. 17	February 2008
100	.102	Amended by SSARS No. 15	July 2007
100	.102	Amended by SSARS No. 17	February 2008
100	.103	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.104	Deleted by SSARS No. 8	October 2000
100	.105	New paragraph added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.105	Amended by SSARS No. 15	July 2007
100	.106	New paragraph added by issuance of SSARS No. 15	July 2007
110		SSARS No. 13 added	July 2005
110	.01	Revised by SSARS No. 19	December 2010
110	.02	Revised by SSARS No. 19	December 2010
110	.04	Revised by SSARS No. 19	December 2010



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110	.05	Revised by SSARS No. 19	December 2010
110	.06	Revised by SSARS No. 19	December 2010
110	.07	Revised by SSARS No. 19	December 2010
110	.08	Revised by SSARS No. 19	December 2010
110	.09	Revised by SSARS No. 19	December 2010
110	.10	New paragraphs added by SSARS No. 19; subsequent paragraphs renumbered	December 2010
110	.11	Revised by SSARS No. 19	December 2010
110	.12	Revised by SSARS No. 19	December 2010
110	.13	Deleted by SSARS No. 19	December 2010
110	.14	Revised by SSARS No. 19	December 2010
110	.15	Amended by SSARS No. 17	May 2008
110	.15	Revised by SSARS No. 19	December 2010
110	.16	Revised by SSARS No. 19	December 2010
110	.17	Added by SSARS No. 19	December 2010
120		SSARS No. 14 added	July 2005
120	.01	Revised by SSARS No. 19	December 2010
120	.02	Revised by SSARS No. 19	December 2010
120	.06	Revised by SSARS No. 19	December 2010
120	.07	Revised by SSARS No. 19	December 2010
120	.09	Revised by SSARS No. 19	December 2010
120	.10	Revised by SSARS No. 19	December 2010
120	.11	Revised by SSARS No. 19	December 2010
120	.12	Revised by SSARS No. 19	December 2010
120	.13	New paragraphs added by SSARS No. 19; subsequent paragraphs renumbered	December 2010
120	.14	Revised by SSARS No. 19	December 2010
120	.15	Revised by SSARS No. 19	December 2010
120	.16	Deleted by SSARS No. 19	December 2010
120	.17	Revised by SSARS No. 19	December 2010
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200	.09	Amended by SSARS No. 7	November 1992
200	.09	Deleted by SSARS No. 19	December 2010
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200	.10	Deleted by SSARS No. 19	December 2010
200	.12	Revised by SSARS No. 19	December 2010
200	.15	Revised by SSARS No. 19	December 2010
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# CODE OF PROFESSIONAL CONDUCT

As Adopted January 12, 1988, unless otherwise indicated.

## INTRODUCTION

### Composition, Applicability, and Compliance

The Code of Professional Conduct of the American Institute of Certified Public Accountants consists of two sections—(1) the Principles and (2) the Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members. The Council of the American Institute of Certified Public Accountants is authorized to designate bodies to promulgate technical standards under the Rules, and the bylaws require adherence to those Rules and standards.

The Code of Professional Conduct was adopted by the membership to provide guidance and rules to all members—those in public practice, in industry, in government, and in education—in the performance of their professional responsibilities.

Compliance with the Code of Professional Conduct, as with all standards in an open society, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.

### Other Guidance

*Interpretations of Rules of Conduct* consist of interpretations which have been adopted, after exposure to state societies, state boards, practice units and other interested parties, by the professional ethics division's executive committee to provide guidelines as to the scope and application of the Rules but are not intended to limit such scope or application. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary hearing. *Interpretations* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

*Ethics Rulings* consist of formal rulings made by the professional ethics division's executive committee after exposure to state societies, state boards, practice units and other interested parties. These rulings summarize the application of Rules of Conduct and Interpretations to a particular set of factual circumstances. Members who depart from such rulings in similar circumstances will be requested to justify such departures. *Ethics Rulings* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

Publication of an Interpretation or Ethics Ruling in *The Journal of Accountancy* constitutes notice to members. Hence, the effective date of the pronouncement is the last day of the month in which the pronouncement is published in *The Journal of Accountancy*. The professional ethics division will take into consideration the time that would have been reasonable for the member to comply with the pronouncement.

A member should also consult, if applicable, the ethical standards of his or her state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental agency, which may regulate his or her client's business or use his or her report to evaluate the client's compliance with applicable laws and related regulations.

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# ET Section 50

## PRINCIPLES OF PROFESSIONAL CONDUCT

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## ET Section 51

### *Preamble*

**.01** Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a certified public accountant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

**.02** These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

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## ET Section 52

### *Article I—Responsibilities*

*In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.*

**.01** As professionals, certified public accountants perform an essential role in society. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.

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## ET Section 53

### *Article II—The Public Interest*

*Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.*

**.01** A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

**.02** In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

**.03** Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

**.04** All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

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## ET Section 54

### *Article III—Integrity*

*To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.*

**.01** Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

**.02** Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

**.03** Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

**.04** Integrity also requires a member to observe the principles of objectivity and independence and of due care.

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**ET Section 55****Article IV—Objectivity and Independence**

*A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.*

**.01** Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services.

**.02** Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

**.03** For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest.

**.04** Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services. Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.

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## ET Section 56

### Article V—Due Care

*A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.*

**.01** The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

**.02** Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles.

**.03** Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

**.04** Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

**.05** Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

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**ET Section 57****Article VI—Scope and Nature of Services**

*A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.*

**.01** The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

**.02** Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be developed to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

**.03** In order to accomplish this, members should

- Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
- Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.
- Assess, in their individual judgments, whether an activity is consistent with their role as professionals.

[Revised May 15, 2000.]

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# ET Section 90

## RULES: APPLICABILITY AND DEFINITIONS

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## ET Section 91

### *Applicability*

As adopted  
January 12, 1988,  
unless otherwise  
indicated

**.01** The bylaws of the AICPA require that members adhere to the rules of the Code of Professional Conduct. Members must be prepared to justify departures from these rules.

**.02** *Interpretation addressing the applicability of the AICPA Code of Professional Conduct.* For purposes of the applicability section of the code, a member is a member, an associated member, or an international associate of the AICPA [sec. 92 par. .21].

1. The rules of conduct that follow apply to all professional services performed except
  - a. when the wording of the rule indicates otherwise.
  - b. that a member who is practicing outside the United States will not be considered in violation of a particular rule for departing from any of the rules stated herein as long as the member's conduct is in accord with the rules of the organized accounting profession in the country in which he or she is practicing. However, when a member is associated with financial statements under circumstances that would lead the reader to assume that U.S. practices were followed, the member must comply with the requirements of Rules 202, *Compliance With Standards* [sec. 202 par. .01], and 203, *Accounting Principles* [sec. 203 par. .01].
  - c. a member who is a member of a group engagement team (see the clarified SAS *Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors]*) will not be considered in violation of a particular rule if a foreign component auditor (accountant) departed from any of the ethics requirements stated herein with respect to the audit or review of group financial statements or other attest engagement, as long as the foreign component auditor's (accountant's) conduct, at a minimum, is in accordance with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants' (IESBA's) Code of Ethics for Professional Accountants, and the members of the group engagement team are in compliance with the rules stated herein.
  - d. the independence of the member's firm will not be considered impaired if another firm or entity located outside the United States that is within the member firm's network departed from any of the rules stated herein, as long as the other firm or entity's conduct, at a minimum, is in accordance with the independence requirements set forth in the IESBA's Code of Ethics for Professional Accountants.

2. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts that, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in public practice whom the member has the authority or capacity to control.
3. A member (as defined in paragraph .21 of section 92) or a covered member (as defined in paragraph .07 of section 92) may be considered to have his or her independence impaired, with respect to a client, as the result of the actions or relationships of certain persons or entities, as described in Rule 101, *Independence* [sec. 101 par. .01], and its interpretations and rulings, whom the member or covered member does not have the authority or capacity to control. Therefore, nothing in this section should lead one to conclude that the member's or covered member's independence is not impaired solely because of his or her inability to control the actions or relationships of such persons or entities.

[Revised September 2011, effective November 30, 2011. Paragraph added August 1989, effective November 30, 1989. Revised December 1998. Revised July 2002 to reflect conforming changes necessary due to the revision of Interpretation 101-1. Revised March 2013, revisions effective May 31, 2013. Revised June 2014, effective September 30, 2014.]

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## ET Section 92

### Definitions

As adopted,  
January 12, 1988,  
unless otherwise  
indicated

*[Pursuant to its authority under the bylaws (BL § 3.6.2.2) to interpret the Code of Professional Conduct, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code effective November 30, 1989.]*

**.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 AU-C section 620], *Using the Work of an Auditor's Specialist*, and individuals who perform only routine clerical functions, such as word processing and photocopying.

[Revised November 2001. Revised May 2013, revisions effective June 30, 2013.]

**.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 the following:

- a. Entities engaged in public practice.
- b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities is
  - i. directly elected by voters of the government or component unit thereof with respect to which professional services are performed;
  - ii. an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
  - iii. 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. Revised March 2013, revisions effective May 31, 2013.]

**.04 Close relative.** A close relative is a parent, sibling, or nondependent child.

[Revised November 2001.]

**.05 Confidential client information.** Confidential client information is any information obtained from the client that is not available to the public. Information that is available to the public includes, but is not limited to, information

- in a book, periodical, newspaper, or similar publication;
- in a client document that has been released by the client to the public or that has otherwise become a matter of public knowledge;
- on publicly accessible websites, databases, online discussion forums, or other electronic media by which members of the public can access the information;
- released or disclosed by the client or other third parties in media interviews, speeches, testimony in a public forum, presentations made at seminars or trade association meetings, panel discussions, earnings press release calls, investor calls, analyst sessions, investor conference presentations, or a similar public forum;
- maintained by, or filed with, regulatory or governmental bodies that is available to the public; or
- obtained from other public sources.

Unless the particular client information is available to the public, such information should be considered confidential client information.

Members are advised that federal, state, or local statutes, rules, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct.

[Effective November 30, 2011.]

**.06 Council.** The council of the AICPA.

[Paragraph renumbered September 2011.]

**.07 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, partner equivalent, or manager who provides nonattest services to the attest client beginning once he or she provides 10 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 10 or more hours of nonattest services to the attest client on a recurring basis;
- d. a partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent 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 in Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 810, *Consolidation*) by any of the individuals or entities described in (a)–(e) or by two or more such individuals or entities if they act together.

[Revised November 2001. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011. Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.]

**[.08] Enterprise.** [Paragraph renumbered September 2011. Revised November 2001.]

**.09 Financial institution.** A financial institution is considered to be an entity that, as part of its normal business operations, makes loans or extends credit to the general public. In addition, for automobile leases addressed under Interpretation 101-5, "Loans From Financial Institution Clients" under Rule 101, *Independence* [sec. 101 par. .07], an entity would be considered a financial institution if it leases automobiles to the general public.

[Revised November 2002 and September 2003. Paragraph renumbered September 2011.]

**.10 Financial statements.** A presentation of financial data, including accompanying notes, if any, intended to communicate an entity's economic resources obligations, or both, 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.

[Paragraph renumbered September 2011.]

**.11 Firm.** A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the council of the AICPA and that is engaged in public practice. *Firm* includes the individual partners thereof except for purposes of applying Rule 101 [sec. 101 par. .01]. For purposes of applying Rule 101, *firm* includes a network firm when the engagement is either a financial statement audit or review engagement, and the audit or review report is not restricted, as defined by professional standards.

[Revised November 2001. Revised May 2010, effective for engagements covering periods beginning on or after July 1, 2011. Paragraph renumbered September 2011. Revised March 2013, revisions effective May 31, 2013.]

**[.12] Holding out.** [Deleted March 2013, effective May 31, 2013.]

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

[Revised November 2001. Paragraph renumbered September 2011.]

**.14 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. Paragraph renumbered September 2011.]

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

[Paragraph renumbered September 2011.]

**.16 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.

[Paragraph renumbered September 2011.]

**.17 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 in FASB ASC 810) the entity or property.

[Revised November 2001. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011.]

**.18 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 previously described.

[Revised November 2001. Paragraph renumbered September 2011.]

**.19 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. Paragraph renumbered September 2011.]

**.20 Manager.** A manager is a professional employee of the firm who has responsibility for the planning and supervision of engagements for specified clients.

[Revised November 2001. Paragraph renumbered September 2011. Revised March 2013, effective May 31, 2013.]

**.21 Member.** A member, associate member, or international associate of the AICPA.

[Paragraph renumbered September 2011.]

**.22 Member in business.** A member employed or engaged on a contractual or volunteer basis in an executive, a staff, a governance, an advisory, or



an administrative capacity in such areas as industry, the public sector, education, the not-for-profit sector, or regulatory or professional bodies. This does not include a member while engaged in public practice.

[Effective November 30, 2011. Revised March 2013, effective May 31, 2013.]

**.23 Network.** For purposes of Interpretation No. 101-17, "Networks and network firms," of Rule 101 [sec. 101 par. .19], a network is an association of entities that includes one or more firms that (a) cooperate for the purpose of enhancing the firms' capabilities to provide professional services and (b) share one or more of the following characteristics:

1. The use of a common brand name (including common initials) as part of the firm name
2. Common control (as defined in FASB ASC 810) among the firms through ownership, management, or other means
3. Profits or costs, excluding the following:
  - a. Costs of operating the association
  - b. Costs of developing audit methodologies, manuals, and training courses
  - c. Other costs that are immaterial to the firm
4. Common business strategy that involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the association's strategy and are held accountable for performance pursuant to that strategy
5. Significant part of professional resources
6. Common quality control policies and procedures that firms are required to implement and that are monitored by the association

A network may comprise a subset of entities within an association if only that subset of entities cooperates and shares one or more of the characteristics set forth in the preceding list.

[Paragraph added May 2010, effective for engagements covering periods beginning on or after July 1, 2011. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011.]

**.24 Network firm.** A network firm is a firm or other entity that belongs to a network, as defined in paragraph .23. This includes any entity (including another firm) that the network firm, by itself or through one or more of its owners, controls (as defined in FASB ASC 810), is controlled by, or is under common control with.

[Paragraph added May 2010, effective for engagements covering periods beginning on or after July 1, 2011. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011.]

**.25 Normal lending procedures, terms, and requirements.** Normal lending procedures, terms, and requirements relating to a covered member's loan from a financial institution are defined as lending procedures, terms, and requirements that are reasonably comparable with those relating to loans of a similar character committed to other borrowers during the period in which the loan to the covered member is committed. Accordingly, in making such comparison and in evaluating whether a loan was made under normal lending procedures, terms, and requirements, the covered member should consider all the circumstances under which the loan was granted, including the following:

- a. The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member.
- b. Repayment terms.
- c. Interest rate, including "points."
- d. Closing costs.
- e. General availability of such loans to the public.

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.

[Revised November 2002. Paragraph renumbered May 2010. Paragraph renumbered September 2011.]

**.26 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. Paragraph renumbered May 2010. Paragraph renumbered September 2011.]

**.27 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. Paragraph renumbered May 2010. Paragraph renumbered September 2011.]

**.28 Partner equivalent.** A *partner equivalent* is a professional employee who is not a partner of the firm as defined in paragraph .27, but who

- a. has the authority to bind the firm to conduct an attest engagement without partner approval (for example, the professional employee has the authority to sign or affix the firm's name to an attest engagement letter or contract to conduct an attest engagement without partner approval); or
- b. has the ultimate responsibility for the conduct of an attest engagement, including the authority to sign or affix the firm's name to an attest report or issue, or authorize others to issue, an attest report on behalf of the firm without partner approval.

Firms may use different titles to refer to professional employees with this authority, although a title is not determinative of a partner equivalent. For purposes of this definition, partner approval does not include any partner approvals that are part of the firm's normal approval and quality control review procedures applicable to a partner.

This definition is solely for the purpose of applying Rule 101 [sec. 101 par. .01] and its interpretations and rulings and should not be used or relied upon in any other context, including the determination of whether the partner equivalent is an owner of the firm.

[Paragraph added March 2013, effective for engagements covering periods beginning on or after December 15, 2014.]

**.29 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. Paragraph renumbered May 2010. Paragraph renumbered September 2011. Paragraph renumbered March 2013.]

**.30 Public practice.** Public practice consists of the performance of professional services for a client by a member or a member's firm.

[Paragraph renumbered May 2010. Revised June 2009. Paragraph renumbered September 2011. Revised and renumbered March 2013, effective May 31, 2013.]

**.31 Professional services.** Professional services include all services performed by a member for a client, an employer, or on a volunteer basis, requiring accountancy or related skills, including but not limited to, accounting, audit and other attest services, tax, bookkeeping, management consulting, financial management, corporate governance, personal financial planning, business valuation, litigation support, educational, and those services for which standards are promulgated by bodies designated by council.

[Paragraph renumbered May 2010. Paragraph renumbered September 2011. Revised and renumbered March 2013, effective May 31, 2013.]

**.32 Significant influence.** The term *significant influence* is as defined in FASB ASC 323-10-15.

[Revised November 2001 and June 2009. Paragraph renumbered May 2010. Paragraph renumbered September 2011. Paragraph renumbered March 2013.]

**.33 Those charged with governance.** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

When an interpretation requires communicating with those charged with governance, the member should determine the appropriate person(s) within the entity's governance structure with whom to communicate, based on the nature and importance of the particular circumstances and matter to be communicated. If the member communicates with a subgroup of those charged with governance (for example, an audit committee or an individual), the member should determine whether communication with all of those charged with governance is also necessary, so that they are adequately informed.

[Paragraph added April 2014, effective April 30, 2014.]



## ET Section 100

## INDEPENDENCE, INTEGRITY, AND OBJECTIVITY

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## ET Section 100-1

# *Conceptual Framework for AICPA Independence Standards*

### Introduction

**.01** This conceptual framework describes the risk-based approach to analyzing independence matters that is used by the Professional Ethics Executive Committee (PEEC) of the AICPA when it develops independence standards. Under that approach, a member's relationship with a client is evaluated to determine whether it poses an unacceptable risk to the member's independence. Risk is unacceptable if the relationship would compromise (or would be perceived as compromising by an informed third party having knowledge of all relevant information) the member's professional judgment when rendering an attest service to the client. Key to that evaluation is identifying and assessing the extent to which a threat to the member's independence exists and, if it does, whether it would be reasonable to expect that the threat would compromise the member's professional judgment and, if so, whether it can be effectively mitigated or eliminated. Under the risk-based approach, steps are taken to prevent circumstances that threaten independence from compromising the professional judgments required in the performance of an attest engagement.

**.02** Professional standards of the AICPA require independence for all attest engagements. The PEEC bases its independence interpretations and rulings under section 100 on the concepts in this framework. However, in certain circumstances the PEEC has determined that it is appropriate to prohibit or restrict certain relationships notwithstanding the fact that the risk may be at an acceptable level. For example, the PEEC has determined that a covered member should not own even an immaterial direct financial interest in an attest client.

**.03** Because this conceptual framework describes the concepts upon which the AICPA's independence interpretations and rulings are based, it may assist AICPA members and others in understanding those interpretations and rulings. In addition, this conceptual framework should be used by members when making decisions on independence matters that are not explicitly addressed by the Code of Professional Conduct. Under no circumstances, however, may the framework be used to overcome prohibitions or requirements contained in the independence interpretations and rulings.

**.04** The risk-based approach entails evaluating the risk that the member would not be independent or would be perceived by a reasonable and informed third party having knowledge of all relevant information as not being independent. That risk must be reduced to an acceptable level to conclude that a member is independent under the concepts in this framework. Risk is at an acceptable level when threats are at an acceptable level, either because of the types of threats and their potential effect, or because safeguards have sufficiently mitigated or eliminated the threats. Threats are at an acceptable level when it is not reasonable to expect that the threat would compromise professional judgment.

**.05** The risk-based approach involves the following steps.

- a. Identifying and evaluating threats to independence—Identify and evaluate threats, both individually and in the aggregate, because threats can have a cumulative effect on a member's independence. Where threats are identified but, due to the types of threats and their potential effects, such threats are considered to be at an acceptable level (that is, it is not reasonable to expect that the threats would compromise professional judgment), the consideration of safeguards is not required. If identified threats are not considered to be at an acceptable level, safeguards should be considered as described in paragraph .05b.
- b. Determining whether safeguards already eliminate or sufficiently mitigate identified threats and whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards—Different safeguards can mitigate or eliminate different types of threats, and one safeguard can mitigate or eliminate several types of threats simultaneously. When threats are sufficiently mitigated by safeguards, the threats' potential to compromise professional judgment is reduced to an acceptable level. A threat has been sufficiently mitigated by safeguards if, after application of the safeguards, it is not reasonable to expect that the threat would compromise professional judgment.<sup>1</sup>
- c. If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

## Definitions

.06 *Independence* is defined as:

- a. *Independence of mind*—The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.
- b. *Independence in appearance*—The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards<sup>2</sup> applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.

.07 This definition reflects the longstanding professional requirement that members who provide services to entities for which independence is required be independent both in fact and in appearance.<sup>3</sup> The state of mind of a member who is independent "in fact" assists the member in performing an attest engagement in an objective manner. Accordingly, independence of mind reflects the longstanding requirement that members be independent in fact.

.08 This definition is used as part of the risk-based approach to analyze independence. Because the risk-based approach requires judgment, the definition should not be interpreted as an absolute. For example, the phrase "without

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<sup>1</sup> In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented as required under "Other Considerations" of Interpretation 101-1, *Interpretation of Rule 101* [section 101.02].

<sup>2</sup> The term *safeguards* is defined in paragraph .20.

<sup>3</sup> Section 55, *Article IV—Objectivity and Independence*, states, "A member in public practice should be independent in fact and appearance when providing auditing and other attestation services."

being affected by influences that compromise professional judgment" is not intended to convey that the member must be free of any and all influences that might compromise objective judgment. Instead, a determination must be made about whether such influences, if present, create an unacceptable risk that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement, or would be perceived as not being able to do so by a reasonable and informed third party that has knowledge of all relevant information.

**.09 *Impair***—For purposes of this framework, *impair* means to effectively extinguish (independence). When a member's independence is impaired, the member is not independent.

**.10 *Threats***—Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether it would be reasonable to expect that the threat would compromise the member's professional judgment and, if so, the specific safeguards applied to reduce or eliminate the threat, and the effectiveness of those safeguards as described in paragraph .21.

**.11** Threats might not involve violations of existing interpretations or rulings. For example, the circumstance described in paragraph .18*b* of this framework is permissible in limited instances under current AICPA independence interpretations and rulings.

**.12** Many different circumstances (or combinations of circumstances) can create threats to independence. It is impossible to identify every situation that creates a threat. However, seven broad categories of threats should always be evaluated when threats to independence are being identified and assessed. They are self-review, advocacy, adverse interest, familiarity, undue influence, financial self-interest, and management participation threats. The following paragraphs define and provide examples, which are not all-inclusive, of each of these threat categories. Some of these examples are the subject of independence interpretations and rulings contained in the Code of Professional Conduct.

**.13 *Self-review threat***—Members reviewing as part of an attest engagement evidence that results from their own, or their firm's, nonattest work such as, preparing source documents used to generate the client's financial statements

**.14 *Advocacy threat***—Actions promoting an attest client's interests or position.<sup>4</sup>

- a. Promoting the client's securities as part of an initial public offering
- b. Representing a client in U.S. tax court

**.15 *Adverse interest threat***—Actions or interests between the member and the client that are in opposition, such as, commencing, or the expressed intention to commence, litigation by either the client or the member against the other.

**.16 *Familiarity threat***—Members having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client.

- a. A member of the attest engagement team whose spouse is in a key position at the client, such as the client's CEO

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<sup>4</sup> This threat does not arise from testifying as a fact witness or defending the results of a professional service that the member performed for the client.

- b. A partner or partner equivalent of the firm who has provided the client with attest services for a prolonged period
- c. A member who performs insufficient audit procedures when reviewing the results of a nonattest service because the service was performed by the member's firm
- d. A member of the firm having recently been a director or an officer of the client
- e. A member of the attest engagement team whose close friend is in a key position at the client

**.17 Undue influence threat**—Attempts by an attest client's management or other interested parties to coerce the member or exercise excessive influence over the member.

- a. A threat to replace the member or the member's firm over a disagreement with client management on the application of an accounting principle
- b. Pressure from the client to reduce necessary audit procedures for the purpose of reducing audit fees
- c. A gift from the client to the member that is other than clearly insignificant to the member

**.18 Financial self-interest threat**—Potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client.

- a. Having a direct financial interest or material indirect financial interest in the client
- b. Having a loan from the client, from an officer or director of the client, or from an individual who owns 10 percent or more of the client's outstanding equity securities
- c. Excessive reliance on revenue from a single attest client
- d. Having a material joint venture or other material joint business arrangement with the client

**.19 Management participation threat**—Taking on the role of client management or otherwise performing management functions on behalf of an attest client.

- a. Serving as an officer or director of the client
- b. Establishing and maintaining internal controls for the client
- c. Hiring, supervising, or terminating the client's employees

**.20 Safeguards**—Controls that eliminate or reduce threats to independence. Safeguards range from partial to complete prohibitions of the threatening circumstance to procedures that counteract the potential influence of a threat. The nature and extent of the safeguards to be applied depend on many factors, including the size of the firm and whether the client is a public interest entity. To be effective, safeguards should eliminate or reduce the threat to an acceptable level.

Solely for the purpose of this conceptual framework, the following entities are considered to be public interest entities: (a) all listed entities<sup>5</sup> and (b) any entity for which an audit is required by regulation or legislation to be conducted in

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<sup>5</sup> Including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body. [Footnote revised September 2011, effective November 30, 2011.]

compliance with the same independence requirements that apply to an audit of listed entities (for example, requirements of the Securities and Exchange Commission, the Public Company Accounting Oversight Board, or other similar regulators or standard setters).<sup>6,7</sup>

**.21** The effectiveness of a safeguard depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of threats
- c. Whether the safeguard is suitably designed to meet its objectives
- d. The party or parties that will be subject to the safeguard
- e. How the safeguard is applied
- f. The consistency with which the safeguard is applied
- g. Who applies the safeguard

**.22** There are three broad categories of safeguards. The relative importance of a safeguard depends on its appropriateness in light of the facts and circumstances.

- a. Safeguards created by the profession, legislation, or regulation
- b. Safeguards implemented by the attest client
- c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements

**.23** Examples of various safeguards within each category are presented in the following paragraphs. The examples are not intended to be all-inclusive and, conversely, the examples of safeguards implemented by the attest client and within the firm's own systems and procedures may not all be present in each instance. In addition, threats may be sufficiently mitigated through the application of other safeguards not specifically identified herein.

**.24** *Examples of safeguards created by the profession, legislation, or regulation*

- a. Education and training requirements on independence and ethics rules for new professionals
- b. Continuing education requirements on independence and ethics
- c. Professional standards and monitoring and disciplinary processes
- d. External review of a firm's quality control system
- e. Legislation governing the independence requirements of the firm
- f. Competency and experience requirements for professional licensure

**.25** *Examples of safeguards implemented by the attest client that would operate in combination with other safeguards*

- a. The attest client has personnel with suitable skill, knowledge, and/or experience who make managerial decisions with respect to the delivery of nonattest services by the member to the attest client

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<sup>6</sup> Members may wish to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered may include (a) the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders; (b) size; and (c) number of employees. [Footnote added September 2011, effective November 30, 2011.]

<sup>7</sup> Members should refer to the independence regulations of authoritative regulatory bodies when a member performs attest services and is required to be independent of the client under such regulations. [Footnote added September 2011, effective November 30, 2011.]

- b. A tone at the top that emphasizes the attest client's commitment to fair financial reporting
- c. Policies and procedures that are designed to achieve fair financial reporting
- d. A governance structure, such as an active audit committee, that is designed to ensure appropriate decision making, oversight, and communications regarding a firm's services
- e. Policies that dictate the types of services that the entity can hire the audit firm to provide without causing the firm's independence to be considered impaired

**.26** *Examples of safeguards implemented by the firm*

- a. Firm leadership that stresses the importance of independence and the expectation that members of attest engagement teams will act in the public interest
- b. Policies and procedures that are designed to implement and monitor quality control in attest engagements
- c. Documented independence policies regarding the identification of threats to independence, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate the threats or reduce them to an acceptable level
- d. Internal policies and procedures that are designed to monitor compliance with the firm's independence policies and procedures
- e. Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and attest clients
- f. The use of different partners, partner equivalents, and engagement teams that have separate reporting lines in the delivery of permitted nonattest services to an attest client, particularly when the separation between reporting lines is significant
- g. Training on, and timely communication of, a firm's policies and procedures, and any changes to them, for all partners and professional staff
- h. Policies and procedures that are designed to monitor the firm's, partner's, or partner equivalent's reliance on revenue from a single client and, if necessary, cause action to be taken to address excessive reliance
- i. Designating someone from senior management as the person who is responsible for overseeing the adequate functioning of the firm's quality control system
- j. A means of informing partners and professional staff of attest clients and related entities from which they must be independent
- k. A disciplinary mechanism that is designed to promote compliance with policies and procedures
- l. Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution
- m. Policies and procedures relating to independence communications with audit committees or others charged with client governance
- n. Discussing independence issues with the audit committee or others responsible for the client's governance



- o.* Disclosures to the audit committee (or others responsible for the client's governance) regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged
- p.* The involvement of another professional accountant who (i) reviews the work that is done for an attest client or (ii) otherwise advises the attest engagement team (This individual could be someone from outside the firm or someone from within the firm who is not otherwise associated with the attest engagement.)
- q.* Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant
- r.* Rotation of senior personnel who are part of the attest engagement team
- s.* Policies and procedures that are designed to ensure that members of the attest engagement team do not make or assume responsibility for management decisions for the attest client
- t.* The involvement of another firm to perform part of the attest engagement
- u.* The involvement of another firm to reperform a nonattest service to the extent necessary to enable it to take responsibility for that service
- v.* The removal of an individual from an attest engagement team when that individual's financial interests or relationships pose a threat to independence
- w.* A consultation function that is staffed with experts in accounting, auditing, independence, and reporting matters who can help attest engagement teams (i) assess issues when guidance is unclear or when the issues are highly technical or require a great deal of judgment and (ii) resist undue pressure from a client when the engagement team disagrees with the client about such issues
- x.* Client acceptance and continuation policies that are designed to prevent association with clients that pose an unacceptable threat to the member's independence
- y.* Policies that preclude audit partners or partner equivalents from being directly compensated for selling nonattest services to the audit client

[Issued April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised September 2011, effective November 30, 2011. Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.]

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## ET Section 101

### *Independence*

**.01 Rule 101—Independence** A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by council.

[As adopted January 12, 1988.]

#### **Interpretations under Rule 101—Independence**

*In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board and the U.S. Securities and Exchange Commission (SEC) if the member's report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member's report will be filed with the DOL, the Government Accountability Office (GAO) if law, regulation, agreement, policy or contract requires the member's report to be filed under GAO regulations, and any organization that issues or enforces standards of independence that would apply to the member's engagement. Such organizations may have independence requirements or rulings that differ from (for example, may be more restrictive than) those of the AICPA.*

**.02 101-1—Interpretation of Rule 101** 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 and
    - (i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or
    - (ii) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
    - (iii) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.
  3. Had a **joint closely held investment** that was material to the covered member.
  4. Except as specifically permitted in Interpretation No. 101-5, "Loans From Financial Institution Clients and Related Terminology" [sec. 101 par. .07], had any **loan** to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

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\* Terms shown in **boldface** type upon first usage in this interpretation are defined in section 92, *Definitions*. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

- 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 5 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 firm, or 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 No. 101-1, "Interpretation of Rule 101" [sec. 101 par. .02(C)], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under Rule 101 [sec. 101 par. .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 a Client or Otherwise Associated With a Client**

A firm's independence would be impaired if a covered member who was formerly<sup>1</sup> (a) employed by a client or (b) 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

- a. fails to disassociate himself or herself from the client prior to becoming a covered member. Disassociation includes the following:
  - i. Ceasing to participate in all employee health and welfare plans sponsored by the client, unless the client is legally required to allow the covered member to participate in the plan (for example, Consolidated Omnibus Budget Reconciliation Act (COBRA)) and the covered member pays 100 percent of his or her portion of the cost of participation on a current basis.
  - ii. Ceasing to participate in all other employee benefit plans by liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, share-based compensation arrangements,<sup>2</sup> deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan.<sup>3</sup>

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<sup>1</sup> This provision applies once the individual has terminated his or her relationship with the client and is no longer employed by, or otherwise associated with, the client. See item (C) of Interpretation No. 101-1, "Interpretation of Rule 101" [par. .02], for matters involving a partner or professional employee who is simultaneously employed by, or otherwise associated with, the client and the firm. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

<sup>2</sup> As defined in the Financial Accounting Standards Board *Accounting Standards Codification* glossary under the term *share-based payment arrangements*. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

<sup>3</sup> When the member is a former employee of a governmental unit that is one of the sponsors of an employee benefit plan, the member may continue to participate in the governmental plan if

(continued)

When the covered member does not participate on the attest engagement team or is not in a position to influence the attest engagement, he or she is not required to liquidate or transfer any vested benefits if such an action is not permitted under the terms of the plan or if a penalty<sup>4</sup> significant to the benefits is imposed upon such liquidation or transfer.

- iii. Disposing of any direct or material indirect financial interests in the client.
  - iv. Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under Interpretation No. 101-5 [par. .07].
  - v. Assessing other relationships with the client to determine if such relationships create threats to independence that would require the application of safeguards to reduce the threats to an acceptable level.
- b. participates on the attest engagement team or is 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.

### **Effective Date**

The revisions to the section "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client" of Interpretation No. 101-1 [par. .02] will be effective on June 1, 2011. Early application is permitted.

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

A covered member's immediate family is subject to Rule 101 [par. .01] and its interpretations and rulings. When materiality of a financial interest is identified as a factor affecting independence in these interpretations and rulings, the immediate family member and the covered member's interests should be combined.

The following exceptions address situations in which independence will not be considered impaired. Notwithstanding the following exceptions, the independence requirement in Interpretation No. 101-1 [par. .02(B)] applies.

### ***Permitted Employment***

An individual in a covered member's immediate family may be employed by an attest client in a position other than a key position.

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*(footnote continued)*

his or her current employer is also one of the sponsors of the plan. In such circumstances, a covered member's participation in the plan will not impair independence, provided that the plan is offered to all employees in comparable employment positions and the covered member has no influence or control over the investment strategy, benefits, or other management activities associated with the plan and is required to continue his or her participation in the plan as a condition of employment. See Ethics Ruling No. 107, "Participation in Health and Welfare Plan Sponsored by Client," of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .214–.215], for further information. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>4</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. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

***Employee Benefit Plans Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans***

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a plan that is an attest client or that is sponsored by an attest client, other than a client's share-based compensation arrangement or nonqualified deferred compensation plan, provided that

- a. the plan is offered to all employees in comparable employment positions;
- b. the immediate family member does not serve in a position of governance (for example, board of trustees) for the plan; and
- c. the immediate family member does not have the ability to supervise or participate in the plan's investment decisions or in the selection of the investment options that will be made available to plan participants.

An immediate family member of a covered member may hold a direct or material indirect financial interest in an attest client through participation in a plan,<sup>5</sup> provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement;
2. such investment is an unavoidable consequence<sup>6</sup> of such participation; and
3. in the event that a plan option to invest in a nonattest client becomes available, the immediate family member selects such option and disposes of any direct or material indirect financial interests in the attest client as soon as practicable but no later than 30 days after such option becomes available.<sup>7</sup>

***Share-Based Compensation Arrangements Resulting in Beneficial Financial Interests<sup>8</sup> in Attest Clients***

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement, such as an employee stock ownership plan (ESOP), that results in his or her holding a beneficial financial interest in an attest client, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement.
2. the immediate family member does not serve as a trustee for the share-based compensation arrangement and does not have the ability to supervise or participate in the selection of the investment options, if any, that are available to participants.

<sup>5</sup> Excluding share-based compensation arrangements and nonqualified deferred compensation plans. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>6</sup> *Unavoidable consequence* means that the immediate family member has no investment options available for selection, including money market or invested cash options, other than in an attest client. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>7</sup> When legal or other similar restrictions exist on a person's right to dispose of a financial interest at a particular time, the person need not dispose of the interest until the restrictions have lapsed. For example, a person does not have to dispose of a financial interest in an attest client if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not fall within this exception. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>8</sup> See Interpretation No. 101-15, "Financial Relationships" [par. .17], for an explanation of when a financial interest is beneficially owned. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

3. when the beneficial financial interests are distributed or the immediate family member has the right to dispose of the shares, the immediate family member
  - a. disposes of the shares as soon as practicable but no later than 30 days after he or she has the right to dispose of the shares or
  - b. exercises his or her put option to require the employer to repurchase the beneficial financial interests as soon as permitted by the terms of the share-based compensation arrangement.<sup>9</sup> Any repurchase obligation due to the immediate family member arising from exercise of the put option that is outstanding for more than 30 days would need to be immaterial to the covered member during the payout period.
4. benefits payable from the share-based compensation arrangement to the immediate family member upon termination of employment, whether through retirement, death, disability, or voluntary or involuntary termination, are funded by investment options other than the employer's financial interests, and any unfunded benefits payable are immaterial to the covered member at all times during the payout period.

*Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client*

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement resulting in a right to acquire shares in an attest client, such as an employee stock option plan<sup>10</sup> or restricted stock rights plan, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement and
2. the immediate family member exercises or forfeits these rights once he or she is vested and the closing market price of the underlying stock equals or exceeds the exercise price for 10 consecutive days (market period). The exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period. In addition, if the immediate family member exercises his or her right to acquire the shares, he or she should dispose of the shares as soon as practicable but no later than 30 days after the exercise date.<sup>11</sup> If the employer repurchases the shares, any employer repurchase obligation due to the immediate family member that is outstanding for more than 30 days would need to be immaterial to the covered member during the payout period.

*Share-Based Compensation Arrangements Based Upon Stock Appreciation*

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement based on the appreciation of an attest client's underlying shares, provided that

1. the share-based compensation arrangement (for example, a stock appreciation or phantom stock plan) does not provide for the issuance of rights to acquire the employer's financial interests.

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<sup>9</sup> See footnote 7. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>10</sup> See Interpretation No. 101-15 [par. .17] for guidance on stock option plans. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>11</sup> See footnote 7. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

2. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement.
3. the immediate family member exercises or forfeits his or her vested compensation rights if the underlying price of the employer's shares equals or exceeds the exercise price for 10 consecutive days (market period). Exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period.
4. any resulting compensation payable to the immediate family member that is outstanding for more than 30 days is immaterial to the covered member during the payout period.

#### ***Nonqualified Deferred Compensation Plan***

As a result of his or her permitted employment at an attest client, an immediate family member of a covered member may participate in a nonqualified deferred compensation plan, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement;
2. the amount of the deferred compensation payable to the immediate family member is funded through life insurance, an annuity, a trust, or similar vehicle and any unfunded portion is immaterial to the covered member; and
3. any funding of the deferred compensation does not include financial interests in the attest client.

#### **Effective Date**

The revisions to the "Application of the Independence Rules to a Covered Member's Immediate Family" section of Interpretation No. 101-1 [par. .02] will be effective on June 1, 2011. Early application is permitted.

#### **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) the individual knows or has reason to believe was material to the close relative 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 or partner equivalent in the office in which the lead attest engagement partner or partner equivalent 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) the individual, partner, or partner equivalent knows or has reason to believe was material to the close relative 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 existed as of November 2001, will not be deemed to impair independence provided such relationships were permitted under preexisting requirements of Rule 101 [sec. 101 par. .01], and its interpretations and rulings.

Employment relationships of a partner equivalent's immediate family and close relatives with an existing attest client that impair independence under this interpretation and existed as of May 31, 2013, will not be deemed to impair independence provided such employment relationships were permitted under preexisting requirements of Rule 101 [sec. 101 par. .01], and its interpretations and rulings.

### Other Considerations<sup>§</sup>

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. In the absence of an independence interpretation or ruling under Rule 101, *Independence* [sec. 101 par. .01] that addresses a particular circumstance, a member should evaluate whether that circumstance 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. When making that evaluation, members should refer to the risk-based approach described in the *Conceptual Framework for AICPA Independence Standards* [see section 100-1]. If the threats to independence are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented.<sup>12</sup>

[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. Revised, effective July 31, 2002, by the Professional Ethics Executive Committee. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee. Revised, April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, August 2009, effective October 31, 2009, by the Professional Ethics Executive Committee. Revised, March 2010, effective June 1, 2011, by the Professional Ethics Executive

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<sup>§</sup> In April 2006, the Professional Ethics Executive Committee (PEEC) of the AICPA issued the *Conceptual Framework for AICPA Independence Standards (Conceptual Framework)* [section 100-1], which describes the risk-based approach to analyzing independence matters that is used by PEEC when it develops independence standards. Consequently, this interpretation has been revised in the "Other Considerations" section to reflect the issuance of the *Conceptual Framework*. Because the *Conceptual Framework* [section 100-1] is effective April 30, 2007, with earlier application encouraged, the revisions made in the "Other Considerations" section of this interpretation are also effective April 30, 2007, with earlier application encouraged.

<sup>12</sup> A failure to prepare the required documentation would be considered a violation of Rule 202, *Compliance With Standards* [sec. 202 par. .01], of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

Committee. Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.]

[.03] [101-1] [Formerly paragraph .02 renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly Interpretation No. 101-1, renumbered as 101-4 and moved to paragraph .06, April 1992.]

**.04 101-2—Employment or association with attest clients.** A firm's independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all the following conditions are met:

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may also be adjusted for inflation and interest may be paid on amounts due.
2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.
3. The former partner or professional employee does not participate or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:
  - The individual provides consultation to the firm.
  - The firm provides the individual with an office and related amenities (for example, secretarial and telephone services).
  - The individual's name is included in the firm's office directory.
  - The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.
4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.
5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.
6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

Responsible members within the firm should implement procedures for compliance with the preceding conditions when firm professionals are employed or associated with attest clients.

With respect to conditions 4, 5, and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the positions he or she held at the firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure.<sup>13</sup>

### **Considering Employment or Association With the Client**

When a member of the attest engagement team or an individual in a position to influence the attest engagement intends to seek or discuss potential employment or association with an attest client, or is in receipt of a specific offer of employment from an attest client, independence will be impaired with respect to the client unless the person promptly reports such consideration or offer to an appropriate person in the firm, and removes himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought. When a covered member becomes aware that a member of the attest engagement team or an individual in a position to influence the attest engagement is considering employment or association with a client, the covered member should notify an appropriate person in the firm.

The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under Rule 102 [sec. 102 par. .01]. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and the individual involved.

[Replaces previous Interpretation No. 101-2, *Retired Partners and Firm Independence*, August, 1989, effective August 31, 1989. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

**.05 101-3—Nonattest Services.** Before a member or his or her firm (member) performs nonattest services (for example, tax or consulting services) for an attest client,<sup>14</sup> the member should determine that the requirements described in this interpretation have been met. In cases where the requirements of this interpretation have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired, except as noted in the following paragraph.

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<sup>13</sup> An inadvertent and isolated failure to meet conditions 4, 5, and 6 would not impair independence provided that the required procedures are performed promptly upon discovery of the failure to do so, and all other provisions of the interpretation are met. [Footnote added, effective April 30, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>14</sup> A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 19, *Compilation and Review Engagements* [paragraph .21 of AR section 80]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010. Footnote revised March 2013.]

A member's independence would not be impaired if the member performed nonattest services that would have impaired independence during the period covered by the financial statements, provided that all the following conditions exist:

- a. The nonattest services were provided prior to the period of the professional engagement.
- b. The nonattest services related to periods prior to the period covered by the financial statements.
- c. The financial statements for the period to which the nonattest services relate were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm).

### **Cumulative Effect on Independence When Providing Nonattest Services**

This interpretation includes various examples of nonattest services that individually would not impair independence because the safeguards contained in the general requirements of this interpretation reduce the self-review and management participation threats to an acceptable level. However, performing multiple nonattest services can increase the significance of these threats as well as other threats to independence.

Before agreeing to perform nonattest services, the member should evaluate whether the performance of multiple nonattest services in the aggregate creates a significant threat to the member's independence that cannot be reduced to an acceptable level by the application of the safeguards contained in the general requirements of this interpretation.

In situations where a member determines that threats are not at an acceptable level, safeguards in addition to the general requirements of this interpretation should be applied to eliminate the threats or reduce them to an acceptable level. If no safeguards are available to eliminate or reduce the threats to an acceptable level, independence would be impaired.

For purposes of this interpretation, the member is not required to consider the possible threats created due to the provision of nonattest services by other network firms within the member's firm's network.

[This section, "Cumulative Effect on Independence When Providing Nonattest Services," is effective for engagements covering periods beginning on or after December 15, 2014.]

### **Activities Related to Attest Services**

Performing attest services often involves communication between the member and client management regarding (a) the client's selection and application of accounting standards or policies and financial statement disclosure requirements, (b) the appropriateness of the client's methods used in determining the accounting and financial reporting, (c) adjusting journal entries that the member has prepared or proposed for client management consideration, and (d) the form or content of the financial statements. These communications are considered a normal part of the attest engagement and would not constitute performing a nonattest service subject to this interpretation.

However, the member should exercise judgment in determining whether his or her involvement has become so extensive that it would constitute performing a separate service that would be subject to the interpretation's "General Requirements for Performing Nonattest Services" section. For example, activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the attest engagement and, therefore,

constitute a nonattest service. Such activities would not impair independence provided the requirements of this interpretation are met.

[The revisions to the "Activities Related to Attest Services" section that require activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations to be subject to this interpretation are effective for engagements covering periods beginning on or after December 15, 2014.]

### **Engagements Subject to Independence Rules of Certain Regulatory Bodies**

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

### **General Requirements for Performing Nonattest Services**

1. The member should not assume management responsibilities for the attest client.
2. Before performing nonattest services, the member should determine that the client has agreed to
  - a. Assume all management responsibilities
  - b. Oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or reperform the services.
  - c. Evaluate the adequacy and results of the services performed.
  - d. Accept responsibility for the results of the services.

To avoid assuming management responsibilities when providing nonattest services to the client, the member should be satisfied that management will be able to meet all these criteria, make an informed judgment on the results of the member's nonattest services, and be responsible for making the significant judgments and decisions that are the proper responsibility of management. In cases in which the client is unable or unwilling to assume these responsibilities (for example, the client cannot oversee the nonattest services provided, or is unwilling to carry out such responsibilities due to lack of time or desire), the member's provision of these services would impair independence.

3. Before performing nonattest services, the member should establish and document in writing<sup>15</sup> his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:

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<sup>15</sup> A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202 [sec. 202 par. .01], provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote revised, January 2005, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- a. Objectives of the engagement
- b. Services to be performed
- c. Client's acceptance of its responsibilities
- d. Member's responsibilities
- e. Any limitations of the engagement

The documentation requirement does not apply to nonattest services performed prior to the client becoming an attest client.<sup>16</sup>

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

### Management Responsibilities

If a member were to assume a management responsibility for an attest client, the management participation threat created would be so significant that no safeguards could reduce the threat to an acceptable level. It is not possible to specify every activity that is a management responsibility. However, management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered a management responsibility and would, therefore, impair independence if performed for an attest client include

- setting policies or strategic direction for the client.
- directing or accepting responsibility for the actions of the client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards.
- authorizing, executing or consummating transactions or otherwise exercising authority on behalf of a client or having the authority to do so.
- preparing source documents<sup>17</sup> in electronic or other form evidencing the occurrence of a transaction.
- having custody of client assets.
- deciding which recommendations of the member or other third parties to implement or prioritize.

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<sup>16</sup> However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client. [Footnote added, effective October 31, 2004, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>17</sup> Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- reporting to those in charge of governance on behalf of management.  
pagebreak
- serving as a client's stock transfer or escrow agent, registrar, general counsel, or its equivalent.
- accepting responsibility for the management of a client's project.
- accepting responsibility for the preparation and fair presentation of the client's financial statements in accordance with the applicable financial reporting framework.
- accepting responsibility for designing, implementing, or maintaining internal control.<sup>[18]</sup>
- performing ongoing evaluations of the client's internal control as part of its monitoring activities.

### **Specific Examples of Nonattest Services**

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

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<sup>[18]</sup> [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010. Footnote deleted, effective August 31, 2012, by the Professional Ethics Executive Committee.]

**Impact on Independence of Performance of Nonattest Services**

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Bookkeeping	<ul style="list-style-type: none"> <li>• Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger.</li> <li>• Prepare financial statements based on information in the trial balance.</li> <li>• Post client-approved entries to a client's trial balance.</li> <li>• Prepare a reconciliation (for example, bank, accounts receivable, and so forth) that identifies reconciling items for the client's evaluation.</li> <li>• Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.</li> <li>• Authorize or approve transactions.</li> <li>• Prepare source documents.</li> <li>• Make changes to source documents without client approval.</li> </ul>
Nontax disbursement	<ul style="list-style-type: none"> <li>• Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.</li> <li>• Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.<sup>[19]</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.</li> <li>• Accept responsibility to sign or cosign client checks, even if only in emergency situations.</li> <li>• Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client.</li> <li>• Approve vendor invoices for payment</li> </ul>

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<sup>[19]</sup> [Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September, 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote deleted by the Professional Ethics Executive Committee, February 2007. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]



### Impact on Independence of Performance of Nonattest Services—*continued*

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Benefit plan administration <sup>20</sup>	<ul style="list-style-type: none"> <li>• Communicate summary plan data to plan trustee.</li> <li>• Advise client management regarding the application or impact of provisions of the plan document.</li> <li>• Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member's electronic medium, such as an interactive voice response system or Internet connection or other media.</li> <li>• Prepare account valuations for plan participants using data collected through the member's electronic or other media.</li> <li>• Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other medium.</li> </ul>	<ul style="list-style-type: none"> <li>• Make policy decisions on behalf of client management.</li> <li>• When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence.</li> <li>• Make disbursements on behalf of the plan.</li> <li>• Have custody of assets of a plan.</li> <li>• Serve a plan as a fiduciary as defined by ERISA.</li> </ul>
Investment—advisory or management	<ul style="list-style-type: none"> <li>• Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, etc.</li> <li>• Perform recordkeeping and reporting of client's portfolio balances including providing a comparative analysis of the client's investments to third-party benchmarks.</li> <li>• Review the manner in which a client's portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client's investment policy statement; (2) meeting the client's investment objectives; and (3) conforming to the client's stated investment styles.</li> <li>• Transmit a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.</li> </ul>	<ul style="list-style-type: none"> <li>• Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments.</li> <li>• Execute a transaction to buy or sell a client's investment.</li> <li>• Have custody of client assets, such as taking temporary possession of securities purchased by a client.</li> </ul>

*(continued)*

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<sup>20</sup> When auditing plans subject to the Employee Retirement Income Security Act, Department of Labor regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

### Impact on Independence of Performance of Nonattest Services—*continued*

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Corporate finance— consulting or advisory	<ul style="list-style-type: none"> <li>• Assist in developing corporate strategies.</li> <li>• Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria.</li> <li>• Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.</li> <li>• Assist in drafting an offering document or memorandum.</li> <li>• Participate in transaction negotiations in an advisory capacity.</li> <li>• Be named as a financial adviser in a client's private placement memoranda or offering documents.</li> </ul>	<ul style="list-style-type: none"> <li>• Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.</li> <li>• Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.</li> <li>• Maintain custody of client securities.</li> </ul>
Executive or employee search	<ul style="list-style-type: none"> <li>• Recommend a position description or candidate specifications.</li> <li>• Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).</li> <li>• Participate in employee hiring or compensation discussions in an advisory capacity.</li> </ul>	<ul style="list-style-type: none"> <li>• Commit the client to employee compensation or benefit arrangements.</li> <li>• Hire or terminate client employees.</li> </ul>
Business risk consulting	<ul style="list-style-type: none"> <li>• Provide assistance in assessing the client's business risks and control processes.</li> <li>• Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.</li> </ul>	<ul style="list-style-type: none"> <li>• Make or approve business risk decisions.</li> <li>• Present business risk considerations to the board or others on behalf of management.</li> </ul>
Information systems—design, installation or integration	<ul style="list-style-type: none"> <li>• Install or integrate a client's financial information system that was not designed or developed by the member (for example, an off-the-shelf accounting package).</li> <li>• Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system.</li> <li>• Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records.</li> <li>• Provide training and instruction to client employees on an information and control system.</li> <li>• Perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings, consistent with management's request.</li> </ul>	<ul style="list-style-type: none"> <li>• Design or develop a client's financial information system.</li> <li>• Make other than insignificant modifications to source code underlying a client's existing financial information system.</li> <li>• Supervise client personnel in the daily operation of a client's information system.</li> <li>• Operate a client's local area network system.</li> </ul>

### Tax Compliance Services

Tax compliance services addressed by this interpretation are preparation of a tax return,<sup>21</sup> transmittal of a tax return and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, and authorized representation of clients in administrative proceedings before a taxing authority.

Preparing a tax return and transmitting the tax return and related tax payment to a taxing authority, in paper or electronic form, would not impair a member's independence provided the member does not have custody or control<sup>22</sup> over the client's funds and the individual designated by the client to oversee the tax services:

- Reviews and approves the tax return and related tax payment; and,
- If required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

However, signing and filing a tax return on behalf of client management would impair independence, unless the member has the legal authority to do so and:

- a. The taxing authority has prescribed procedures in place for a client to permit a member to sign and file a tax return on behalf of the client (for example, Form 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in I.R.S. Form 8879; or
- b. An individual in client management who is authorized to sign and file the client's tax return provides the member with a signed statement that clearly identifies the return being filed and represents that:
  1. Such individual is authorized to sign and file the tax return;
  2. Such individual has reviewed the tax return, including accompanying schedules and statements, and it is true, correct and complete to the best of his or her knowledge and belief; and
  3. Such individual authorizes the member or another named individual in the member's firm to sign and file the tax return on behalf of the client.

Authorized representation of a client in administrative proceedings before a taxing authority would not impair a member's independence provided the member obtains client agreement prior to committing the client to a specific resolution with the taxing authority. However, representing a client in a court<sup>23</sup> to resolve a tax dispute would impair a member's independence.

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<sup>21</sup> For purposes of this interpretation, a tax return includes informational tax forms (for example, estimated tax vouchers, extension forms, and Forms 990, 5500, 1099, and W-2) filed with a taxing authority or other regulatory agencies. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>22</sup> Making electronic tax payments under a taxing authority's specified criteria or remitting a check payable to the taxing authority and signed by the client would not be considered having custody or control over a client's funds. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>23</sup> The term *court* encompasses a tax, district, or federal court of claims, and the equivalent state, local, or foreign forums. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

### Transition

Independence would not be impaired as a result of the more restrictive requirements of the tax compliance services provisions provided such services are pursuant to engagements commenced prior to February 28, 2007, and completed prior to January 1, 2008, and the member complied with all applicable independence interpretations and rulings in effect on February 28, 2007.

### Appraisal, Valuation, and Actuarial Services

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

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

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence.<sup>24</sup> However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

### Forensic Accounting Services

For purposes of this interpretation, forensic accounting services<sup>25</sup> are nonattest services that involve the application of special skills in accounting, auditing, finance, quantitative methods and certain areas of the law, and research, and investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings and consist of:

- Litigation services; and
- Investigative services.

Litigation services recognize the role of the member as an expert or consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of the following services:

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<sup>24</sup> Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>25</sup> The definitions of the specific services identified in this interpretation are solely for purposes of this interpretation and are not intended to be used for any other purpose. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- a. Expert witness services<sup>26</sup> are those litigation services where a member is engaged to render an opinion before a trier of fact as to the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events.

Expert witness services create the appearance that a member is advocating or promoting a client's position.<sup>27</sup> Accordingly, if a member conditionally or unconditionally agrees to provide expert witness testimony for a client,<sup>28</sup> independence would be considered to be impaired.

However, independence would not be considered impaired if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more attest clients of the firm provided that at the outset of the engagement: (1) the member's attest clients constitute less than 20 percent of (i) the members of the group (ii) the voting interests of the group, and (iii) the claim; (2) no attest client within the group is designated as the "lead" plaintiff or defendant of the group; and (3) no attest client has the sole decision-making power to select or approve the expert witness.

While testifying as a fact witness,<sup>29</sup> a member may be questioned by the trier of fact or counsel as to his or her opinions pertaining to matters within the member's area of expertise. Answering such questions would not impair the member's independence.

- b. Litigation consulting services are those litigation services where a member provides advice about the facts, issues, and strategy of a matter. The consultant does not testify as an expert witness before a trier of fact.

The performance of litigation consulting services would not impair independence provided the member complies with the general requirements set forth under this interpretation.<sup>30</sup> However, if the member

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<sup>26</sup> In determining whether the member's services are considered to be expert witness services or fact witness testimony, members should refer to the Federal Rules of Evidence, Article VII, Opinions and Expert Testimony (Rules 701, 702, and 703), and other applicable laws, regulations, and rules. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>27</sup> See advocacy threat as defined in the *Conceptual Framework for AICPA Independence Standards* (section 100-1). However, even though there is an appearance of advocacy, when providing expert witness services, a member must comply with Rule 102, *Integrity and Objectivity*, which requires that a member maintain objectivity and integrity and not subordinate his or her judgment to others. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>28</sup> The client in this case refers to the party to the litigation on whose behalf the member is providing testimony and not to the law firm that engaged the member on the client's behalf. If the law firm that engaged the member on behalf of the client is also an attest client of the member, the member should consider the applicability of Interpretation No. 101-12, "Independence and Cooperative Arrangements with Clients" [par. .14]. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>29</sup> A fact witness is also referred to as a percipient witness or a sensory witness. Fact witness testimony is based on the member's direct knowledge of the facts or events in dispute. A fact witness may have obtained his or her direct knowledge of the facts or events in dispute from the performance of prior professional services for the client. As a fact witness, the member's role is to provide factual testimony to the trier of fact. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>30</sup> For purposes of complying with general requirement 2, the client may designate its attorney to oversee the litigation consulting services. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

subsequently agrees to serve as an expert witness, independence would be considered to be impaired.

- c. Other services are those litigation services where a member serves as a trier of fact, special master, court-appointed expert, or arbitrator (including serving on an arbitration panel), in a matter involving a client. These other services create the appearance that the member is not independent. Accordingly, if a member serves in such a role, independence would be considered to be impaired. However, independence would not be considered impaired if a member serves as a mediator or any similar role in a matter involving a client provided the member is not making any decisions on behalf of the parties, but rather is acting as a facilitator by assisting the parties in reaching their own agreement.<sup>31</sup>

Investigative services include all forensic services not involving actual or threatened litigation such as performing analyses or investigations that may require the same skills as used in litigation services. Such services would not impair independence provided the member complies with the general requirements set forth under this interpretation.

### Transition

Independence would not be impaired as a result of the more restrictive requirements of the forensic accounting services provisions, provided such services are pursuant to engagements commenced prior to February 28, 2007, and the member complied with all applicable independence interpretations and rulings in existence on February 28, 2007.

### Internal Audit Assistance Services

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

Assisting the client in performing financial and operational<sup>32</sup> internal audit activities would impair independence, unless the member takes appropriate steps to be satisfied that the client accepts its responsibility for<sup>[33]</sup> designing, implementing, and maintaining internal control and directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

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<sup>31</sup> However, the member should consider the requirements of Interpretation No. 102-2, "Conflicts of Interests" [sec. 102 par. .03]. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>32</sup> For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>[33]</sup> [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote deleted and subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

Designing, implementing, or maintaining the client's monitoring activities are management responsibilities. Accordingly, independence would be impaired if a member accepts responsibility for performing such activities. *Monitoring activities* are procedures performed to assess whether components of internal control are present and functioning. Monitoring can be done through ongoing evaluations, or separate evaluations, or some combination of the two. Ongoing evaluations are generally defined, routine operations built in to the client's business processes and performed on a real-time basis. Ongoing evaluations, including managerial activities and everyday supervision of employees, monitor the presence and functioning of the components of internal control in the ordinary course of managing the business. A member who performs such activities for a client would be considered to be accepting responsibility for maintaining the client's internal control. Accordingly, the management participation threat created by a member performing ongoing evaluations is so significant that no safeguards could reduce the threat to an acceptable level.

Separate evaluations are conducted periodically and generally not ingrained within the business but can be useful in taking a fresh look at whether internal controls are present and functioning. Such evaluations include observations, inquiries, reviews, and other examinations, as appropriate, to ascertain whether controls are designed, implemented, and conducted. The scope and frequency of separate evaluations is a matter of judgment and vary depending on assessment of risks, effectiveness of ongoing evaluations, and other considerations. Because separate evaluations are not built into the client's business process, separate evaluations generally do not create a significant management participation threat to independence.

Members should refer to the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework*, for additional guidance on monitoring activities and distinguishing between ongoing and separate evaluations.

Members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation threat to independence, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall financial statements of the client, as well as the frequency of the internal audit services. If the threat to independence is considered significant, the member should apply safeguards to eliminate or reduce the threat to an acceptable level. If no safeguards could reduce the threat to an acceptable level, then independence would be impaired.

To reduce the threat of assuming a management responsibility, in addition to the general requirements of this interpretation, the member should be satisfied that client management

- designates an<sup>[34]</sup> individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function.
- determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services.

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<sup>[34]</sup> [Footnote deleted by the Professional Ethics Executive Committee, January 2005. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services.
- evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures.

The member may assist the individual responsible for the internal audit function when performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. The member should also be satisfied that those charged with governance are informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide those charged with governance a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The following are examples of activities (in addition to those listed in the "Management Responsibilities" section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Performing separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the client's business process
- Having client management rely on the member's work as the primary basis for the client's assertions on the design or operating effectiveness of internal controls
- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

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

#### **Attest-Related Services**

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and



analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

When a member performs internal audit services that would not impair independence under this interpretation and is subsequently engaged to perform an attestation engagement to report on management's assertion regarding the effectiveness of its internal control, independence would not be considered impaired, provided the member is satisfied that client management does not rely on the member's work as the primary basis for its assertion.

[The revisions to the "Internal Audit Services" section made in March 2013 are effective for engagements covering periods beginning on or after December 15, 2013. Early implementation is allowed.]

### **Transition**

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

[Formerly paragraph .04, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective May 31, 1999, by the Professional Ethics Executive Committee. Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective December 31, 2003 (except for the documentation requirement, which takes effect for any new engagements that begin after December 31, 2004), with earlier application permitted, by the Professional Ethics Executive Committee. Revised, effective October 31, 2004, by the Professional Ethics Executive Committee. Revised, effective January 27, 2005, by the Professional Ethics Executive Committee. Revised, effective February 28, 2007, by the Professional Ethics Executive Committee. Revised, effective July 31, 2007, by the Professional Ethics Executive Committee. Revised, effective August 31, 2012, by the Professional Ethics Executive Committee. Revised March 2013, revisions effective May 31, 2013 (except for the revisions made to the "Activities Related to Attest Services" and "Internal Audit Services" sections, which are effective as described in the respective sections).]

**.06 101-4—Honorary directorships and trusteeships of not-for-profit organization.** Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be considered to impair independence under Rule 101 [sec. 101 par. .01] provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or she must be identified as an honorary director or honorary trustee. [Formerly paragraph .05, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Renumbered as Interpretation No. 101-4 and moved from

paragraph .03, April, 1992. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

**.07 101-5—Loans from financial institution clients and related terminology [Revised]** Item (A)(4) of Interpretation No. 101-1 of Rule 101 [sec. 101 par. .02] provides that, except as permitted in this interpretation, independence shall be considered to be impaired if a **covered member**<sup>†</sup> has any **loan** to or from a **client**, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests. This interpretation describes the conditions a covered member (or his or her **immediate family**) must meet in order to apply an exception for a "Grandfathered Loan" or "Other Permitted Loan."

### **Grandfathered Loans**

Unsecured loans that are not material to the covered member's net worth, home mortgages,<sup>35</sup> and other secured loans<sup>35</sup> are grandfathered if

1. they were obtained from a **financial institution** under that institution's **normal lending procedures, terms, and requirements**,
2. after becoming a covered member they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement,<sup>36</sup> and
3. they were
  - a. obtained from the financial institution prior to its becoming a client requiring independence; or
  - b. obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or
  - c. obtained prior to February 5, 2001, and met the requirements of previous provisions of this interpretation covering grandfathered loans; or
  - d. obtained between February 5, 2001, and May 31, 2002, and the covered member was in compliance with the applicable independence requirements of the SEC during that period; or
  - e. obtained after May 31, 2002, from a financial institution client requiring independence by a borrower prior to his or her becoming a covered member with respect to that client.

<sup>†</sup> Terms shown in **boldface** type upon first usage in this interpretation are defined in section 92.

<sup>35</sup> The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered member's net worth. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>36</sup> Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.

For purposes of applying the grandfathered loans provision when the covered member is a partner in a partnership

- a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered member who is a partner in the partnership on the basis of their legal liability as a limited or general partner if
  - the covered member's interest in the limited partnership, either individually or combined with the interest of 1 or more covered members, exceeds 50 percent of the total limited partnership interest; or
  - the covered member, either individually or together with one or more covered members, can control (as defined in Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 810, *Consolidation*) the general partnership.
- even if no amount of a partnership loan is ascribed to the covered member(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described subsequently.

### Other Permitted Loans

This interpretation permits only the following new loans and leases to be obtained from a financial institution client for which independence is required. These loans and leases must be obtained under the institution's normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms.

1. Automobile loans and leases collateralized by the automobile
2. Loans fully collateralized by the cash surrender value of an insurance policy
3. Loans fully collateralized by cash deposits at the same financial institution (for example, "passbook loans")
4. Aggregate outstanding balances from credit cards and overdraft reserve accounts that are reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the SEC.

[Revised, November 30, 1987, by the Professional Ethics Executive Committee. Formerly paragraph .06, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References revised to reflect issuance of AICPA 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, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, November 2002, by the Professional Ethics Executive Committee. Revised, September 2003, by the Professional Ethics Executive Committee.

Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

**.08 101-6—The effect of actual or threatened litigation on independence.** In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

*Litigation between client and member*

The relationship between the management of the client and a covered member must be characterized by complete candor and full disclosure regarding all aspects of the client's business operations. In addition, there must be an absence of bias on the part of the covered member so that he or she can exercise professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against a covered member, the covered member and the client's management may be placed in adversarial positions in which the management's willingness to make complete disclosures and the covered member's objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the covered member and the covered member's client or its management are in threatened or actual positions of material adverse interests by reason of threatened or actual litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.
2. The commencement of litigation by the covered member against the present management alleging management fraud or deceit would be considered to impair independence.
3. An expressed intention by the present management to commence litigation against the covered member alleging deficiencies in audit work for the client would be considered to impair independence if the auditor concludes that it is probable that such a claim will be filed.
4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered member's firm<sup>37</sup> or to the client company<sup>37</sup> would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

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<sup>37</sup> Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment. [Footnote renumbered and revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

*Litigation by security holders*

A covered member may also become involved in litigation ("primary litigation") in which the covered member and the client or its management are defendants. Such litigation may arise, for example, when one or more stockholders bring a stockholders' derivative action or a so-called "class action" against the client or its management, its officers, directors, underwriters and covered members under the securities laws. Such primary litigation in itself would not alter fundamental relationships between the client or its management and the covered member and therefore would not be deemed to have an adverse impact on independence. These situations should be examined carefully, however, since the potential for adverse interests may exist if cross-claims are filed against the covered member alleging that the covered member is responsible for any deficiencies or if the covered member alleges fraud or deceit by the present management as a defense. In assessing the extent to which independence may be impaired under these conditions, the covered member should consider the following additional guidelines:

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered member in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered member's firm<sup>38</sup> or to the client.
2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.
3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

*Other third-party litigation*

Another type of third-party litigation against the covered member may be commenced by a lending institution, other creditor, security holder, or insurance company who alleges reliance on financial statements of the client with which the covered member is associated as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may commence litigation (under subrogation rights) against the covered member in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered member and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered member alleges, in his or her defense, fraud, or deceit by the present management.

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<sup>38</sup> See footnote 37. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently revised and renumbered by the revision of Interpretation No. 101-1, March 2010.]

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered member ("the plaintiff client"), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered member's firm<sup>39</sup> or to the plaintiff client.

#### *Effects of impairment of independence*

If the covered member believes that the circumstances would lead a reasonable person having knowledge of the facts to conclude that the actual or intended litigation poses an unacceptable threat to independence, the covered member should either (a) disengage himself or herself, or (b) disclaim an opinion because of lack of independence. Such disengagement may take the form of resignation or cessation of any attest engagement then in progress pending resolution of the issue between the parties.

#### *Termination of impairment*

The conditions giving rise to a lack of independence are generally eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between the covered member and client. The covered member should carefully review the conditions of such resolution to determine that all impairments to the covered member's objectivity have been removed.

[Formerly paragraph .07, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective September 30, 1995, by the Professional Ethics Executive Committee, by deletion of subhead and paragraph and reissuance as ethics ruling No. 100, *Actions Permitted When Independence is Impaired*, under Rule 101. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

**[.09] [101-7]—[Deleted]** [Formerly paragraph .08, renumbered by adoption of the Code of Professional Conduct on January 12, 1988.]

### **.10 101-8—Effect on Independence of Financial Interests in Non-clients Having Investor or Investee Relationships With a Covered Member's Client.**

#### **Introduction**

Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in other rulings [sec. 191 par. .138–.139 and par. .162–.163].

#### **Terminology**

The following specifically identified terms are used in this interpretation as indicated:

1. *Client*. The term *client* means the person or entity with whose financial statements a covered member is associated.
2. *Significant influence*. The term *significant influence* is as defined in FASB ASC 323-10-15.

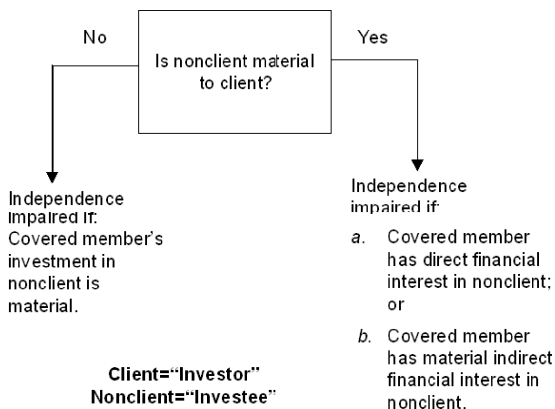
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<sup>39</sup> See footnote 37. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently revised and renumbered by the revision of Interpretation No. 101-1, March 2010.]

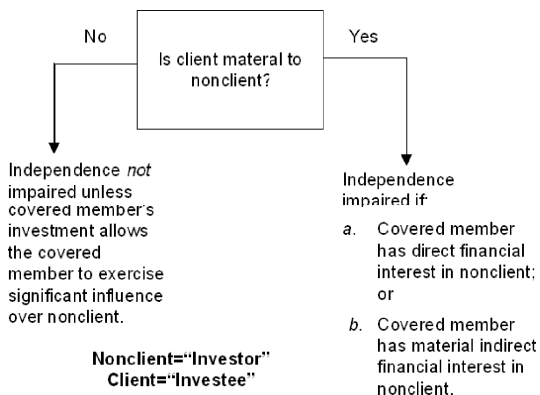
3. *Investor*. The term *investor* means (a) a parent, (b) general partner, or (c) natural person or corporation that has the ability to exercise significant influence.
4. *Investee*. The term *investee* means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

**Interpretation**

When a nonclient investee is material to a client investor, any direct or material indirect financial interest of a covered member in the nonclient investee would be considered to impair independence with respect to the client investor. If the nonclient investee is immaterial to the client investor, a covered member's material investment in the nonclient investee would cause an impairment of independence.



When a client investee is material to a nonclient investor, any direct or material indirect financial interest of a covered member in the nonclient investor would be considered to impair independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a covered member's financial interest in the nonclient investor allows the covered member to exercise significant influence over the actions of the nonclient investor, independence would be considered to be impaired.



Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered member should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.

In general, in brother-sister common control situations, an immaterial financial interest of a covered member in the nonclient investee would not impair independence with respect to the client investee, provided the covered member could not exercise significant influence over the nonclient investor. However, if a covered member's financial interest in a nonclient investee is material, the covered member could be influenced by the nonclient investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered member in the nonclient investor would not impair the independence of the covered member with respect to the client investor, provided that the covered member could not exercise significant influence over the nonclient investor.

If a covered member does not and could not reasonably be expected to have knowledge of the financial interests or relationship described in this interpretation, independence would not be considered to be impaired under this interpretation.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

**[.11] [101-9]—[Deleted]**

**.12 101-10—The effect on independence of relationships with entities included in the governmental financial statements.**<sup>40</sup> For purposes of this interpretation, a financial reporting entity's basic financial statements, issued in conformity with generally accepted accounting principles, include the government-wide financial statements (consisting of the entity's governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures, jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

**Auditor of Financial Reporting Entity**

A covered member issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity,

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<sup>40</sup> Except for a financial reporting entity's basic financial statements, which is defined within the text of this interpretation, certain terminology used throughout the interpretation is specifically defined by the Governmental Accounting Standards Board. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]



as defined in paragraph 1 of this interpretation. However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a member to be independent of that organization.

However, the covered member and his or her immediate family should not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

**Auditor of a Major Fund, Nonmajor Fund, Internal Service Fund, Fiduciary Fund, or Component Unit of the Financial Reporting Entity or Other Entity That Should Be Disclosed in the Notes to the Basic Financial Statements**

A covered member who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, should be independent with respect to those financial statements that the covered member is reporting upon. The covered member is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered member and his or her immediate family should not hold a key position within the primary government. For purposes of this interpretation, a covered member and immediate family member would not be considered employed by the primary government if the exceptions provided for in paragraph .03 of section 92 are met.<sup>[41-42]</sup>

[Formerly paragraph .11, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous Interpretation No. 101-10, "The Effect on Independence of Relationships Prescribed by Rule 101 and its Interpretations With Nonclient Entities Included With a Member's Client in the Financial Statements of a Governmental Reporting Entity," April 1991, effective April 30, 1991. Replaces previous Interpretation No. 101-10, "The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements," January 1996, effective January 31, 1996. Revised, July 2002, to reflect conforming changes necessary

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<sup>[41-42]</sup> [Footnotes deleted by the Professional Ethics Executive Committee, March 2003. Footnotes renumbered by the revision of Interpretation No. 101-2, April 2003. Footnotes subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnotes subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnotes subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnotes subsequently renumbered by the revision of Interpretation No. 101-3, February and July 2007. Footnotes subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

due to the revision of Interpretation No. 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]

**.13 101-11—Modified application of Rule 101 for engagements performed in accordance with Statements on Standards for Attestation Engagements.** Rule 101, *Independence* [sec. 101 par. .01], and its interpretations and rulings apply to all attest engagements. However, the following exceptions apply when performing engagements to issue reports in accordance with Statements on Standards for Attestation Engagements (SSAEs) when independence is required, or the member's compilation report does not disclose a lack of independence:

- Covered members need to be independent with respect to the responsible party(ies).<sup>43</sup> See the following section for specific guidance for agreed-upon procedures (AUP) engagements performed under SSAEs.
- In circumstances in which the individual or entity that engages the member is not the responsible party, covered members need not be independent of that individual or entity. However, consideration should be given to the requirements of Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* [sec. 102 par. .03], with regard to any relationships that may exist with the individual or entity that engages the member to perform these services.
- Nonattest services that would otherwise impair independence under Interpretation No. 101-3 [sec. 101 par. .05] may be provided to the responsible party(ies) when such services do not relate to the specific subject matter<sup>44</sup> of the SSAE engagement, provided that the general requirements of Interpretation No. 101-3 [sec. 101 par. .05] are met.

### AUP Engagements

When performing an AUP engagement under the SSAEs, only the following covered members and their immediate families are required to be independent with respect to the responsible party(ies), in accordance with Rule 101 [sec. 101 par. .01]:

- Individuals participating on the AUP engagement team
- Individuals who directly supervise or manage the AUP engagement partner or partner equivalent

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<sup>43</sup> For purposes of this interpretation, the term *responsible party* is as defined in the Statement on Standards for Attestation Engagements (SSAEs). [Footnote revised September 2011, effective November 30, 2011. Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>44</sup> For purposes of this interpretation, the term *subject matter* is as defined in the SSAEs. [Footnote revised and renumbered September 2011, effective November 2011.]

- Individuals who consult with the attest engagement team regarding technical or industry-related issues specific to the AUP engagement

In addition, independence would be impaired if the firm had a financial relationship covered by item (A) of Interpretation No. 101-1 [sec. 101 par. .02] with the responsible party(ies) that was material to the firm.

Independence will not be impaired if the general requirements of Interpretation No. 101-3 [sec. 101 par. .05] are not met when the member is also providing nonattest services, unless such services relate to the specific subject matter of the AUP engagement.

[Revised, February 2012, effective April 30, 2012. Revised September 2011, effective November 30, 2011. Replaces previous Interpretation No. 101-11, "Independence and Attest Engagements," January 1996, effective January 31, 1996. Revised, effective November 30, 2001, by the Professional Ethics Executive Committee. Revised March 2013, revision effective for engagements covering periods beginning on or after December 15, 2014.]

**.14 101-12—Independence and cooperative arrangements with clients.** Independence will be considered to be impaired if, during the period of a professional engagement, a member or his or her firm had any cooperative arrangement with the client that was material to the member's firm or to the client.

*Cooperative Arrangement*—A cooperative arrangement exists when a member's firm and a client jointly participate in a business activity. The following are examples, which are not all inclusive, of cooperative arrangements:

1. Prime/subcontractor arrangements to provide services or products to a third party
2. Joint ventures to develop or market products or services
3. Arrangements to combine one or more services or products of the firm with one or more services or products of the client and market the package with references to both parties
4. Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the client's products or services, or the client acts as the distributor or marketer of the products or services of the firm

Nevertheless, joint participation with a client in a business activity does not ordinarily constitute a cooperative arrangement when all the following conditions are present:

- a. The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.
- b. The firm assumes no responsibility for the activities or results of the client, and vice versa.
- c. Neither party has the authority to act as the representative or agent of the other party.

In addition, the member's firm should consider the requirements of Rule 302 [sec. 302 par. .01] and Rule 503 [sec. 503 par. .01].

[Effective November 30, 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[.15] [101-13]—[Deleted]

**.16 101-14—The effect of alternative practice structures on the applicability of independence rules.** Because of changes in the manner in which **members**<sup>‡</sup> are structuring their practices, the AICPA's Professional Ethics Executive Committee (PEEC) studied various alternatives to "traditional structures" to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many "nontraditional structures," a substantial (the nonattest) portion of a member's practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled (as defined in FASB ASC 810) by the member. All such structures must comply with applicable laws, regulations, and Rule 505, *Form of Organization and Name* [sec. 505 par. .01]. In complying with laws, regulations, and Rule 505 [sec. 505 par. .01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [sec. 505 par. .01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the "traditional firm" engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and subsequent chart provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

The example APS in this interpretation is one where an existing CPA practice ("Oldfirm") is sold by its owners to another (possibly public) entity ("PublicCo"). PublicCo has subsidiaries or divisions such as a bank, insurance company, or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (for example, tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm ("Newfirm") to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office

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<sup>‡</sup> Terms shown in **boldface** type upon first usage in this interpretation are defined in section 92. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

space, and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

### **APS Independence Rules for Covered Members**

The term **covered member** in an APS includes both employed and leased individuals. The **firm** in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

**Partners** of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

### **APS Independence Rules for Persons and Entities Other Than Covered Members**

As stated previously, the independence rules normally extend only to those persons and entities included in the definition of *covered member*. This normally would include only the "traditional firm" (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled (as defined by FASB ASC 810) by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PEEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

**1. Direct Superiors.** Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can *directly control* the activities of such partner or manager. For this purpose, a person who can *directly control* is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the Direct Superior can exercise significant influence<sup>45</sup>) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in

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<sup>45</sup> For purposes of this interpretation, *significant influence* means having the ability to exercise significant influence over the financial, operating, or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner, or director, (2) being in a policy-making position such as CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. *Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence*<sup>46</sup> *are subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety.*

**2. Indirect Superiors and Other PublicCo Entities.** Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the **immediate family** of the Indirect Superior.

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

- a.* Indirect Superiors and Other PublicCo Entities may not have a relationship contemplated by item (A) of Interpretation No. 101-1 [sec. 101 par. .02] (for example, investments, loans, and so on) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be

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<sup>46</sup> For purposes of this interpretation, significant influence means having the ability to exercise significant influence over the financial, operating, or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner, or director; (2) being in a policy-making position such as CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity's financial statements.

- b. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence<sup>47</sup> over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.
- c. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.
- d. Except as noted in (c), Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety.

### Other Matters

1. An example, using the following chart, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.

2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an **attest engagement** for PublicCo or any of its subsidiaries or divisions.

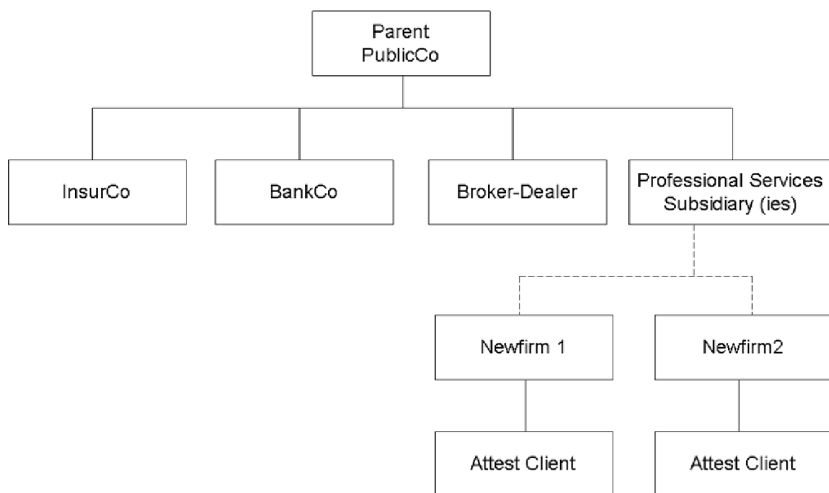
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<sup>47</sup> For purposes of this interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner, or director, (2) being in a policy-making position such as CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence<sup>48</sup> over PublicCo.

4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation No. 102-2 of Rule 102 [sec. 102 par. .03].

### Alternative Practice Structure (APS) Model



[Effective February 28, 1999. Revised, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

#### .17 101-15—Financial relationships.

##### Financial Interests

Item (A)(1) of Interpretation No. 101-1 [sec. 101 par. .02] states that independence shall be considered to be impaired if, during the period of the professional engagement, a covered member had or was committed to acquire any direct or

<sup>48</sup> For purposes of this interpretation, significant influence means having the ability to exercise significant influence over the financial, operating, or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner, or director, (2) being in a policy-making position such as CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]



material indirect financial interest in the client. When reviewing this interpretation, the covered member should also refer to Interpretation No. 101-1 [sec. 101 par. .02] for the application of Rule 101 and its interpretations and rulings to the covered member's immediate family and close relatives.

This interpretation provides definitions of direct and indirect financial interests and further guidance on whether various types of financial interests should be considered to be direct or indirect financial interests and provides certain limited exceptions under which a covered member could hold a direct or material indirect financial interest in an attest client without being considered to have impaired his or her independence.

### Definitions

A **financial interest** is an ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

A **direct financial interest** is a financial interest:

1. Owned directly by an individual or entity (including those managed on a discretionary basis by others); or
2. Under the control<sup>49</sup> of an individual or entity (including those managed on a discretionary basis by others); or
3. Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary:
  - a. Controls the intermediary; or
  - b. Has the authority to supervise or participate in the intermediary's investment decisions.

An **indirect financial interest** is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions.

A financial interest is **beneficially owned** when an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

### Unsolicited Financial Interests

Independence would not be considered to be impaired if an unsolicited financial interest in a client is received, such as through gift or inheritance, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the covered member has knowledge of and the right to dispose of the financial interest. In addition, when the covered member becomes aware that he or she will receive or has received a material direct or material indirect

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<sup>49</sup> When used herein, the term *control* includes situations where the covered member, individually or acting together with his or her firm or with other partners or professional employees of his or her firm, has the ability to exercise such control. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

financial interest in a client requiring independence but does not have the right to dispose of the financial interest, independence would be considered to be impaired unless the covered member does not participate on the attest engagement team and disposes of the financial interest as soon as practicable but no later than 30 days after the right to dispose exists.

### **Mutual Funds**

The ownership of shares in a mutual fund is considered to be a direct financial interest in the mutual fund. The underlying investments of a mutual fund are considered to be indirect financial interests.

If the mutual fund is diversified,<sup>50</sup> a covered member's ownership of 5 percent or less of the outstanding shares of the mutual fund would not be considered to constitute a material indirect financial interest in the underlying investments.

If a covered member owns more than 5 percent of the outstanding shares of a diversified mutual fund, or if the mutual fund is not diversified, the covered member should evaluate the underlying investments of the mutual fund to determine whether the covered member holds a material indirect financial interest in any of the underlying investments.

For example, if a nondiversified mutual fund owns shares in attest client Company A, and

- The mutual fund's net assets are \$10,000,000;
- The covered member owns 1 percent of the outstanding shares of the mutual fund, having a value of \$100,000; and
- The mutual fund has 10 percent of its assets invested in Company A;

the indirect financial interest of the covered member in Company A is \$10,000 and this amount should be measured against the covered member's net worth (including the net worth of his or her immediate family) to determine if it is material.

### **Retirement, Savings, Compensation, or Similar Plans**

Depending upon the facts and circumstances, investments held in a retirement, savings, compensation, or similar plan may be considered a covered member's direct or indirect financial interests as follows:<sup>[51]</sup>

- Investments held by a retirement, savings, compensation, or similar plan sponsored by a covered member's firm would be considered direct financial interests of the firm.
- If a covered member or his or her immediate family member self-directs the investments in a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan's investment decisions, the investments held by the plan would be considered direct financial interests of the covered member. Otherwise, the underlying plan investments would be considered indirect financial interests of the covered member.

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<sup>50</sup> To determine if the mutual fund is diversified, the covered member should refer to (1) the mutual fund's prospectus to see if the prospectus discloses that the fund is *not* diversified or (2) Section 5(b)(1) of the Investment Company Act of 1940. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

<sup>[51]</sup> [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote deleted and renumbered by the Professional Ethics Executive Committee, March 2010.]

- Investments held in a defined benefit plan would not be considered financial interests of the covered member unless the covered member or his or her immediate family member is a trustee of the plan or otherwise has the ability to supervise or participate in the plan's investment decisions.
- Allocated shares held in an ESOP would be considered indirect financial interests that are beneficially owned until such time as the covered member or his or her immediate family has the right to dispose of the financial interest. Once the participant has the right to dispose of the financial interest, the financial interest is considered a direct financial interest.
- Rights to acquire equity interests, restricted stock awards, or other share-based compensation arrangements are considered direct financial interests, regardless of whether such financial interests are vested or exercisable.

The following examples illustrate these concepts:

1. If a covered member or his or her immediate family member is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan's investment decisions (including through the selection of investment managers or pooled investment vehicles), the underlying investments would be considered to be direct financial interests of the covered member.
2. If investments in a defined contribution plan are participant directed, whereby a covered member or his or her immediate family member selects his or her underlying plan investments or selects from investment alternatives offered by the plan, the underlying investments would be considered to be direct financial interests of the covered member.
3. If investments in a defined contribution plan are not participant directed and the covered member or his or her immediate family member has no authority to supervise or participate in the plan's investment decisions, the underlying investments would be considered to be indirect financial interests of the covered member.

Also refer to Ethics Ruling No. 107 [sec. 191 par. .214–.215] and the "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated with a Client," "Application of the Independence Rules to a Covered Member's Immediate Family," and "Application of the Independence Rules to Close Relatives" sections of Interpretation No. 101-1 [par. .02].

### Section 529 Plans<sup>52</sup>

Section 529 plans are sponsored by states or higher education institutions, and may be prepaid tuition plans or savings plans. Both types of plans are established by an account owner for the benefit of a single beneficiary. The

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<sup>52</sup> However, a covered member who is an employee of a governmental organization that is required by law or regulation to audit a Section 529 plan sponsored by a governmental unit will be permitted to be an account owner in the plan for a period not to exceed one year from the effective date of this interpretation. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

account owner may change the beneficiary at any time to another individual who is related to the previous beneficiary.

A covered member who is the account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan but not in the investments of the plan because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the investment performance of the plan or the cost of the education at the future date.

A covered member who is the account owner of a Section 529 savings plan is considered to have a direct financial interest in both the plan and the investments of the plan because he or she decides in which sponsor's Section 529 savings plan to invest and prior to making the investment has access to information about the plan's investments.

If a covered member invests in a Section 529 savings plan that does not hold financial interests in an attest client at the time of the investment, but the plan subsequently invests in an attest client, the covered member should (1) transfer the account to another sponsor's Section 529 savings plan or (2) transfer the account to another account owner who is not a covered member. However, when the transfer of the account will result in a penalty or tax that is significant to the account, the covered member may continue to own the account until the account can be transferred without significant penalty or tax, provided the covered member does not participate on the attest engagement team and is not in a position to influence the attest engagement.

A covered member who is a beneficiary of a Section 529 account is not considered to have a financial interest in the plan or the investments of the plan because he or she does not own the account or possess any of the underlying benefits of ownership and the beneficiary's only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

Before becoming engaged to perform an attest engagement for a government or governmental entity that sponsors a Section 529 plan, covered members that are account owners of a Section 529 plan should consider the guidance in Interpretation No. 101-10 [sec. 101 par. .12].

### **Trust Investments**

When a covered member is a grantor of a trust, the trust and the underlying investments held by the trust are considered to be direct financial interests if the covered member retains the right to amend or revoke the trust, or otherwise has the authority to control the trust or to supervise or participate in the trust's investment decisions. However, where the covered member does not have the authority to amend or revoke the trust or to supervise or participate in the trust's investment decisions, he or she is not considered to have a financial interest in the trust or the underlying investments held by the trust.

When a covered member is a beneficiary of a trust, the trust is considered to be a direct financial interest of the covered member and the underlying investments held by the trust are considered to be indirect financial interests of the covered member. However, if the covered member controls the trust or supervises or participates in the investment decisions of the trust, the underlying investments held by the trust are considered to be direct financial interests of the covered member.

In a blind trust, the grantor is also the beneficiary, but does not supervise or participate in the trust's investment decisions during the term of the trust. However, the investments will ultimately revert to the grantor, and the grantor usually retains the right to amend or revoke the trust. Therefore, both the blind trust and the underlying investments held in a blind trust are considered to be direct financial interests of the covered member.

See item (A)(2) of Interpretation No. 101-1 [sec. 101 par. .02] and Ethics Ruling No. 11, "Member Designated to Serve as Executor or Trustee," of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .021-.022], for additional guidance on trustee relationships.

### Partnerships

The ownership of a general or limited partnership interest is considered a direct financial interest in the partnership.

The financial interests held by a partnership are considered to be direct financial interests of a covered member that is a general partner because the covered member is in a position to control the partnership or to supervise or participate in the partnership's investment decisions.

The financial interests held by a limited partnership are considered to be indirect financial interests of a covered member who is a limited partner as long as the covered member does not control the partnership or supervise or participate in the partnership's investment decisions. However, if the covered member has the ability to replace the general partner or has the authority to supervise or participate in the partnership's investment decisions, the financial interests of the partnership would be considered to be direct financial interests of the covered member.

See item (A)(3) of Interpretation No. 101-1 [sec. 101 par. .02] for additional guidance on joint closely held investments and Interpretation No. 101-8, "Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Covered Member's Clients" [sec. 101 par. .10], for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

### Limited Liability Companies

The ownership of an interest in a limited liability company (LLC) is considered a direct financial interest in the LLC.

In an LLC, members who are managers control the LLC and have the authority to supervise or participate in the LLC's investment decisions. Accordingly, if a covered member is a manager of the LLC, the financial interests of the LLC are considered to be direct financial interests of the covered member. If a covered member is a member but not a manager of the LLC, the covered member should look to the operating agreement of the LLC to determine whether he or she can control the LLC or has the authority to supervise or participate in the investment decisions of the LLC. If the covered member does not control the LLC, or have the authority to supervise or participate in the LLC's investment decisions, the financial interests held by the LLC would be considered to be indirect financial interests of the covered member.

### Insurance Products

An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered to be a financial interest. Accordingly, if a covered member owns an insurance policy issued by an attest client, independence is not considered to be impaired, provided the policy does not offer the policy holder an investment option and the policy was purchased under the insurance company's normal terms, procedures, and requirements. If a mutual insurance company begins the demutualization process, covered members who hold an insurance policy from the company should refer to the guidance contained in the "Unsolicited Financial Interests" section of this interpretation.

Some insurance policies offer an investment option whereby the policy owner may choose to invest part of the cash value in a variety of underlying investments. The underlying investments of this type of insurance policy are considered to be a financial interest, and the covered member should apply the guidance in this interpretation to determine whether the underlying investments are direct or indirect financial interests. For example, if the covered member has the ability to select the underlying investments or the authority to supervise or participate in the investment decisions and the cash value of the insurance policy is invested in a mutual fund, the mutual fund is considered to be a direct financial interest and the underlying investments of the mutual fund are considered to be indirect financial interests.

See item (A)(3) of Interpretation No. 101-1 [sec. 101 par. .02] for additional guidance on joint closely held investments and Interpretation No. 101-8 [sec. 101 par. .10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

[Effective December 31, 2005. Revised March 2010, effective May 31, 2010, by the Professional Ethics Executive Committee.]

**[.18] [101-16]—[Reserved]**

**.19 101-17—Networks and network firms.<sup>53</sup>**

#### General

To enhance their capabilities to provide professional services, firms frequently join larger groups, which typically are membership associations that are separate legal entities that are otherwise unrelated to their members. The associations facilitate their members' use of association services and resources; they do not themselves typically engage in public practice or provide professional services to their members' clients or to other third parties. Firms and other entities in the association cooperate with the firms and other entities that are members of the association to enhance their capabilities to provide professional services. For example, a firm may become a member of an association in order to refer work to, or receive referrals from, other association members. That characteristic alone would not be sufficient for the association to constitute a network or for the firm to be considered a network firm. However, an association would be

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<sup>53</sup> Members may review the implementation guidance issued by the Ethics Division regarding this Interpretation No. 101-17, "Networks and Network Firms." This guidance may be found on the AICPA Ethics Division website. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011.]

considered a network under this interpretation if one or more additional characteristics of a network are shared, in addition to cooperation among member firms [paragraph .23 of ET section 92]. These additional characteristics are discussed further in this interpretation.

A network firm is required to be independent of financial statement audit and review clients of the other network firms if the use of the audit or review report for the client is not restricted, as defined by professional standards. For all other attest clients, consideration should be given to any threats the firm knows or has reason to believe may be created by network firm interests and relationships. If those threats are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. The independence requirements apply to any entity within the network that meets the definition of a network firm [paragraph .24 of ET section 92].

Whether an association is a network and whether an entity is a network firm should be applied consistently by all members of the association. Due consideration should be given to what a reasonable and informed third party would be likely to conclude after weighing all the specific facts and circumstances. The determination that a firm or other entity or an association of firms or other entities meets the definition of a network firm and a network, as herein defined, is solely for purposes of this interpretation and should not be used or relied upon in any other context. In particular, the determination of whether a firm or other entity is a network firm or an association of firms or other entities is a network for purposes of defining legal responsibilities from one firm to the other, or to third parties, is beyond the scope of this interpretation. The definitions contained herein should not be used or relied upon for that purpose.

### **Characteristics of a Network**

#### ***Sharing Common Brand Name***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the members of the association or entities controlled (as defined by FASB ASC 810) by members of the association share the use of a common brand name or share common initials as part of the firm name, the association is considered to be a network.

A firm that does not use a common brand name as part of its firm name but makes reference in its stationery or promotional materials to being a member of an association of firms should carefully consider how it describes that membership and take steps to avoid the perception that it belongs to a network. The firm may wish to avoid such a perception by clearly describing the nature of its membership in the association, for example, by stating on its stationery or promotional material that it is "an independently owned and operated member firm of XYZ Association."

#### ***Sharing Common Control***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association are under common control (as defined by FASB ASC 810) with other firms in the association through ownership, management, or other means (for example, by contract), it is considered to be a network. However, compliance with association requirements as a condition of membership does not indicate that members are under common control; rather, it reflects the type of cooperation that is expected when an entity joins the association.

#### ***Sharing Profits or Costs***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the firms share profits or costs, the association is considered to be a network. However, the

sharing of immaterial costs or costs related to operating the association does not by itself create a network. In addition, the sharing of costs related to the development of audit methodologies, manuals, and training courses does not by itself create a network. Further, an arrangement between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not by itself create a network.

### ***Sharing Common Business Strategy***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association share a common business strategy, the association is considered to be a network. Sharing a common business strategy involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the association's strategy and are held accountable for performance pursuant to that strategy. An entity's ability to pursue an alternative strategy may be limited by the common business strategy because, as a member, it must act in accordance with the common business strategy and, therefore, in the best interest of the association. An entity is not considered to be a network firm merely because it cooperates with another entity solely to market professional services or respond jointly to a request for a proposal for the provision of a professional service.

### ***Sharing Significant Professional Resources***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association share a significant part of professional resources, it is considered to be a network.

Professional resources include

- common systems that enable firms to exchange information, such as client data, billing, and time records;
- partners and staff;
- technical departments to consult on technical or industry specific issues, transactions, or events for assurance engagements;
- audit methodology or audit manuals; and
- training courses and facilities.

The determination of whether the shared professional resources are significant should be made based on both qualitative and quantitative factors.

When the entities within the association do not share a significant amount of human resources or significant client information (for example, client data, billing, and time records) and have the ability to make independent decisions regarding technical matters, audit methodology, training, and the like, the entities are not considered to be sharing a significant part of professional resources.

When the shared professional resources are limited to a common audit methodology, audit manuals, training courses, or facilities, and when they do not include a significant amount of human resources or client or market information, the shared professional resources are not considered significant. However, when the shared professional resources involve the exchange of client information or personnel, such as when staff are drawn from a shared pool, or a common technical department is created within the association to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared professional resources are significant. An entity generally is not deemed a network



because it occasionally uses personnel of another member firm to assist with an engagement, such as observing a client's physical inventory count.

### ***Sharing Common Quality Control Policies and Procedures***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association are required to follow common quality control policies and procedures monitored by the association, it is considered to be a network. *Monitoring* is the process comprising an ongoing consideration and evaluation of the firms' systems of quality control, the objective of which is to enable the association to obtain reasonable assurance that the firms' systems of quality control are designed appropriately and operating effectively.

[Effective for engagements covering periods beginning on or after July 1, 2011. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Revised March 2013, and revisions effective May 31, 2013.]

## **.20 101-18—Application of the independence rules to affiliates.**

### **Introduction**

Financial interests in, and other relationships with, entities that are related in various ways to a financial statement attest client may impair independence. This interpretation provides guidance on which entities should be considered an affiliate of a financial statement attest client and subject to the independence provisions of the AICPA Code of Professional Conduct. This interpretation does not apply to a financial statement attest client that would be covered by Interpretation No. 101-10 [sec. 101 par. .12].

### **Definitions**

The following specifically identified terms are used in this interpretation as indicated:

**Affiliate.** The following entities should be considered affiliates of a financial statement attest client:

- a. An entity (for example, subsidiary, partnership, or LLC) that a financial statement attest client can control.
- b. An entity in which a financial statement attest client or an entity controlled by the financial statement attest client has a direct financial interest that gives the financial statement attest client significant influence over such entity and that is material to the financial statement attest client.
- c. An entity (for example, parent, partnership, or LLC) that controls a financial statement attest client when the financial statement attest client is material to such entity.
- d. An entity with a direct financial interest in the financial statement attest client when that entity has significant influence over the financial statement attest client, and the interest in the financial statement attest client is material to such entity.
- e. A sister entity of a financial statement attest client if the financial statement attest client and sister entity are each material to the entity that controls both.
- f. A trustee that is deemed to control a trust financial statement attest client that is not an investment company.

- g. The sponsor of a single employer employee benefit plan financial statement attest client.
- h. Any union or participating employer that has significant influence over a multiple or multiemployer employee benefit plan financial statement attest client.
- i. An employee benefit plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client. A financial statement attest client that sponsors an employee benefit plan includes, but is not limited to, a union whose members participate in the plan and participating employers of a multiple or multiemployer plan.
- j. An investment adviser, general partner, or trustee of an investment company financial statement attest client (fund) if the fund is material to the investment adviser general partner or trustee, and they are deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

**Control(s) (led).** The term *control(s) (led)* is as used in FASB ASC 810 for commercial entities and FASB ASC 958-805-20 for not-for-profit entities.

**Financial statement attest client.** An entity whose financial statements are audited, reviewed, or compiled when the member's compilation report does not disclose a lack of independence.

**Significant influence.** The term *significant influence* is as used in FASB ASC 323-10-15.

### Application of the Independence Rules to Affiliates

When a client is a financial statement attest client, members should apply the independence provisions of the AICPA Code of Professional Conduct applicable to the client to its affiliates, except in the following situations:

- a. A covered member may have a loan to or from an individual who is an officer, a director, or a 10 percent or more owner of an affiliate of a financial statement attest client unless the covered member knows or has reason to believe that the individual is in such a position with such an affiliate. If the covered member knows or has reason to believe that the individual is an officer, a director, or a 10 percent or more owner of such an affiliate, the covered member should evaluate the effect that the relationship would have on the member's independence by applying the *Conceptual Framework for AICPA Independence Standards* [section 100-1].
- b. A member or his or her firm may provide prohibited nonattest services to entities described under subparagraphs (c)–(j) of the definition of *affiliate*, as defined in the previous "Definitions" section, provided that it is reasonable to conclude that the services do not create a self-review threat with respect to the financial statement attest client because the results of the nonattest services will not be subject to financial statement attest procedures. For any other threats that are created by the provision of the nonattest services that are not at an acceptable level (in particular, those relating to management participation), such threats should be eliminated or reduced to an acceptable level by the application of safeguards.
- c. A firm will only have to apply conditions (1)–(6) of Interpretation No. 101-2, "Employment or Association With Attest Clients"

[sec. 101 par. .04], if the former employee, by virtue of his or her employment at an entity described under subparagraphs (c)–(j) of the definition of *affiliate*, as defined in the previous "Definitions" section, would put the employee in a key position with respect to the financial statement attest client. Individuals in a position to influence the attest engagement and on the attest engagement team who are considering employment with an affiliate of a financial statement attest client will still need to report consideration of employment to an appropriate person in the firm and remove themselves from the financial statement attest engagement, even if the position with the affiliate is not a key position.

- d. Immediate family members and close relatives of a covered member may be employed at an entity described under subparagraphs (c)–(j) of the definition of *affiliate*, as defined in the previous "Definitions" section, in a key position, provided that the position does not put them in a key position with respect to the financial statement attest client.

### Other Considerations

A member must expend best efforts to obtain the information necessary to identify a financial statement attest client's affiliates. If, after expending best efforts, a member is unable to obtain the information to determine which entities are affiliates of a financial statement attest client, the member is required to (a) discuss the matter, including the potential impact on independence, with those charged with governance; (b) document the results of that discussion and the efforts taken to obtain the information; and (c) obtain written assurance from the financial statement attest client that it is unable to provide the member with the information necessary to identify the client's affiliates.

### Effective Date

This interpretation will be effective for engagements covering periods beginning on or after January 1, 2014. Early implementation is allowed.

[Effective November 30, 2011.]

### **.21 101-19—Permitted employment with client educational institution.**

Partners or professional employees of a firm may seek employment as an adjunct faculty member of an educational institution. Partners or professional employees of a firm who provide these types of services to an educational institution that is a client of the firm would not be considered to impair independence with respect to the educational institution, provided that the partner or professional employee

- a. does not hold a key position at the educational institution;
- b. does not participate on the attest engagement team;
- c. is not an individual in a position to influence the attest engagement;
- d. is employed by the educational institution on a part-time and nontenure basis;
- e. does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required; and
- f. does not assume any management responsibilities or set policies for the educational institution.

Upon termination of such employment, the partner or professional employee should comply with the requirements of the "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With A Client" section of Interpretation No. 101-1 [sec. 101 par. .02].

[Effective November 30, 2011.]

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## ET Section 102

### *Integrity and Objectivity*

**.01 Rule 102—Integrity and Objectivity** In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[As adopted January 12, 1988.]

#### *Interpretations under Rule 102—Integrity and Objectivity*

**.02 102-1—Knowing Misrepresentations in the Preparation of Financial Statements or Records** A member shall be considered to have knowingly misrepresented facts in violation of Rule 102 [ET sec. 102 par. .01] when he or she knowingly—

- a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records; or
- b. Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

**.03 102-2—Conflicts of Interest for Members in Public Practice** A member in public practice or his or her firm may be faced with a conflict of interest when performing a professional service. In determining whether a professional service, relationship or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the *Integrity and Objectivity* rule [ET sec. 102 par. .01]. For example, threats may be created when

- the member or the member's firm provides a professional service related to a particular matter involving two or more clients whose interests with respect to that matter are in conflict; or
- the interests of the member or the member's firm with respect to a particular matter and the interests of the client for whom the member or the member's firm provides a professional service related to that matter are in conflict.

Certain professional engagements, such as audits, reviews, and other attest services require independence. Independence impairments under the *Independence* rule [ET sec. 101 par. .01], its interpretations, and rulings cannot be eliminated by the safeguards provided in this interpretation or by disclosure and consent.

The following are examples of situations in which conflicts of interest may arise:

- Providing corporate finance services to a client seeking to acquire an audit client of the firm, when the firm has obtained confidential information during the course of the audit that may be relevant to the transaction
- Advising two clients at the same time who are competing to acquire the same company when the advice might be relevant to the parties' competitive positions
- Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction
- Preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets
- Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership
- Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement
- Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest in the business
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client
- Advising a client on the acquisition of a business which the firm is also interested in acquiring
- Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service
- Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm
- Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests
- Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement

### ***Identification of a Conflict of Interest***

Before accepting a new client relationship, engagement, or business relationship, a member should take reasonable steps to identify circumstances that might create a conflict of interest including identification of

- the nature of the relevant interests and relationships between the parties involved, and
- the nature of the service and its implication for relevant parties.

The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a member is asked to conduct an engagement for a client in a situation that may become adversarial with respect to another client or the member or member's

firm, even though the parties who engage the member may not initially be involved in a dispute. A member should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a member in identifying actual or potential conflicts of interest that may create significant threats to compliance with the *Integrity and Objectivity* rule prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example clients or potential clients. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a member being able to apply safeguards to eliminate or reduce significant threats to an acceptable level. The process to identify actual or potential conflicts of interest will depend on such factors as

- the nature of the professional services provided,
- the size of the firm,
- the size and nature of the client base, and
- the structure of the firm, for example the number and geographic location of offices.

If the firm is a member of a network, the member is not required to take specific steps to identify conflicts of interest of other network firms; however, if the member knows or has reason to believe that such conflicts of interest may exist or might arise due to interests and relationships of a network firm, the member should evaluate the significance of the threat created by such conflicts of interest as described below.

#### ***Evaluation of a Conflict of Interest***

When an actual conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both qualitative and quantitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. In evaluating the significance of an identified threat, members should consider both of the following:

- The significance of relevant interests or relationships.
- The significance of the threats created by performing the professional service or services. In general, the more direct the connection between the professional service and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

- Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include
  - a. using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
  - b. creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing

of confidential client information from one practice area to another within a firm;

- c. establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and the physical and electronic separation of confidential information.
- Regularly reviewing the application of safeguards by a senior individual not involved with the client engagement or engagements.
  - Having a member of the firm who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
  - Consulting with third parties, such as a professional body, legal counsel, or another professional accountant.

In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

#### ***Disclosure of a Conflict of Interest and Consent***

When a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional services. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

Disclosure and consent may take different forms. The following are examples:

- General disclosure to clients of circumstances in which the member, in keeping with common commercial practice, does not provide services exclusively for any one client (for example, in a particular service in a particular market sector) in order for the client to provide general consent accordingly. Such disclosure might be made in a member's standard terms and conditions for the engagement.
- Specific disclosure to affected clients of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the client to make an informed decision with respect to the matter and to provide specific consent.

The member should determine whether the nature and significance of the conflict of interest is such that specific disclosure and specific consent are necessary, as opposed to general disclosure and general consent. For this purpose, the member should exercise professional judgment in evaluating the circumstances that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

When a member has requested specific consent from a client and that consent has been refused by the client, the member should (a) decline to perform or discontinue professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level, such that consent can be obtained, after applying any additional safeguards, if necessary.



The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a member should remain alert to the requirements of Rule 301, *Confidential Client Information* [ET sec. 301 par. .01], and Interpretation No. 501-9, "Confidential information obtained from employment or volunteer activities," under Rule 501, *Acts Discreditable* [ET sec. 501 par. .10]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct.

When practicing before the IRS or other taxing authorities, members should ensure compliance with any requirements that are more restrictive. For example, Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, provides more restrictive requirements concerning written consent by the client when a conflict of interest exists.

[Replaces previous Interpretation No. 102-2, *Conflicts of Interest*, June 2014, effective September 30, 2014.]

**.04 102-3—Obligations of a Member to His or Her Employer's External Accountant** Under Rule 102 [ET sec. 102 par. .01], a member must maintain objectivity and integrity in the performance of a professional service. In dealing with his or her employer's external accountant, a member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which his or her employer's external accountant requests written representation.

[Effective November 30, 1993.]

**.05 102-4—Subordination of Judgment by a Member** Rule 102 [ET sec. 102 par. .01] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services for a client, for an employer, or on a volunteer basis. Although Rule 102 prohibits subordination of judgment to a client, this interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the member's organization.

If a member and his or her supervisor or any other person within the member's organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations, then self-interest, familiarity, and undue influence threats to the member's compliance with Rule 102 may exist.<sup>[1]</sup> Accordingly, the member should apply appropriate safeguards so that the member does not subordinate his or her judgment when the member concludes the difference of opinion creates significant threats to the member's integrity and objectivity.

In assessing the significance of any identified threats, the member should form a conclusion, after appropriate research or consultation, about whether the result of the position taken by the supervisor or other person

- a. fails to comply with professional standards, when applicable;
- b. creates a material misrepresentation of fact; or
- c. may violate applicable laws or regulations.

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<sup>[1]</sup> [Footnote deleted, effective August 31, 2013, by the Professional Ethics Executive Committee.]

If the member concludes that the position taken is not in compliance with professional standards but does not result in a material misrepresentation of fact or a violation of applicable laws or regulations, then threats would not be considered significant. However, the member should discuss his or her conclusions with the person taking the position.

If the member concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then threats would be considered significant. In such circumstances, the member should discuss his or her concerns with the supervisor. If the difference of opinion is still not resolved, then the member should discuss his or her concerns with the appropriate higher level(s) of management within the member's organization (for example, the supervisor's immediate superior, senior management, and those charged with governance).

If after discussing such concerns with the supervisor and appropriate higher level(s) of management within the member's organization, the member concludes that appropriate action was not taken, then the member should consider, in no specific order, the following safeguards to ensure that threats to the member's compliance with Rule 102 are eliminated or reduced to an acceptable level:

- Determining whether any additional requirements exist under his or her employer's internal policies and procedures for reporting differences of opinion.
- Determining whether any responsibilities exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In considering such communications, the member should be cognizant of his or her obligations under Interpretation No. 501-9, "Confidential Information Obtained From Employment or Volunteer Activities," under Rule 501, *Acts Discreditable* [ET sec. 501 par. .10], and Interpretation No. 102-3, "Obligations of a Member to His or Her Employer's External Accountant," under Rule 102 [ET sec. 102 par. .04].
- Consulting with his or her legal counsel regarding his or her responsibilities.
- Documenting his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

If the member concludes that no safeguards can eliminate or reduce the threats to an acceptable level or if the member concludes that appropriate action was not taken, then he or she should consider his or her continuing relationship with the member's organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

Nothing in this interpretation would preclude a member from resigning from the member's organization at any time. However, resignation may not relieve the member of his or her responsibilities in the situation, including any responsibility to disclose to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

A member should use professional judgment and apply similar safeguards, as appropriate, to other situations involving a difference of opinion so that the member does not subordinate his or her judgment.

[Effective November 30, 1993. Revised March 2013, revisions effective May 31, 2013. Revised May 2013, revisions effective August 31, 2013.]

**.06 102-5—Applicability of Rule 102 to Members Performing Educational Services** Educational services (for example, teaching full- or part-time at a university, teaching a continuing professional education course, or engaging in research and scholarship) are professional services as defined in ET section 92 paragraph .30, and are therefore subject to Rule 102 [ET sec. 102 par. .01]. Rule 102 [ET sec. 102 par. .01] provides that the member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[Effective March 31, 1995.]

**.07 102-6—Professional Services Involving Client Advocacy** A member or a member's firm may be requested by a client—

1. To perform tax or consulting services engagements that involve acting as an advocate for the client.
2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.

Services provided or actions taken pursuant to such types of client requests are professional services [ET sec. 92 par. .30] governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201, *General Standards* [ET sec. 201 par. .01], Rule 202, *Compliance With Standards* [ET sec. 202 par. .01], and Rule 203, *Accounting Principles* [ET sec. 203 par. .01], and interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with Rule 102 [ET sec. 102 par. .01], which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with Rule 101 [ET sec. 101 par. .01] of the Code of Professional Conduct.

Moreover, there is a possibility that some requested professional services involving client advocacy may appear to stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk of impairing the reputation of the member and his or her firm with respect to independence, integrity, and objectivity. In such circumstances, the member and the member's firm should consider whether it is appropriate to perform the service.

[Effective August 31, 1995.]

**.08 102-7—Conflicts of Interest for Members in Business**

A member in business may be faced with a conflict of interest when undertaking a professional service. In determining whether a professional service, relationship, or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the *Integrity and Objectivity* rule [ET sec. 102 par. .01]. For example, threats may be created when

- a member undertakes a professional service related to a particular matter involving two or more parties whose interests with respect to that matter are in conflict, or
- the interests of a member with respect to a particular matter and the interests of a party for whom the member undertakes a professional service related to that matter are in conflict.

A party may include an employing organization, a vendor, a customer, a lender, a shareholder, or other party.

The following are examples of situations in which conflicts of interest may arise:

- Serving in a management or governance position for two employing organizations and acquiring confidential information from one employing organization that could be used by the member to the advantage or disadvantage of the other employing organization
- Undertaking a professional service for each of two parties in a partnership employing the member to assist in dissolving their partnership
- Preparing financial information for certain members of management of the employing organization who are seeking to undertake a management buy-out
- Being responsible for selecting a vendor for the member's employing organization when the member or his or her immediate family member could benefit financially from the transaction
- Serving in a governance capacity or influencing an employing organization that is approving certain investments for the company in which one of those specific investments will increase the value of the personal investment portfolio of the member or his or her immediate family member

#### ***Identification of a Conflict of Interest***

In identifying whether a conflict of interest exists or may be created, a member should take reasonable steps to determine

- the nature of the relevant interests and relationships between the parties involved and
- the nature of the services and its implication for relevant parties.

The nature of the relevant interests and relationships and the services may change over time. The member should remain alert to such changes for the purposes of identifying circumstances that might create a conflict of interest.

#### ***Evaluation of a Conflict of Interest***

When an actual conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both qualitative and quantitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level.

In evaluating the significance of an identified threat, members should consider the following:

- The significance of relevant interests or relationships.
- The significance of the threats created by undertaking the professional service or services. In general, the more direct the connection between the member and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

- Restructuring or segregating certain responsibilities and duties

- Obtaining appropriate oversight
- Withdrawing from the decision making process related to the matter giving rise to the conflict of interest
- Consulting with third parties, such as a professional body, legal counsel, or another professional accountant

In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

***Disclosure of a Conflict of Interest and Consent***

When a conflict of interest exists, the member should disclose the nature of the conflict to the relevant parties, including to the appropriate levels within the employing organization and obtain their consent to undertake the professional service. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

When addressing a conflict of interest, a member is encouraged to seek guidance from within the employing organization or from others, such as a professional body, legal counsel, or another professional accountant. When making disclosures and seeking guidance of third parties, the member should remain alert to the requirements of Interpretation No. 501-9, "Confidential information obtained from employment or volunteer activities," under Rule 501, *Acts Discreditable* [ET sec. 501 par. .10]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of employer information may be more restrictive than the requirements contained in the Code of Professional Conduct.

A member may encounter other threats to compliance with the *Integrity and Objectivity* rule. This may occur, for example, when preparing or reporting financial information as a result of undue pressure from others within the employing organization or financial, business or personal relationships that close relatives or immediate family members of the member have with the employing organization. Guidance on managing such threats is covered by Interpretation Nos. 102-1, "Knowing misrepresentations in the preparation of financial statements or records," and 102-4, "Subordination of judgment by a member" [ET sec. 102 par. .02 and .05], under the *Integrity and Objectivity* rule.

[Added June 2014, effective September 30, 2014.]

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## ET Section 191

# *Ethics Rulings on Independence, Integrity, and Objectivity*

### [1.] Acceptance of a Gift

[.001–.002] [Deleted, January 2006.]

### 2. Association Membership

**.003** *Question*—Would independence be considered to be impaired if a member joined a trade association that is a client of the firm?

**.004** *Answer*—Independence would not be considered to be impaired provided the member did not serve as an officer, director, or in any capacity equivalent to that of a member of management.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

### [3.] Member as Signer or Cosigner of Checks

[.005–.006] [Deleted, May 1999.]

### [4.] Payroll Preparation Services

[.007–.008] [Deleted, May 1999.]

### [5.] Member as Bookkeeper

[.009–.010] [Deleted, June 1991.]

### [6.] Member's Spouse as Accountant of Client

[.011–.012] [Deleted, November 2001.]

### [7.] Member Providing Contract Services

[.013–.014] [Deleted, May 1999.]

### 8. Member Providing Advisory Services

**.015** *Question*—A member provides extensive advisory services for a client. In that connection, the member attends board meetings, interprets financial statements, forecasts and other analyses, counsels on potential expansion plans and on banking relationships. Would independence be considered to be impaired under these circumstances?

**.016** *Answer*—Independence would not be considered to be impaired because the member's role is advisory in nature.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

**[9.] Member as Representative of Creditor's Committee**

[.017-.018] [Deleted, November 2011.]

**[10.] Member as Legislator**

[.019-.020] [Deleted, November 2011.]

**11. Member Designated to Serve as Executor or Trustee**

.021 *Question*—A member has been designated to serve as an executor or trustee of the estate of an individual who owns the majority of a client's stock. Would independence be considered to be impaired with respect to the client?

.022 *Answer*—The mere designation of a *covered* member as executor or trustee would not be considered to impair independence, however, if a covered member actually served in such capacity, independence would be considered to be impaired.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

**[12.] Member as Trustee of Charitable Foundation**

[.023-.024] [Deleted, November 2011.]

**[13.] Member as Bank Stockholder**

[.025-.026] [Deleted, November 1993.]

**14. Member on Board of Federated Fund-Raising Organization**

.027 *Question*—A member serves as a director or officer of a United Way or similar federated fund-raising organization (the organization). Certain local charities receive funds from the organization. Would independence be considered to be impaired with respect to such charities?

.028 *Answer*—Independence would be considered to be impaired if *any* partner or professional employee of the firm served as a director or officer of the organization and the organization exercised managerial control over the local charities. (See Ethics Ruling No. 93, "Service on Board of Directors of Federated Fund-Raising Organization" [par. .186-.187] under Rule 101, *Independence* [sec. 101 par. .01] for additional guidance.)

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 14, "Member on Board of Directors of United Fund," April 1991.]

**[15.] Retired Partner as Director**

[.029-.030] [Deleted, June 1991.]

**[16.] Member on Board of Directors of Nonprofit Social Club**

[.031-.032] [Deleted, November 2011.]

**17. Member of Social Club**

.033 *Question*—Would independence be considered to be impaired if a member belongs to a social club (for example, country club, tennis club) that



requires him or her to acquire a pro rata share of the club's equity or debt securities?

**.034 Answer**—As long as membership in a club is essentially a social matter, a *covered* member's association with the club would not impair independence because such equity or debt ownership would not be considered to be a direct financial interest within the meaning of Rule 101 [sec. 101 par. .01]. Also see item C of Interpretation No. 101-1, "Interpretation of Rule 101," under Rule 101 [sec. 101 par. .02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 17, *Member as Stockholder in Country Club*, February 1991.]

### **[18.] Member as City Council Chairman**

[.035–.036] [Deleted, June 1991.]

### **[19.] Member on Deferred Compensation Committee**

[.037–.038] [Deleted, November 2011.]

## **20. Member Serving on Governmental Advisory Unit**

**.039 Question**—A member serves on a citizens' committee which is studying possible changes in the form of a county government that the firm audits. The member also serves on a committee appointed to study the financial status of a state. Would independence be considered to be impaired with respect to a county in that state?

**.040 Answer**—Independence would not be considered to be impaired with respect to the county through the member's service on either committee.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

## **21. Member as Director and Auditor of an Entity's Profit Sharing and Retirement Trust**

**.041 Question**—A member serves in the dual capacity of director of an entity and auditor of the financial statements of that entity's profit sharing and retirement trust (the trust). Would independence be considered to be impaired with respect to the trust?

**.042 Answer**—Service as director of an entity constitutes participation in management functions that affect the entity's trust. Accordingly, independence would be considered to be impaired if any partner or professional of the firm served in such capacity.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

### **[22.] Family Relationship, Brother**

[.043–.044] [Deleted, June 1991.]

### **[23.] Family Relationship, Uncle by Marriage**

[.045–.046] [Deleted, June 1991.]

**[24.] Family Relationship, Father**

[.047–.048] [Deleted, June 1991.]

**[25.] Family Relationship, Son**

[.049–.050] [Deleted, June 1991.]

**[26.] Family Relationship, Son**

[.051–.052] [Deleted, June 1991.]

**[27.] Family Relationship, Spouse as Trustee**

[.053–.054] [Deleted, June 1991.]

**[28.] Cash Account With Brokerage Client**

[.055–.056] [Superseded by Ethics Ruling No. 59.]

**[29.] Member as Bondholder**

[.057–.058] [Deleted, November 2011.]

**[30.] Financial Interest by Employee**

[.059–060] [Deleted, July 1979.]

**31. Performance of Services for Common Interest Realty Associations (CIRAs), Including Cooperatives, Condominium Associations, Planned Unit Developments, Homeowners Associations, and Timeshare Developments**

**.061 Question**—A member belongs to a common interest realty association (CIRA) as the result of the ownership or lease of real estate. Would independence be considered to be impaired with respect to the CIRA?

**.062 Answer**—Independence would be considered to be impaired if a *covered* member was a member of a CIRA unless all of the following conditions are met:

- a. The CIRA performs functions similar to local governments, such as public safety, road maintenance, and utilities.
- b. The covered member's annual assessment is not material to either the covered member or the CIRA's operating budgeted assessments.
- c. The liquidation of the CIRA or the sale of common assets would not result in a distribution to the covered member.
- d. The CIRA's creditors would not have recourse to the covered member's assets if the CIRA became insolvent.

Also see item C of Interpretation No. 101-1 [sec. 101 par. .02] for additional restrictions related to associations with a client.

If the member has a relationship with a real estate developer or management company that is associated with the CIRA, see Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* [sec. 102 par. .03], for guidance.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective May 31, 1998, by the Professional Ethics Executive Committee.]

**[32.] Mortgage Loan to Member's Corporation**

[.063--.064] [Deleted, December 1991.]

**[33.] Member as Participant in Employee Benefit Plan**

[.065--.066] [Deleted, May 1998.]

**[34.] Member as Auditor of Common Trust Funds**

[.067--.068] [Deleted, February 1991.]

**[35.] Stockholder in Mutual Funds**

[.069--.070] [Deleted, December 2005.]

**[36.] Participant in Investment Club**

[.071--.072] [Deleted, December 2005.]

**[37.] Retired Partners as Co-Trustee**

[.073--.074] [Deleted, November 1980.]

**38. Member as Co-Fiduciary With Client Bank**

**.075 Question**—A member serves with a client bank in a co-fiduciary capacity with respect to an estate or a trust. Would independence be considered to be impaired with respect to the bank or the bank's trust department?

**.076 Answer**—Independence would not be considered to be impaired, provided the assets in the estate or trust were not material to the total assets of the bank or the bank's trust department, or both.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

**[39.] Member as Officially Appointed Stock Transfer Agent or Registrar**

[.077--.078] [Deleted, May 1999.]

**[40.] Controller Entering Public Practice**

[.079--.080] [Deleted, June 1979.]

**41. Financial Services Company Client Has Custody of a Member's Assets**

**.081 Question**—A financial services company client (for example, insurance company, investment adviser, broker-dealer, bank, or other depository institution) has custody of a member's assets (other than depository accounts), including retirement plan assets. Would independence be considered to be impaired?

**.082 Answer**—If a covered member's assets were held by a financial services company client, independence would not be considered to be impaired provided the services were rendered under the company's normal terms, procedures, and requirements and any of the covered member's assets subject to the risk of loss were immaterial to the covered member's net worth. Risk of loss may include losses arising from the bankruptcy of or defalcation by the

client but would exclude losses due to a market decline in the value of the assets. When considering the materiality of assets subject to the risk of loss, the covered member should consider the following:

- Protection provided by state or federal regulators (for example, state insurance funds)
- Private insurance or other forms of protection (for example, the Securities Investor Protection Corporation) obtained by the financial services company to protect the assets
- Protection from creditors (for example, assets held in a pooled separate account)

For guidance dealing with depository accounts, see Ethics Ruling No. 70, "Member's Depository Relationship With Client Financial Information" [par. .140-.141].

[Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 41, "Member as Auditor of Mutual Insurance Company," November, 1990.]

**[42.] Member as Life Insurance Policy Holder**

[.083-.084] [Deleted, April 1991.]

**[43.] Member's Employee as Treasurer of a Client**

[.085-.086] [Deleted, June 1991.]

**[44.] Past Due Billings**

[.087-.088] [Superseded by Ethics Ruling No. 52.]

**[45.] Past Due Fees: Client in Bankruptcy**

[.089-.090] [Deleted, November 1990.]

**[46.] Member as General Counsel**

[.091-.092] [Superseded by Ethics Ruling No. 51.]

**[47.] Member as Auditor of Mutual Fund and Shareholder of Investment Advisor/Manager**

[.093-.094] [Deleted, February 1991.]

**[48.] Faculty Member as Auditor of a Student Fund**

[.095-.096] [Deleted, November 2011.]

**[49.] Investor and Investee Companies**

[.097-.098] [Superseded by Interpretation No. 101-8.]

**[50.] Family Relationship, Brother-in-Law**

[.099-.100] [Deleted, June 1983.]

**[51.] Member Providing Legal Services**

[.101-.102] [Deleted, May 1999.]

## 52. Unpaid Fees

**.103 Question**—A client of the member's firm has not paid fees for previously rendered professional services. Would independence be considered to be impaired for the current year?

**.104 Answer**—Independence is considered to be impaired if, when the report on the client's current year is issued, billed or unbilled fees, or a note receivable arising from such fees, remain unpaid for any professional services provided more than one year prior to the date of the report.

This ruling does not apply to fees outstanding from a client in bankruptcy.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective November 30, 1997, by the Professional Ethics Executive Committee. Replaces previous Ethics Ruling No. 52, "Past Due Fees," November 1990.]

## [53.] Member as Auditor of Employee Benefit Plan and Sponsoring Company

[.105–.106] [Deleted, June 1991.]

## [54.] Member Providing Appraisal, Valuation, or Actuarial Services

[.107–.108] [Deleted, May 1999.]

## [55.] Independence During Systems Implementation

[.109–.110] [Deleted, May 1999.]

## [56.] Executive Search

[.111–.112] [Deleted, May 1999.]

## [57.] MAS Engagement to Evaluate Service Bureaus

[.113–.114] [Deleted, August 1995.]

## [58.] Member as Lessor

[.115–.116] [Deleted, May 1998.]

## [59.] Account With Brokerage Client

[.117–.118] [Deleted, November 1987.]

## 60. Employee Benefit Plans—Member's Relationships With Participating Employer

**.119 Question**—A member has been asked to audit the financial statements of an employee benefit plan (the plan) that may have one or more participating employer(s). Would independence be considered to be impaired with respect to the plan if the member had financial or other relationships with a participating employer(s)?

**.120 Answer**—Independence would be considered to be impaired with respect to the plan if any partner or professional employee of the firm had significant influence over such employer; was in a key position with the employer; or was associated with the employer as a promoter, an underwriter, or a voting trustee.

When auditing plans subject to the Employee Retirement Income Security Act of 1974 (ERISA), Department of Labor (DOL) regulations must be followed. Currently, DOL regulations are more restrictive than the position taken in this ruling.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18.]

### **[61.] Participation of Member's Spouse in Client's Stock Ownership Plans (Including an ESOP)**

[.121-.122] [Deleted, May 1998.]

### **[62.] Member and Client Are Limited Partners in a Limited Partnership**

[.123-.124] [Deleted, April 1991.]

### **[63.] Review of Prospective Financial Information—Member's Independence of Promoters**

[.125-.127] [Deleted, August 1992.]

## **64. Member Serves on Board of Organization for Which Client Raises Funds**

**.128 Question**—A member serves on the board of directors of an organization. A fund-raising foundation functions solely to raise funds for that organization. Would independence be considered to be impaired with respect to the fund-raising foundation?

**.129 Answer**—Independence would be considered to be impaired with respect to the fund-raising foundation if *any* partner or professional employee of the firm served on the organization's board of directors. However, if the directorship were clearly honorary (in accordance with Interpretation No. 101-4, "Honorary Directorships and Trusteeships of Not-for-Profit Organization," under Rule 101 [sec. 101 par. .06]) independence would not be considered to be impaired.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

### **[65.] Use of the CPA Designation by Member Not in Public Practice**

[.130-.131] [Deleted March 2013, effective May 31, 2013.]

### **[66.] Member's Retirement or Savings Plan Has Financial Interest in Client**

[.132-.133] [Deleted, December 2005.]

## **67. Servicing of Loan**

**.134 Question**—Would the mere servicing of a loan by a client financial institution impair independence with respect to the client?

**.135 Answer**—No.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 67, "Servicing of Loan," November 1993.]

**[68.] Blind Trust**

[.136--.137] [Deleted, December 2005.]

**69. Investment With a General Partner**

**.138 Question**—A private, closely held entity is the general partner and controls (as defined in accounting principles generally accepted in the United States of America) limited partnership A. The member has a material financial interest in limited partnership A. The member's firm has been asked to perform an attest engagement for a new limited partnership (B) that has the same general partner as limited partnership A. Would independence be considered to be impaired with respect to limited partnership B?

**.139 Answer**—Because the general partner has control over limited partnership A, the covered member would be considered to have a joint closely held investment with the general partner, who has significant influence over limited partnership B, the proposed client. Accordingly, independence would be considered to be impaired with respect to limited partnership B if the covered member had a material investment in limited partnership A.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

**70. Member's Depository Relationship With Client Financial Institution**

**.140 Question**—A member maintains checking or savings accounts, certificates of deposit, or money market accounts at a client financial institution. Would these depository relationships impair independence?

**.141 Answer**—If an individual is a covered member, independence would not be considered to be impaired provided that—

- The checking accounts, savings accounts, certificates of deposit, or money market accounts were fully insured by the appropriate state or federal government deposit insurance agencies or by any other insurer; or
- The uninsured amounts, in the aggregate, were not material to the net worth of the covered member. (When uninsured amounts were considered material, independence would not be considered impaired provided the uninsured balance was reduced to an immaterial amount no later than 30 days from the date the uninsured amount becomes material.)

A firm's depository relationship would not impair its independence provided that the likelihood of the financial institution experiencing financial difficulties was considered to be remote.

[Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, October 2013, to reflect editorial changes necessary.]

**71. Use of Nonindependent CPA Firm on an Engagement**

**.142 Question**—Firm A is not independent with respect to a client. Partners or professional employees of Firm A are participating on Firm B's attest engagement team for that client. Would Firm B's independence be considered to be impaired?

**.143 Answer**—Yes. The use by Firm B of partners or professional employees from Firm A as part of the attest engagement team would impair Firm B's independence with respect to that engagement.

However, use of the work of such individuals in a manner similar to internal auditors is permissible provided that there is compliance with the Statements on Auditing Standards (SASs). Applicable literature contained in the SASs should be consulted.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

## 72. Member on Advisory Board of Client

**.144 Question**—Would service on a client's advisory board impair independence?

**.145 Answer**—Independence would be considered to be impaired if *any* partner or professional employee of the firm served on the advisory board unless all the following criteria are met: (a) the responsibilities of the advisory board are in fact advisory in nature; (b) the advisory board has no authority to make nor does it appear to make management decisions on behalf of the client; and (c) the advisory board and those having authority to make management decisions (including the board of directors or its equivalent) are distinct groups with minimal, if any, common membership.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

## [73.] Meaning of the Period of a Professional Engagement

[.146–.147] [Deleted, February 1998.]

## [74.] Audits, Reviews, or Compilations and a Lack of Independence

[.148–.149] [Deleted, April 2012.]

## 75. Membership in Client Credit Union

**.150 Question**—Does membership in a client credit union impair independence?

**.151 Answer**—A *covered* member's association with a client credit union would not impair independence provided all of the following criteria are met:

1. The covered member individually qualifies to join the credit union (other than by virtue of the professional services provided to the client).
2. Any loans from the credit union to the covered member meet the conditions specified in item A(4) of Interpretation No. 101-1 [sec. 101 par. .02] and are made under normal lending procedures, terms, and requirements (see Interpretation No. 101-5, "Loans from financial institution clients and related terminology" [sec. 101 par. .07]).
3. Any deposits with the credit union meet the conditions specified in Ethics Ruling No. 70 [par. .140–.141] under Rule 101 [sec. 101 par. .01].



Partners and professional employees may be subject to additional restrictions as described in item B of Interpretation No. 101-1 [sec. 101 par. 02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Effective February 28, 1992, earlier application is encouraged.]

**[76.] Guarantee of Loan**

[.152–.153] [Deleted, December 1991.]

**[77.] Individual Considering or Accepting Employment With the Client**

[.154–.155] [Deleted, April 2003.]

**[78.] Service on Governmental Board**

[.156–.157] [Deleted, August 1995.]

**[79.] Member's Investment in a Partnership That Invests in Client**

[.158–.159] [Deleted, December 2005.]

**[80.] The Meaning of a Joint Closely Held Business Investment**

[.160–.161] [Deleted, November 2001.]

**81. Member's Investment in a Limited Partnership**

**.162 Question**—A member is a limited partner in a limited partnership (LP), including a master LP. A client is a general partner in the same LP. Is independence considered to be impaired with respect to (a) the LP, (b) the client, and (c) any subsidiaries of the LP?

**.163 Answer**—

- a. A covered member's LP interest in the LP is a direct financial interest in the LP that would impair independence under Interpretation No. 101-1 item A(1) [sec. 101 par. .02].
- b. The LP is an investee of the client because the client is a general partner in the LP. Therefore, under Interpretation No. 101-8 [sec. 101 par. .10], if the investment in the LP were material to the client, a covered member's financial interest in the LP would impair independence. However, if the client's financial interest in the LP were not material to the client, a covered member's immaterial financial interest in the LP would not impair independence.
- c. If the covered member is a limited partner in the LP, the covered member is considered to have an indirect financial interest in all subsidiaries of the LP. If the indirect financial interest in the subsidiaries were material to the covered member, independence would be considered to be impaired with respect to those subsidiaries under Interpretation No. 101-1 item A(1) [sec. 101 par. .02].

If the covered member or client general partner, individually or together, can control the LP, the LP would be considered a joint closely held investment under section 92 paragraph .17.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

## 82. Campaign Treasurer

**.164 Question**—A member serves as the campaign treasurer of a mayoral candidate. Would independence be considered to be impaired with respect to (a) the political party with which the candidate is associated, (b) the municipality of which the candidate may become mayor, or (c) the campaign organization?

**.165 Answer**—Independence would not be considered to be impaired with respect to the political party or municipality. However, if *any* partner or professional employee of the firm served as campaign treasurer, independence would be considered to be impaired with respect to the campaign organization.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

## [83.] Member on Board of Component Unit and Auditor of Oversight Entity

[.166–.167] [Deleted, January 1996.]

## [84.] Member on Board of Material Component Unit and Auditor of Another Material Component Unit

[.168–.169] [Deleted, January 1996.]

## 85. Bank Director

**.170 Question**—May a member in public practice serve as a director of a bank?

**.171 Answer**—Yes; however, before accepting a bank directorship, the member should carefully consider the implications of such service if the member has clients that are customers of the bank.

These implications fall into two categories:

- a. **Confidential Client Information**—Rule 301, *Confidential Client Information* [sec. 301 par. .01], provides that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This ethical requirement applies even though failure to disclose information may constitute a breach of the member's fiduciary responsibility as a director.
- b. **Conflicts of Interest**—Interpretation No. 102-2 [sec. 102 par. .03] provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from all appropriate parties, performance of the service shall not be prohibited.

In view of the above factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is

engaged in public practice, the member should avoid the high probability of a conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with the member's ability to serve the client's interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances, it would be more appropriate for the member as part of the member's public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit activities to those which did not involve conflicts of interest or confidentiality problems.

### **[86.] Partially Secured Loans**

[.172–.173] [Deleted, February 1998.]

### **[87.] Loan Commitment or Line of Credit**

[.174–.175] [Deleted, February 1998.]

### **[88.] Loans to Partnership in Which Members Are Limited Partners**

[.176–.177] [Deleted, February 1998.]

### **[89.] Loan to Partnership in Which Members Are General Partners**

[.178–.179] [Deleted, February 1998.]

### **[90.] Credit Card Balances and Cash Advances**

[.180–.181] [Deleted, February 1998.]

## **91. Member Leasing Property to or From a Client**

**.182 Question**—Would independence be considered to be impaired if a member leased property to or from a client?

**.183 Answer**—Independence would not be considered to be impaired if the lease meets the criteria of an operating lease (as described in Generally Accepted Accounting Principles), the terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature, and all amounts are paid in accordance with the terms of the lease.

Independence would be considered to be impaired if a *covered* member had a lease that meets the criteria of a capital lease (as described in generally accepted accounting principles) unless the lease is in compliance with item A(4) of Interpretation Nos. 101-1 [sec. 101 par. .02] and 101-5 [sec. 101 par. .07], because the lease would be considered to be a loan to or from the client.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective May 31, 1998, by the Professional Ethics Executive Committee.]

## **92. Joint Interest in Vacation Home**

**.184 Question**—A member has a joint interest in a vacation home with a client (or one of the client's officers or directors, or any owner who has the ability to exercise significant influence over the client). Would the vacation

home constitute a "joint closely held investment" as defined in paragraph .17 of section 92, *Definitions*?

**.185 Answer**—Yes. The vacation home, even if solely intended for the personal use of the owners, would be considered a joint closely held investment as defined in paragraph .17 of section 92 if it meets the criteria described in the aforementioned definition.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

### 93. Service on Board of Directors of Federated Fund-Raising Organization

**.186 Question**—A member serves as a director or officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities receive funds. Some of those charities are clients of the member's firm. Does the member have a conflict of interest under Rule 102 [sec. 102 par. .01]?

**.187 Answer**—Interpretation No. 102-2 [sec. 102 par. .03] provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by the client or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from the appropriate parties, performance of the service shall not be prohibited. (If the service being provided is an attest engagement, consult Ethics Ruling No. 14 [par. .027–.028] under Rule 101 [sec. 101 par. .01]).

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

### 94. Indemnification Clause in Engagement Letters

**.188 Question**—A member or his or her firm proposes to include in engagement letters a clause that provides that the client would release, indemnify, defend, and hold the member (and his or her partners, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from knowing misrepresentations by management. Would inclusion of such an indemnification clause in engagement letters impair independence?

**.189 Answer**—No.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

### 95. Agreement With Attest Client to Use ADR Techniques

**.190 Question**—Alternative dispute resolution (ADR) techniques are used to resolve disputes (in lieu of litigation) relating to past services, but are not used as a substitute for the exercise of professional judgment for current services. Would a predispute agreement to use ADR techniques between a member or his or her firm and a client cause independence to be impaired?

**.191 Answer**—No. Such an agreement would not cause independence to be impaired since the member (or the firm) and the client would not be in threatened or actual positions of material adverse interests by reason of threatened or actual litigation.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

## 96. Commencement of ADR Proceeding

**.192 Question**—Would the commencement of an alternative dispute resolution (ADR) proceeding impair independence?

**.193 Answer**—Except as stated in the next sentence, independence would not be considered to be impaired because many of the ADR techniques designed to facilitate negotiation and the actual conduct of those negotiations do not place the member or his or her firm and the client in threatened or actual positions of material adverse interests. Nevertheless, if a *covered* member and the client are in a position of material adverse interests because the ADR proceedings are sufficiently similar to litigation, Interpretation No. 101-6, "The Effect of Actual or Threatened Litigation on Independence," under Rule 101 [sec. 101 par. .08] should be applied. Such a position would exist if binding arbitration were used.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

## [97.] Performance of Certain Extended Audit Services

[.194–.195] [Deleted, August 1996.]

## 98. Member's Loan From a Nonclient Subsidiary or Parent of an Attest Client

**.196 Question**—A member has obtained a loan from a nonclient. The member's firm performs an attest engagement for the parent or a subsidiary of the nonclient. Does the loan from the nonclient subsidiary or parent impair independence?

**.197 Answer**—A covered member's loan that is not a "grandfathered" or "permitted" loan under Interpretation No. 101-5 [sec. 101 par. .07] from a nonclient subsidiary would impair independence with respect to the client parent. However, a loan from a nonclient parent would not impair independence with respect to the client subsidiary, as long as the subsidiary is not material to its parent.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

## 99. Member Providing Services for Company Executives

**.198 Question**—A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in the member recommending to the executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

**.199 Answer**—Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102 [sec. 102 par. .01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member should also consider informing

the company and the executives of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301 [sec. 301 par. .01].

### **100. Actions Permitted When Independence Is Impaired**

**.200 Question**—If a member or a member's firm (member) was independent when its report was initially issued, may the member re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired?

**.201 Answer**—Yes. A member may re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired, provided that no "post-audit work" is performed by the member during the period of impairment. The term "post-audit work," in this context, does not include inquiries of successor auditors, reading of subsequent financial statements, or such procedures as may be necessary to assess the effect of subsequently discovered facts on the financial statements covered by the member's previously issued report.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

### **[101.] Client Advocacy and Expert Witness Services**

[.202–.203] [Deleted, July 2007.]

### **102. Indemnification of a Client**

**.204 Question**—As a condition to retaining a member or his or her firm to perform an attest engagement, a client or prospective client requests that the member (or the firm) enter into an agreement providing, among other things, that the member (or the firm) indemnify the client for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to client acts. Would entering into such an agreement impair independence?

**.205 Answer**—Yes. Such an agreement would impair independence under item A of Interpretation No. 101-1 [sec. 101 par. .02] and item C of Interpretation No. 101-1 [sec. 101 par. .02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

### **[103.] Attest Report on Internal Controls**

[.206–.207] [Deleted, November 2011.]

### **[104.] Operational Auditing Services**

[.208–.209] [Deleted, September 2003.]

### **[105.] Frequency of Performance of Extended Audit Procedures**

[.210–.211] [Deleted, September 2003.]

### **106. Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client**

**.212 Question**—Would independence be considered to be impaired if a member or his or her firm had *significant influence*, as defined in section 92 paragraph .31, over an entity that has significant influence over a client?

**.213 Answer**—Independence would be considered to be impaired if any partner or professional of the firm had significant influence over an entity that has significant influence over a client. By having such influence over the non-client entity, the partner or professional employee would also be considered to have significant influence over the client.

See Interpretation No. 101-8 [sec. 101 par. .10] for further guidance.

[Revised July 2002 to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

### 107. Participation in Employee Benefit Plan Sponsored by Client

**.214 Question**—A member participates in, or receives benefits from, an employee benefit plan (plan) that is a client or is sponsored by a client. Would independence be considered to be impaired with respect to the client sponsor or the plan?

**.215 Answer**—A covered member's participation in a plan that is a client or is sponsored by a client would impair independence with respect to the client sponsor and the plan, except when the covered member is

- permitted by the "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client" section of Interpretation No. 101-1 [sec. 101 par. .02] to continue his or her participation in the plan or
- an employee of a governmental organization that is required by law or regulation to audit a plan sponsored by a governmental unit. In such circumstances, a covered member's participation in the plan will not impair independence, provided that the plan is offered to all employees in comparable employment positions and the covered member
  - is not associated with the plan in any capacity prohibited by item C of Interpretation No. 101-1 [sec. 101 par. .02];
  - has no influence or control over the investment strategy, benefits, or other management activities associated with the plan; and
  - is required to participate in the plan as a condition of employment.

In addition, a covered member's independence would not be impaired if he or she receives benefits as a result of an immediate family member's participation in a plan that is permitted by the "Application of the Independence Rules to a Covered Member's Immediate Family" section of Interpretation No. 101-1 [sec. 101 par. .02].

[Revised, March 2010, effective May 31, 2010, by the Professional Ethics Executive Committee. Revised, November 2002, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

**[108.] Participation of Member, Spouse or Dependent in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client**

[.216–.217] [Deleted, November 2001.]

**[109.] Member's Investment in Financial Services Products That Invest in Clients**

[.218–.219] [Deleted, December 2005.]

**110. Member Is Connected With an Entity That Has a Loan to or From a Client**

**.220 Question**—A member is associated with an entity as an officer, director, or a shareholder who is able to exercise significant influence over an entity. That entity has a loan to or from a client of the member's firm. Would independence be considered to be impaired with respect to the client?

**.221 Answer**—If a *covered* member has control over the entity (as defined by Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 810, *Consolidation*), the existence of a loan to or from the client would impair independence unless the loan from the client is specifically permitted under Interpretation No. 101-5 of Rule 101 [sec. 101 par. .07].

If *any* partner or professional employee of the firm is connected with the entity as an officer, director, or shareholder who is able to exercise significant influence over the entity, but is unable to control the entity, he or she should consider Interpretation No. 102-2 [sec. 102 par. .03]. Interpretation No. 102-2 provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by the client or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client and other appropriate parties, the rule shall not operate to prohibit the performance of the professional service.

When making the decision as to whether to perform a professional service and in making disclosure to the appropriate parties, the member should consider Rule 301 [sec. 301 par. .01].

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

**111. Employee Benefit Plan Sponsored by Client**

**.222 Question**—A member or his or her firm provides asset management or investment services that may include having custody of assets, performing management functions, or making management decisions for an employee benefit plan (the plan) sponsored by a client. Would independence be considered to be impaired with respect to the plan and the client sponsor?

**.223 Answer**—The performance of investment management or custodial services for a plan would be considered to impair independence with respect to the plan. Independence would also be considered to be impaired with respect to the client sponsor of a defined benefit plan if the assets under management or in the custody of the member are material to the plan or the client sponsor.



Independence would not be considered to be impaired with respect to the client sponsor of a defined contribution plan, provided the member does not make any management decisions or perform management functions on behalf of the client sponsor or have custody of the sponsor's assets.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

## 112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services

**.224 Question**—A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by FASB ASC 810) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients. Does Rule 102 [sec. 102 par. .01], require the member to disclose the use of the third-party service provider to the client?

**.225 Answer**—Yes. The concept of integrity set forth in Rule 102 [sec. 102 par. .01] and section 54, *Article III—Integrity*, requires a member to be honest and candid. Clients might not have an expectation that a member would use a third-party service provider to assist the member in providing the professional services. Accordingly, before disclosing confidential client information to a third-party service provider, a member should inform the client, preferably in writing, that the member may use a third-party service provider. This disclosure does not relieve the member from his or her obligations under Ethics Ruling No. 1, "Use of a Third-Party Service Provider to provide Professional Services to Clients or Administrative Support Services to the Member," of section 391, *Ethics Rulings on Responsibilities to Clients* [sec. 391 par. .001–.002]. If the client objects to the member's use of a third-party service provider, the member should provide the professional services without using the third-party service provider or the member should decline the engagement.

A member is not required to inform the client when he or she uses a third-party service provider to provide administrative support services (for example, record storage, software application hosting, or authorized e-file tax transmittal services) to the member.

See Ethics Ruling No. 12, "Applicability of General and Technical Standards When Using a Third-Party Service Provider," of section 291, *Ethics Rulings on General and Technical Standards* [sec. 291 par. 023–.024]; and Ethics Ruling No. 1 of section 391 [sec. 301 par. .001–.002] for additional responsibilities of the member when using a third-party service provider.

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

## 113. Acceptance or Offering of Gifts or Entertainment

**.226 Question**—Would objectivity or integrity be considered to be impaired if a member offers or accepts gifts or entertainment to or from a client (or an individual in a key position with a client or an individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests), or a customer or vendor of the member's employer (or a representative of the customer or vendor)?

**.227 Answer**—Objectivity would be considered to be impaired unless the gift or entertainment is reasonable in the circumstances.

The member should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Relevant facts and circumstances would include, but are not limited to:

- The nature of the gift or entertainment
- The occasion giving rise to the gift or entertainment
- The cost or value of the gift or entertainment
- The nature, frequency, and value of other gifts and entertainment offered or accepted
- Whether the entertainment was associated with the active conduct of business either directly before, during, or after the entertainment
- Whether other clients, customers, or vendors also participated in the entertainment
- The individuals from the client, customer, or vendor and the member's firm or employer who participated in the entertainment

In addition, a member would be presumed to lack integrity if he or she accepted or offered gifts or entertainment that he or she knew or was reckless in not knowing would violate the member, client, customer, or vendor's policies or applicable laws and regulations.

See Ethics Ruling No. 114, "Acceptance or Offering of Gifts and Entertainment to or From an Attest Client" [par. .228–.229], under Rule 101 [sec. 101 par. .01], for guidance applicable to the offer or acceptance of gifts or entertainment to or from an attest client.

#### **114. Acceptance or Offering of Gifts and Entertainment to or From an Attest Client**

**.228 Question**—Would independence be considered to be impaired if a member or the member's firm offers or accepts gifts or entertainment to or from an attest client, an individual in a key position with an attest client, or an individual owning 10 percent or more of the attest client's outstanding equity securities or other ownership interests (collectively, an attest client)?

**.229 Answer**—Independence would be considered to be impaired if the member's firm or a member on the attest engagement team or in a position to influence the attest engagement accepts a gift from an attest client, unless the value is clearly insignificant to the recipient. Independence would not be considered to be impaired if a covered member accepts entertainment from an attest client, provided the entertainment is reasonable in the circumstances.

Independence would not be considered to be impaired if a covered member offers gifts or entertainment to an attest client, provided the gift or entertainment is reasonable in the circumstances.

See Ethics Ruling No. 113, "Acceptance or Offering of Gifts or Entertainment" [par. .226–.227], under Rule 102 [sec. 102 par. .01], for criteria a member should consider in determining whether the gifts or entertainment would be considered reasonable in the circumstances.

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## ET Section 200

# GENERAL STANDARDS—ACCOUNTING PRINCIPLES

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## ET Section 201

### *General Standards*

**.01 Rule 201—General standards** A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council.

- A. *Professional Competence.* Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.
- B. *Due Professional Care.* Exercise due professional care in the performance of professional services.
- C. *Planning and Supervision.* Adequately plan and supervise the performance of professional services.
- D. *Sufficient Relevant Data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

[As adopted January 12, 1988.]

(See Appendix A.)

#### ***Interpretations under Rule 201—General Standards***

**.02 201-1—Competence** A member's agreement to perform professional services implies that the member has the necessary competence to complete those professional services according to professional standards, applying his or her knowledge and skill with reasonable care and diligence, but the member does not assume a responsibility for infallibility of knowledge or judgment.

Competence to perform professional services involves both the technical qualifications of the member and the member's staff and the ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques and the technical subject matter involved, and to the capability to exercise sound judgment in applying such knowledge in the performance of professional services.

The member may have the knowledge required to complete the services in accordance with professional standards prior to performance. In some cases, however, additional research or consultation with others may be necessary during the performance of the professional services. This does not ordinarily represent a lack of competence, but rather is a normal part of the performance of professional services.

However, if a member is unable to gain sufficient competence through these means, the member should suggest, in fairness to the client and the public, the engagement of someone competent to perform the needed professional service, either independently or as an associate.

[.03] [201-2]—[Deleted]

[.04] [201-3]—[Deleted]

[.05] [201-4]—[Deleted]



## ET Section 202

### *Compliance With Standards*

**.01 Rule 202—Compliance with standards** A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council.

[As adopted January 12, 1988.]

(See Appendix A.)

#### ***Interpretation under Rule 202—Compliance With Standards***

[.02] [202-1]—[Deleted]

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## ET Section 203

### **Accounting Principles**

**.01 Rule 203—Accounting principles** A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

[As adopted January 12, 1988.]

(See appendix A, *Council Resolution Designating Bodies to Promulgate Technical Standards.*)

#### **Interpretations under Rule 203—Accounting Principles**

**.02 203-1—Departures from generally accepted accounting principles** Reference to generally accepted accounting principles (GAAP) in Rule 203, *Accounting Principles* [sec. 203 par. .01], means those accounting principles promulgated by bodies designated by council, which are listed in appendix A, *Council Resolution Designating Bodies to Promulgate Technical Standards.* In the establishment of such principles, it is difficult to anticipate all circumstances to which such principles might be applied. There is a strong presumption that adherence to GAAP would, in nearly all instances, result in financial statements that are not misleading. Rule 203 [sec. 203 par. .01] recognizes that, upon occasion, there may be unusual circumstances when the literal application of GAAP would have the effect of rendering financial statements misleading. In such cases, the proper accounting treatment is that which will render the financial statements not misleading.

The question of what constitutes unusual circumstances as referred to in Rule 203 [sec. 203 par. .01] is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle within GAAP would be regarded generally by reasonable persons as producing misleading financial statements.

Examples of events that may justify a departure from GAAP are new legislation or the evolution of a new form of business transaction. An unusual degree of materiality or the existence of conflicting industry practices are examples of circumstances that would not ordinarily be regarded as unusual in the context of Rule 203 [sec. 203 par. .01].

[Revised, February 2012, effective April 30, 2012, by the Professional Ethics Executive Committee.]

**.03 203-2—Status of FASB, GASB and FASAB interpretations** Council is authorized under Rule 203 [sec. 203 par. .01] to designate bodies to establish accounting principles. Council has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB *Accounting Standards Codification*<sup>TM</sup> (ASC) constitutes accounting principles as contemplated in Rule 203 [sec. 203 par. .01]. Council has also designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities pursuant to Rule 203 [sec. 203 par. .01]. Council has also designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities pursuant to Rule 203 [sec. 203 par. .01].

In determining the existence of a departure from an accounting principle as established in FASB ASC and encompassed by Rule 203 [sec. 203 par. .01], or the existence of a departure from an accounting principle established by a Statement of Governmental Accounting Standards or a Statement of Federal Accounting Standards encompassed by Rule 203 [sec. 203 par. .01], the division of professional ethics will construe such codification or statements, in the light of any interpretations thereof issued by FASB, GASB, or FASAB.

[As amended, April 30, 2000. Revised, June 2009.]

**[.04] [203-3]—[Deleted]**

**.05 203-4—Responsibility of employees for the preparation of financial statements in conformity with GAAP** Rule 203 [sec. 203 par. .01] provides, in part, that a member shall not state affirmatively that financial statements or other financial data of an entity are presented in conformity with GAAP if such statements or data contain any departure from an accounting principle promulgated by a body designated by council to establish such principles that has a material effect on the statements or data taken as a whole.

Rule 203 [sec. 203 par. .01] applies to all members with respect to any affirmation that financial statements or other financial data are presented in conformity with GAAP. Representation regarding GAAP conformity included in a letter or other communication from a client entity to its auditor or others related to that entity's financial statements is subject to Rule 203 [sec. 203 par. .01] and may be considered an affirmative statement within the meaning of the rule with respect to members who signed the letter or other communication; for example, signing reports to regulatory authorities, creditors and auditors.

[Effective November 30, 1993.]

**.06 203-5—Financial statements prepared pursuant to financial reporting frameworks other than GAAP** Reference to GAAP in Rule 203 [sec. 203 par. .01] means those accounting principles promulgated by bodies designated by council, which are listed in appendix A. Financial statements prepared pursuant to other accounting principles would be considered financial reporting frameworks other than GAAP within the context of Rule 203 [sec. 203 par. .01].

However, Rule 203 [sec. 203 par. .01] does not preclude a member from preparing or reporting on financial statements that have been prepared pursuant to financial reporting frameworks other than GAAP, such as (a) financial reporting frameworks generally accepted in another country, including jurisdictional variations of International Financial Reporting Standards (IFRSs) such that the entity's financial statements do not meet the requirements for full compliance with IFRSs as promulgated by the International Accounting Standards

Board; (b) financial reporting frameworks prescribed by an agreement or a contract; or (c) an other comprehensive basis of accounting, including statutory financial reporting provisions required by law or a U.S or foreign governmental regulatory body to whose jurisdiction the entity is subject.

In such circumstances, however, the financial statements or reports should not purport that the financial statements are in accordance with GAAP and the financial statements or reports on those financial statements, or both, should make clear the financial reporting framework(s) used.

[Added, February 2012, effective April 30, 2012, by the Professional Ethics Executive Committee.]

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## ET Section 291

### *Ethics Rulings on General and Technical Standards*

#### [1.] Association of Name With Unaudited Statements When Member Is Not Independent

[.001–.002] [Deleted, September 1995.]

#### [2.] Opinion by Member Not in Public Practice

[.003–.004] [Deleted, December 1986.]

#### [3.] Controller, Preparation of Financial Statements

[.005–.006] [Deleted, May 1995.]

#### [4.] Two-Year Opinion—Prior Year Previously Unaudited

[.007–.008] [Deleted, May 1995.]

#### [5.] Interim Financial Statements

[.009–.010] [Deleted, October 1995.]

#### [6.] Letterhead

[.011–.012] [Deleted, September 1995.]

#### [7.] Non-CPA Partner

[.013–.014] [Transferred to sec. 591 par. .379–.380 as Ethics Ruling No. 190, April 1995.]

### **8. Subcontractor Selection for Management Consulting Service Engagements**

**.015 Question**—A member has been engaged to design and program a computer system. The engagement is well within the member's competence. The member plans to retain a contract programming organization as a subcontractor to provide additional qualified manpower. What procedures should the member consider in making the selection of a subcontractor?

**.016 Answer**—When selecting subcontractors the member has a responsibility to ensure that the subcontractors have the professional qualifications, technical skills and other resources required. Factors that can be helpful in evaluating a prospective subcontractor include business, financial and personal references from banks, from other CPAs, and from other customers of the subcontractor; the subcontractor's professional reputation and recognition; published materials (articles and books authored); and the member's personal evaluation of the subcontractor.

## 9. Supervision of Technical Specialist on Management Consulting Services Engagements

**.017 Question**—A member would like to add to the member's staff a systems analyst who specializes in developing computer systems. Must the member be able to perform all of the services that the specialist can perform in order to be able to supervise the specialist?

**.018 Answer**—The member must be qualified to supervise and evaluate the work of specialists in the member's employ. Although supervision does not require that the member be qualified to perform each of the specialist's tasks, the member should be able to define the tasks and evaluate the end product.

## 10. Submission of Financial Statements by a Member in Public Practice

**.019 Question**—A member in public practice is also a stockholder, partner, director, officer, or employee of an entity and in this capacity submits the entity's financial statements to third parties. What are the ethical considerations?

**.020 Answer**—If the member submits the financial statements in his or her capacity as a stockholder, partner, director, officer, or employee to a third party, the member should clearly communicate, preferably in writing, the relationship of the member to the entity and should not imply that the member is independent of the entity [sec. 191 par. .130–.131]. In addition, if the communication states affirmatively that the financial statements are presented in conformity with generally accepted accounting principles, the member is subject to Rule 203, *Accounting Principles* [sec. 203 par. .01], of the Code of Professional Conduct.

If the member prepares financial statements as a member in public practice and/or submits them using the member's public practitioner's letterhead or other identification, the member should comply with applicable standards, including any requirement to disclose a lack of independence.

[Revised, effective July 31, 2002, by the Professional Ethics Executive Committee.]

## [11.] Applicability of Rule 203 to Members Performing Litigation Support Services

[.021–.022] [Deleted, November 2011.]

## 12. Applicability of General and Technical Standards When Using a Third-Party Service Provider

**.023 Question**—What responsibility does a member in public practice have for complying with the general and technical standards under Rule 201, *General Standards* [ET sec. 201 par. .01], and Rule 202, *Compliance With Standards* [sec. 202 par. .01], when using an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients?

**.024 Answer**—Using a third-party service provider to assist the member in providing professional services to clients does not in any way relieve the member from his or her responsibilities to comply with the requirements of Rules 201 [sec. 201 par. .01] and 202 [sec. 202 par. .01]. Accordingly, the member

remains responsible for the adequate oversight of all services performed by the third-party service provider and for ensuring that all professional services are performed with professional competence and due professional care. In addition, the member must adequately plan and supervise the professional services provided by the third-party service provider, obtain sufficient relevant data to support his or her work product and comply with all technical standards applicable to the professional services.

This ruling does not extend the member's responsibility for planning and supervising the work of a third-party service provider beyond the requirements of applicable professional standards, which may vary depending upon the nature of the member's engagement.

See Ethics Ruling No. 112, "Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services," of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .224–.225], and Ethics Ruling No. 1, "Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member," of section 391, *Ethics Rulings on Responsibilities to Clients* [sec. 391 par. .001–.002], for additional responsibilities of the member when using a third-party service provider.

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

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# ET Section 300

## RESPONSIBILITIES TO CLIENTS

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## ET Section 301

### *Confidential Client Information*

**.01 Rule 301—Confidential client information** A member in public practice shall not disclose any confidential client information without the specific consent of the client.

This rule shall not be construed (1) to relieve a member of his or her professional obligations under rules 202 [ET section 202.01] and 203 [ET section 203.01], (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

[As amended January 14, 1992.]

#### ***Interpretations under Rule 301 — Confidential Client Information***

[.02] [301-1]—[Deleted]

[.03] [301-2]—[Deleted]

**.04 301-3—Confidential information and the purchase, sale, or merger of a practice** Rule 301 [ET section 301.01] prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client. The rule provides that it shall not be construed to prohibit the review of a member's professional practice under AICPA or state CPA society authorization.

For purposes of rule 301 [ET section 301.01], a review of a member's professional practice is hereby authorized to include a review in conjunction with a prospective purchase, sale, or merger of all or part of a member's practice. The member must take appropriate precautions (for example, through a written confidentiality agreement) so that the prospective purchaser does not disclose any information obtained in the course of the review, since such information is deemed to be confidential client information.

Members reviewing a practice in connection with a prospective purchase or merger shall not use to their advantage nor disclose any member's confidential client information that comes to their attention.

[Effective February 28, 1990.]



## ET Section 302

### *Contingent Fees*

**.01 Rule 302—Contingent fees** A member in public practice shall not

- (1) Perform for a contingent fee any professional services for, or receive such a fee from a client for whom the member or the member's firm performs,
  - (a) an audit or review of a financial statement; or
  - (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
  - (c) an examination of prospective financial information;or
- (2) Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

The prohibition in (1) above applies during the period in which the member or the member's firm is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in any such listed services.

Except as stated in the next sentence, a contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. Solely for purposes of this rule, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

A member's fees may vary depending, for example, on the complexity of services rendered.

[As adopted May 20, 1991.]

#### ***Interpretation under Rule 302—Contingent Fees***

**.02 302-1—Contingent fees in tax matters** This interpretation defines certain terms in Rule 302 [ET sec. 302 par. .01] and provides examples of the application of the rule. When practicing before the IRS or other taxing authorities, members should ensure compliance with any requirements that are more restrictive.

#### **Definition of Terms**

- (a) Preparation of an original or amended tax return or claim for tax refund includes giving advice on events that have occurred at the time the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a return or claim for refund.

- (b) A fee is considered determined based on the findings of governmental agencies if the member can demonstrate a reasonable expectation, at the time of a fee arrangement, of substantive consideration by an agency with respect to the member's client. Such an expectation is deemed not reasonable in the case of preparation of original tax returns.

### Examples

The following are examples, not all-inclusive, of circumstances where a contingent fee would be permitted:

1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return.
2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case (involving a different taxpayer) or with respect to which the taxing authority is developing a position.
3. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation (\$1 million at March 1991) or state taxing authority.
4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests.
5. Requesting, by means of "protest" or similar document, consideration by the state or local taxing authority of a reduction in the "assessed value" of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value.
6. Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute.

The following is an example of a circumstance where a contingent fee would not be permitted:

1. Preparing an amended federal or state income tax return for a client claiming a refund of taxes because a deduction was inadvertently omitted from the return originally filed. There is no question regarding the propriety of the deduction; rather the claim is filed to correct an omission.

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

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## ET Section 391

### ***Ethics Rulings on Responsibilities to Clients***

#### **1. Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member**

**.001 Question**—A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined in Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*) or an individual not employed by the member (a "third-party service provider") to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients or for providing administrative support services to the member (for example, record storage, software application hosting, or authorized e-file tax transmittal services). Does Rule 301, *Confidential Client Information* [sec. 301 par. .01], require the member to obtain the client's consent before disclosing confidential client information to the third-party service provider?

**.002 Answer**—No. Rule 301 [sec. 301 par. .01] is not intended to prohibit a member in public practice from disclosing confidential client information to a third-party service provider used by the member for purposes of providing professional services to clients or for administrative support purposes. However, before using such a service provider, the member should enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the information and be reasonably assured that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential information to others. The nature and extent of procedures necessary to obtain reasonable assurance depends on the facts and circumstances, including the extent of publicly available information on the third-party service provider's controls and procedures to safeguard confidential client information.

In the event the member does not enter into a confidentiality agreement with a third-party service provider, specific client consent should be obtained before the member discloses confidential client information to the third-party service provider.

See Ethics Ruling No. 112, "Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services," of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .224–.225], and Ethics Ruling No. 12, "Applicability of General and Technical Standards When Using a Third-Party Service Provider," of section 291, *Ethics Rulings on General and Technical Standards* [sec. 291 par. .023–.024], for additional responsibilities of the member when using a third-party service provider.

[Revised, effective July 1, 2005, except for professional services performed pursuant to agreements in existence on June 30, 2005, that are completed by December 31, 2005, by the Professional Ethics Executive Committee. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

## 2. Disclosure of Client Information to Third Parties

**.003 Question**—A member has received a request from a third party (for example, a trade association, member of academia, or surveying or benchmarking organization) to disclose client information or intends to use such information for the member's own purposes (for example, publication of benchmarking data or studies) in a manner that may result in the client's information being disclosed to others without the client being specifically identified. May the member comply with such a request or use client information for such purposes without violating Rule 301 [sec. 301 par. .01]?

**.004 Answer**—A member would be in violation of Rule 301 [sec. 301 par. .01] if the information is considered to be confidential client information, unless the member has the clients' specific consent, preferably in writing, for the disclosure or use of such information. The disclosure or use of information that is available to the public is not subject to Rule 301 [sec. 301 par. .01]. The member should be cautious in the disclosure or use of the information so as not to disclose client information that may go beyond what is available to the public or that the client has agreed may be disclosed.

Accordingly, before disclosing confidential client information to a third party or using such information for the member's own purposes when the use of such information results in disclosure of confidential client information to others, the member should obtain the client's specific consent, preferably in writing, about the nature of the information that may be disclosed, the type of third party to whom it may be disclosed, and its intended use.

A member is not prohibited from marketing his or her services or advising a third party, such as a current or prospective client, of information based on his or her expertise or knowledge obtained from prior experiences with clients (for example, the nature of services provided to other clients or common practices within a client's industry). However, in cases when such information may be identifiable to one or more clients, specific consent, preferably in writing, would be required from such client(s). Prior to disclosing confidential client information to a third party, the member should consider whether a contractual agreement with the third party to maintain the confidentiality, or limit the use, of the information is necessary.

In addition, the member should consider whether federal, state, or local statutes, rules, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in this ethics ruling.

See Ethics Ruling No. 12 of section 291 [sec. 291 par. .023–.024], and Ethics Ruling No. 1, "Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member," of this section [sec. 391 par. .001–.002] for guidance when disclosing confidential client information to a third party used to assist the member in providing professional services to clients that will not result in disclosure to others.

[Revised September 2011, effective November 30, 2011.]

## 3. Information to Successor Accountant About Tax Return Irregularities

**.005 Question**—A member withdrew from an engagement on discovering irregularities in his or her client's tax return. May he or she reveal to the successor accountant why the relationship was terminated?

**.006 Answer**—Rule 301 [sec. 301 par. .01] is not intended to help an unscrupulous client cover up illegal acts or otherwise hide information by changing CPAs. If the member is contacted by the successor he or she should, at a minimum, suggest that the successor ask the client to permit the member to



discuss all matters freely with the successor. The successor is then on notice of some conflict. Because of the serious legal implications, the member should seek legal advice as to his or her status and obligations in the matter.

#### **[4.] Prior Client Relationship**

[.007–.008] [Deleted August 1989]

#### **[5.] Records Retention Agency**

[.009–.010] [Deleted October 2004]

### **6. Revealing Client Information to Competitors**

**.011 Question**—A municipality in a particular state enforces a personal property tax on business inventories, fixtures and equipment, and machinery by retaining a firm of CPAs to examine the books and records of the businesses to be sure the proper amount has been declared. In the course of its engagement, the CPA firm will examine sales, purchases, gross profit percentages, and inventories as well as fixed asset accounts. A member serving one of the companies involved objects to these procedures on the ground that information gathered from the books and records of his or her client could be inadvertently conveyed to competitors by employees of the CPA firm doing the audit. Is such an engagement ethically proper?

**.012 Answer**—It would be proper for a member's firm to perform such services. It should be emphasized to everyone concerned that Rule 301 [sec. 301 par. .01] prohibits members from revealing to others any confidential information obtained in their professional capacity.

### **7. Revealing Names of Clients**

**.013 Question**—May a member in public practice disclose the name of a client for whom the member or the member's firm performed professional services?

**.014 Answer**—It is permissible under Rule 301 [sec. 301 par. .01] for a member to disclose the name of a client, whether publicly or privately owned, without the client's specific consent unless the disclosure of the client's name constitutes the release of confidential information. For example, if a member's practice is limited to bankruptcy matters, the disclosure of a client's name would suggest that the client may be experiencing financial difficulties, which could be confidential client information.

[Replaced previous Ethics Ruling No. 7, *Revealing Names of Employer's Clients*, effective August 31, 1989.]

#### **[8.] Fee as Percentage of Bond Issue**

[.015–.016] [Deleted June 1991]

#### **[9.] Finder's Fee**

[.017–.018] [Deleted June 1991]

#### **[10.] Fee as Expert Witness**

[.019–.020] [Deleted June 1991]

#### **[11.] Fee Contingent on Mortgage Commitment**

[.021–.022] [Deleted June 1991]

**[12.] Fee as Percentage of Tax Savings**

[.023-.024] [Deleted June 1991]

**[13.] Contingent Fees to Fire Adjuster**

[.025-.026] [Deleted June 1991]

**14. Use of Confidential Information on Management Consulting Service Engagements**

**.027 Question**—In the course of performing a feasibility study a nonclient outside source has provided pertinent information to the member's firm with the understanding that the source and the details of the information will not be disclosed. The information, which the firm believes is pertinent, directly affects its conclusions and recommendations. How may this information be utilized in connection with the feasibility study engagement and related conclusions and recommendations?

**.028 Answer**—Rule 301 [sec. 301 par. .01] regarding confidential client information is not directly applicable to the circumstances described; however, Rule 501, *Acts Discreditable* [sec. 501 par. .01], is applicable to situations involving confidential relationships with non-clients. For an engagement in which it appears likely that the development of pertinent information will have to come from outside nonclient sources, and such information must remain confidential, the terms of the engagement with the client should specify that the confidences of outside nonclient sources will not be divulged by the member's firm even when they might affect the outcome of the engagement. If the use of confidential outside sources is necessary and the terms of the engagement are silent regarding disclosure of source and details, the member should promptly seek the approval of the client to present his or her recommendations without making disclosures that include confidential information. If the client does not agree to this, the member should withdraw rather than breach a confidence or improperly limit the inclusion of information in his or her final recommendation.

**15. Earlier Similar Management Consulting Service Study With Negative Outcome**

**.029 Question**—A prospective client has asked a member's firm to study the desirability of his or her using a newly developed electronic ticketing system for his or her business. A recent study made for another client leads the member's firm to believe that the system would not be desirable for him or her. Must the firm state its reservations at the risk of disclosing information acquired while performing an assignment for a client competitor?

**.030 Answer**—Rule 301 [sec. 301 par. .01] provides that a member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. Knowledge and expertise which results in a special competence in a particular field can be provided to a client without violating the confidence of another client. Reservations that the firm may have concerning the electronic ticketing system should be communicated to the prospective client provided the details of the other client's engagement are not disclosed. If, however, circumstances are such that the prospective client would clearly know the origin of the information on which the member's reservations are based, and such information is sensitive, the engagement should not be accepted without clearance with the first client.

## 16. Disclosure of Confidential Client Information

**.031 Question**—A member has prepared a married couple's joint tax returns for several years. The member was engaged by and has dealt exclusively with spouse A. Divorce proceedings are now under way and spouse B has approached the member with requests for confidential information relating to prior tax returns. Spouse A has directed the member not to comply with spouse B's requests. Would release of this information by the member to spouse B constitute a violation of Rule 301 [sec. 301 par. .01]?

**.032 Answer**—As defined by the Code of Professional Conduct, spouse B would be considered to be a client with respect to the prior tax returns in question. Therefore, release of the requested information to spouse B would not be prohibited by Rule 301 [sec. 301 par. .01]. The member should consider, however, reviewing the legal implications of such a disclosure with an attorney.

## 17. Definition of the Receipt of a Contingent Fee or a Commission

**.033 Question**—Rules 302, *Contingent Fees* [sec. 302 par. .01], and 503, *Commissions and Referral Fees* [sec. 503 par. .01], prohibit, among other acts, the receipt of contingent fees for the performance of certain services and the receipt of a commission for the referral of products or services under certain circumstances. When is a contingent fee or commission deemed to be received?

**.034 Answer**—A contingent fee or a commission is deemed to be received when the performance of the related services is complete and the fee or the commission is determined. For example, if in one year a member sells a life insurance policy to a client and the member's commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year the policy is sold.

## 18. Bank Director

**.035 Question**—May a member in public practice serve as a director of a bank?

**.036 Answer**—Yes; however, before accepting a bank directorship, the member should carefully consider the implications of such service if the member has clients that are customers of the bank.

These implications fall into two categories:

- a. **Confidential Client Information**—Rule 301 [sec. 301 par. .01] provides that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This ethical requirement applies even though failure to disclose information may constitute a breach of the member's fiduciary responsibility as a director.
- b. **Conflicts of Interest**—Interpretation No. 102-2, "Obligations of a Member to His or Her Employer's External Accountant" [sec. 102 par. .03], provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from all appropriate parties, performance of the service shall not be prohibited.

In view of the preceding factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is engaged in public practice, the member should avoid the high probability of a conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with the member's ability to serve the client's interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances, it would be more appropriate for the member as part of the member's public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit activities to those which did not involve conflicts of interest or confidentiality problems.

### 19. Receipt of Contingent Fees or Commissions by Member's Spouse

**.037 Question**—May a member's spouse provide services to the member's attest client for a contingent fee or refer products or services for a commission to or from the member's attest client without causing the member to be in violation of Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01]?

**.038 Answer**—Yes, if the activities of the member's spouse are separate from the member's practice and the member is not significantly involved in those activities. The member, however, should consider whether a conflict of interest may exist as described in Rule 102, *Integrity and Objectivity* [sec. 102 par. .01], and Interpretation 102-2 [sec. 102 par. .03].

### 20. Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

**.039 Question**—A member has learned of a potential claim that may be filed against the member. The member's professional liability insurance policy requires that the carrier be promptly notified of actual or potential claims. If the member notifies the carrier and complies with its request for documents that would constitute confidential client information without the client's permission, would the member be in violation of Rule 301 [sec. 301 par. .01]?

**.040 Answer**—No. Rule 301 [sec. 301 par. .01] is not intended to prohibit a member from releasing confidential client information to the member's liability insurance carrier solely to assist the defense against an actual or potential claim against the member.

### 21. Member Providing Services for Company Executives

**.041 Question**—A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in the member recommending to the executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

**.042 Answer**—Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102 [sec. 102 par. .01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member should also consider informing

the company and the executives of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301 [sec. 301 par. .01].

## **[22.] Member Removing Client Files From an Accounting Firm**

[.043--.044] [Deleted December 1998]

### **23. Disclosure of Confidential Client Information in Legal or Alternative Dispute Resolution Proceedings**

**.045 Question**—A member discloses confidential client information to the member's attorney or a court or in documents or proceedings in connection with an actual or threatened lawsuit or alternative dispute resolution proceedings relating to that client. Would the member be in violation of the Rule 301 [sec. 301 par. .01] of the Code of Professional Conduct?

**.046 Answer**—No. Rule 301 [sec. 301 par. .01] is not included to prohibit a member from disclosing the information necessary to initiate, pursue or defend himself or herself in such proceedings.

This ruling is not intended to prohibit a member's compliance with applicable federal or state laws or regulations.

### **24. Investment Advisory Services**

**.047 Question**—A member or member's firm ("member") provides investment advisory services for an attest client for a fee based on a percentage of the client's investment portfolio. Would the member be considered to be in violation of Rule 302 [sec. 302 par. .01]?

**.048 Answer**—Yes. However, the fee would not be contingent upon portfolio performance and, therefore, would not be in violation of Rule 302 [sec. 302 par. .01] if all of the following conditions are met:

1. The fee is determined as a specified percentage of the client's investment portfolio.
2. The dollar amount of the portfolio on which the fee is based is determined at the beginning of each quarterly period (or longer period of time as may be agreed upon) and is adjusted only for additions or withdrawals made by the client during the period.
3. The fee arrangement is not renewed with the client more frequently than on a quarterly basis.

When performing such services, the member should also consider Rule 101, *Independence* [sec. 101 par. .01], especially Interpretation 101-3, "Performance of Nonattest Services" [sec. 101 par. .05].

### **25. Commission and Contingent Fee Arrangements With Nonattest Client**

**.049 Question**—A member or member's firm (member) provides for a contingent fee investment advisory services, or refers for a commission products or services of a nonclient or a nonattest client, to the owners, officers, or employees of an attest client or to a nonattest client employee benefit plan sponsored by an attest client. Would the member be considered to be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01]?

**.050** *Answer*—No. The member would not be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01] provided that, with respect to Rule 503 [sec. 503 par. .01], the member discloses the commission to the owners, officers, or employees or to the employee benefit plan. The member should also consider the applicability of Interpretation 102-2 [sec. 102 par. .03], and his or her professional responsibility to clients under Rule 301 [sec. 301 par. .01].

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**ET Section 400**  
**RESPONSIBILITIES TO COLLEAGUES**

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*[Reserved.]*

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## ET Section 500

## OTHER RESPONSIBILITIES AND PRACTICES

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## ET Section 501

### ***Acts Discreditable***

**.01 Rule 501—Acts discreditable** A member shall not commit an act discreditable to the profession.

[As adopted January 12, 1988.]

#### ***Interpretations under Rule 501—Acts Discreditable***

##### **.02 501-1—Response to requests by clients and former clients for records**

###### Terminology

The following terms are defined subsequently solely for use with this interpretation:

- The term *client* includes current and former clients.
- *Client-provided records* are accounting or other records belonging to the client that were provided to the member by, or on behalf of, the client, including hard copy or electronic reproductions of such records.
- *Member-prepared records* are accounting or other records that the member was not specifically engaged to prepare and that are not in the client's books and records or are otherwise not available to the client, with the result that the client's financial information is incomplete. Examples include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries), and supporting schedules and documents that are proposed or prepared by the member as part of an engagement (for example, an audit).
- *Member's work products* are deliverables as set forth in the terms of the engagement, such as tax returns.
- *Member's working papers* are all other items prepared solely for purposes of the engagement and include items prepared by the
  - member, such as audit programs, analytical review schedules, and statistical sampling results and analyses, and
  - client, at the request of the member and reflecting testing or other work done by the member.

###### Interpretation

Members must comply with the rules and regulations of authoritative regulatory bodies, such as the member's state board(s) of accountancy, when the member performs services for a client and is subject to the rules and regulations of such regulatory body. For example, a member's state board(s) of accountancy may not permit a member to withhold certain records notwithstanding fees due to the member for the work performed. Failure to comply with the more restrictive provisions contained in the rules and regulations of the applicable regulatory body concerning the return of certain records would constitute a violation of this interpretation.

Client-provided records in the member's custody or control should be returned to the client at the client's request.

Unless a member and the client have agreed to the contrary, when a client makes a request for member-prepared records or a member's work products that are in the custody or control of the member or the member's firm (member) that have not previously been provided to the client, the member should respond to the client's request as follows:<sup>1</sup>

- Member-prepared records relating to a completed and issued work product should be provided to the client, except that such records may be withheld if there are fees due to the member for the specific work product.
- Member's work products should be provided to the client, except that such work products may be withheld
  - if there are fees due to the member for the specific work product;
  - if the work product is incomplete;
  - for purposes of complying with professional standards (for example, withholding an audit report due to outstanding audit issues); or
  - if threatened or outstanding litigation exists concerning the engagement or member's work.

Once the member has complied with these requirements, he or she is under no ethical obligation to comply with any subsequent requests to again provide such records or copies of such records. However, if subsequent to complying with a request, a client experiences a loss of records due to a natural disaster or an act of war, the member should comply with an additional request to provide such records.

Member's working papers are the member's property and need not be provided to the client under provisions of this interpretation; however, such requirements may be imposed by state and federal statutes and regulations, and contractual agreements.

In connection with any request for client-provided records, member-prepared records or a member's work products, the member may

- charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records and require that such fee be paid prior to the time such records are provided to the client,
- provide the requested records in any format usable by the client, and
- make and retain copies of any records returned or provided to the client.

The member is not required to convert records that are not in electronic format to electronic format or to convert electronic records into a different type of electronic format. However, if the client requests records in a specific format, and the records are available in such format within the member's custody and control, the client's request should be honored. In addition, the member is not required to provide the client with formulas, unless the formulas support the client's underlying accounting or other records, or the member was engaged to provide such formulas as part of a completed work product.

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<sup>1</sup> The member is under no obligation to retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed.

Where a member is required to return or provide records to the client, the member should comply with the client's request as soon as practicable but, absent extenuating circumstances, no later than 45 days after the request is made. The fact that the statutes of the state in which the member practices grants the member a lien on certain records in his or her custody or control does not relieve the member of his or her obligation to comply with this interpretation.

[Revised, February 2012, effective April 30, 2012, by the Professional Ethics Executive Committee. Revised, effective February 28, 2011. Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, effective April 30, 2006, by the Professional Ethics Executive Committee.]

**.03 501-2—Discrimination and harassment in employment practices** Whenever a member is finally determined by a court of competent jurisdiction to have violated any of the antidiscrimination laws of the United States or any state or municipality thereof, including those related to sexual and other forms of harassment, or has waived or lost his or her right of appeal after a hearing by an administrative agency, the member will be presumed to have committed an act discreditable to the profession in violation of Rule 501, *Acts Discreditable* [sec. 501 par. .01].

[Revised, effective November 30, 1997, by the Professional Ethics Executive Committee.]

**.04 501-3—Failure to follow standards and/or procedures or other requirements in governmental audits** Engagements for audits of government grants, government units or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules, and regulations, in addition to generally accepted auditing standards. If a member has accepted such an engagement and undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules and regulations, in addition to generally accepted auditing standards, he or she is obligated to follow such requirements. Failure to do so is an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01], unless the member discloses in his or her report the fact that such requirements were not followed and the reasons therefor.

**.05 501-4—Negligence in the preparation of financial statements or records** A member shall be considered to have committed an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01] when, by virtue of his or her negligence, such member—

- a. Makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity; or
- b. Fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry; or
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

**.06 501-5—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies** Many governmental bodies, commissions or other regulatory agencies have established requirements such as audit standards, guides, rules, and regulations that members are required to follow in the preparation of financial statements or related information, or

in performing attest or similar services for entities subject to their jurisdiction. For example, the Securities and Exchange Commission (SEC), Federal Communications Commission, state insurance commissions, and other regulatory agencies, such as the Public Company Accounting Oversight Board, have established such requirements.

If a member prepares financial statements or related information (for example, management's discussion and analysis) for purposes of reporting to such bodies, commissions, or regulatory agencies, the member should follow the requirements of such organizations in addition to generally accepted accounting principles. If a member agrees to perform an attest or similar service for the purpose of reporting to such bodies, commissions, or regulatory agencies, the member should follow such requirements, in addition to generally accepted auditing standards (where applicable). A material departure from such requirements is an act discreditable to the profession, unless the member discloses in the financial statements or his or her report, as applicable, that such requirements were not followed and the reasons therefore.

[Effective August 31, 1989. Revised, effective October 31, 2000, by the Professional Ethics Executive Committee. Revised, effective April 30, 2004, by the Professional Ethics Executive Committee.]

**.07 501-6—Solicitation or disclosure of CPA examination questions and answers** A member who solicits or knowingly discloses the May 1996 or later Uniform CPA Examination question(s) or answer(s), or both, without the written authorization of the AICPA shall be considered to have committed an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01].

[Effective January 31, 1996. Revised May 1996, by the Professional Ethics Executive Committee.]

**.08 501-7—Failure to file tax return or pay tax liability** A member who fails to comply with applicable federal, state, or local laws or regulations regarding the timely filing of his or her personal tax returns or tax returns of the member's firm, or the timely remittance of all payroll and other taxes collected on behalf of others, may be considered to have committed an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01].

[Effective May 31, 1999.]

**.09 501-8—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnification and limitation of liability provisions in connection with audit and other attest services** Certain governmental bodies, commissions, or other regulatory agencies (collectively, *regulators*) have established requirements through laws, regulations, or published interpretations that prohibit entities subject to their regulation (*regulated entity*) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators or that provide that the existence of such provisions causes a member to be disqualified from providing such services to these entities. For example, federal banking regulators, state insurance commissions, and the SEC have established such requirements.

If a member enters into, or directs or knowingly permits another individual to enter into, a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the member should not include, or knowingly permit or direct another individual to include, an indemnification or limitation of liability provision that would cause the regulated entity or a member to be in violation of such requirements or that would cause a member to be disqualified from providing such services to the regulated entity. A member who enters into, or directs or knowingly permits another individual

to enter into, such an agreement for the performance of audit or other attest services that would cause the regulated entity or a member to be in violation of such requirements, or that would cause a member to be disqualified from providing such services to the regulated entity, would be considered to have committed an act discreditable to the profession.

Members should also consult Ethics Ruling No. 94, "Indemnification Clause in Engagement Letters," of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .188–.189] and Ethics Ruling No. 102, "Indemnification of a Client," of ET section 191 [sec. 191 par. .204–.205] under Rule 101, *Independence*, for guidance related to use of indemnification clauses in engagement letters and the impact on a member's independence.

[Effective July 31, 2008.]

**.10 501-9—Confidential information obtained from employment or volunteer activities** A member should maintain confidentiality of his or her employer's or firm's (employer) confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship (for example, discussions with the employer's vendors, customers, or lenders). This includes, but is not limited to, any confidential information pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the member is working in a volunteer capacity. For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the member may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

A member should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or a close or immediate family member. The member should also take reasonable steps to ensure that staff under his or her control or others within the employing organization and persons from whom advice and assistance is obtained are aware of the confidential nature of the information.

When a member changes employment, a member should not use confidential employer information acquired as a result of the prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain confidentiality of an employer's confidential information continues even after the end of the relationship between a member and the employer. However, the member is entitled to use experience and expertise gained through prior employment relationships.

A member would be considered to have committed an act discreditable to the profession if the member discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the member may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

The following are examples when members are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the employer.
- b. Disclosure is required by law, for example, to
  - i. comply with a validly issued and enforceable subpoena or summons or

- ii. inform the appropriate public authorities of violations of law that have been discovered.
- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
  - i. initiate a complaint with, or respond to any inquiry made by, the professional ethics division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;
  - ii. protect the professional interests of a member in legal proceedings;
  - iii. comply with professional standards and other ethics requirements; or
  - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the employer's confidential complaint hotline or those charged with governance.

Members should also consider Interpretation 102-4, "Subordination of Judgment by a Member," under Rule 102, *Integrity and Objectivity* [sec. 102 par. .05], for additional guidance.
- d. Disclosure is permitted on behalf of the employer to
  - i. obtain financing with lenders;
  - ii. deal with vendors, clients, and customers; or
  - iii. deal with the employer's external accountant, attorneys, regulators, and other business professionals.

In deciding whether to disclose confidential employer information, relevant factors to consider include, but are not limited to, the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable (when the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, professional judgment should be used in determining the type of disclosure to be made, if any)
- b. Whether the parties to whom the communication may be addressed are appropriate recipients

A member may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information.

[Effective November 30, 2011.]

**.11 501-10—False, misleading, or deceptive acts in promoting or marketing professional services** A member in business who promotes or markets his or her abilities to provide professional services or makes claims about his or her experience or qualifications in a manner that is false, misleading, or deceptive will be considered to have committed an act discreditable to the profession, in violation of Rule 501 [sec. 501 par. .01]. A false, misleading, or deceptive promotion includes any claim or representation that would be likely to cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body.

[Effective November 30, 2011.]

**.12 501-11—Use of the CPA Credential** A member should refer to applicable state accountancy laws and board of accountancy rules and regulations

for guidance regarding the use of the CPA credential. A member who fails to follow the accountancy laws, rules, and regulations regarding the use of the CPA credential in all the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of Rule 501 [sec. 501 par. .01].

[Added March 2013, effective May 31, 2013.]

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## ET Section 502

### *Advertising and Other Forms of Solicitation*

**.01 Rule 502—Advertising and other forms of solicitation** A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited.

[As adopted January 12, 1988.]

#### *Interpretations under Rule 502—Advertising and Other Forms of Solicitation*

[.02] [502-1]—[Deleted]

**.03 502-2—False, misleading or deceptive acts in advertising or solicitation** Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that—

1. Create false or unjustified expectations of favorable results.
2. Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
3. Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood.
4. Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

[Revised, November 30, 1990, by the Professional Ethics Executive Committee.]

[.04] [502-3]—[Deleted]

[.05] [502-4]—[Deleted]

**.06 502-5—Engagements obtained through efforts of third parties** Members are often asked to render professional services to clients or customers of third parties. Such third parties may have obtained such clients or customers as the result of their advertising and solicitation efforts.

Members are permitted to enter into such engagements. The member has the responsibility to ascertain that all promotional efforts are within the bounds of the Rules of Conduct. Such action is required because the members will receive the benefits of such efforts by third parties, and members must not do through others what they are prohibited from doing themselves by the Rules of Conduct.

**.07 502-6—Use of the CPA Credential** A member should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A member who fails to follow the accountancy laws, rules, and regulations regarding the use of the CPA

credential in all the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of Rule 502 [sec. 502 par. .01].

[Added March 2013, effective May 31, 2013.]

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## ET Section 503

### *Commissions and Referral Fees*

#### **.01 Rule 503—Commissions and referral fees**

##### *A. Prohibited commissions*

A member in public practice shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to be supplied by a client, or receive a commission, when the member or the member's firm also performs for that client

- (a) an audit or review of a financial statement; or
- (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
- (c) an examination of prospective financial information.

This prohibition applies during the period in which the member is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in such listed services.

##### *B. Disclosure of permitted commissions*

A member in public practice who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall disclose that fact to any person or entity to whom the member recommends or refers a product or service to which the commission relates.

##### *C. Referral fees*

Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

[As adopted May 23, 1990, effective August 9, 1990.]

#### ***Interpretation under Rule 503—Commissions and Referral Fees***

[.02] [503-1]—[Deleted]

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## ET Section 505

### *Form of Organization and Name*

**.01 Rule 505—Form of organization and name** A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.

A member shall not practice public accounting under a firm name that is misleading. Names of one or more past owners may be included in the firm name of a successor organization.

A firm may not designate itself as "Members of the American Institute of Certified Public Accountants" unless all of its CPA owners are members of the Institute.

[As amended January 14, 1992 and October 28, 1997. Revised May 15, 2000.]

(See Appendix B.)

#### *Interpretations under Rule 505—Form of Organization and Name*

[.02] [505-1]—[Deleted]

**.03 505-2—Application of rules of conduct to members who own a separate business** A member in public practice may own an interest in a separate business that performs for clients any of the professional services of accounting, tax, personal financial planning, litigation support services, and those services for which standards are promulgated by bodies designated by council (see paragraph .06 in section 92, *Definitions*). If the member, individually or collectively with his or her firm or members of his or her firm, controls the separate business (as defined in Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*), the entity and all its owners (including the member) and employees must comply with all of the provisions of the Code of Professional Conduct. For example, in applying Rule 503, *Commissions and Referral Fees* [sec. 503 par. .01], if one or more members individually or collectively can control the separate business, such business would be subject to Rule 503 [sec. 503 par. .01], its interpretations, and rulings. With respect to an attest client, Rule 101, *Independence* [sec. 101 par. .01], and all its interpretations and rulings would apply to the separate business, its owners, and employees.

If the member, individually or collectively with his or her firm or members of his or her firm, does not control the separate business, the provisions of the code would apply to the member for his or her actions but not apply to the entity, its other owners, and employees. For example, the entity could enter into a contingent fee arrangement with an attest client of the member or accept commissions for the referral of products or services to such attest client.

[Replaces previous Interpretation No. 505-2, with the same title, March 1993, effective March 31, 1993. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Revised March 2013, revisions effective May 31, 2013.]

**.04 505-3—Application of rule 505 to alternative practice structures** Rule 505, *Form of Organization and Name* [sec. 505 par. .01], states, "A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council." The Council Resolution (the Resolution) requires, among other things, that a majority of the financial interests in a firm engaged in attest services (as defined therein) be owned by CPAs. In the context of alternative practice structures (APS) in which (1) the majority of the financial interests in the attest firm is owned by CPAs and (2) all or substantially all of the revenues are paid to another entity in return for services and the lease of employees, equipment, and office space, questions have arisen as to the applicability of Rule 505 [sec. 505 par. .01].

The overriding focus of the Resolution is that CPAs remain responsible, financially and otherwise, for the attest work performed to protect the public interest. The Resolution contains many requirements that were developed to ensure that responsibility. In addition to the provisions of the Resolution, other requirements of the Code of Professional Conduct and bylaws ensure that responsibility:

- a. Compliance with all aspects of applicable state law or regulation
- b. Enrollment in an AICPA-approved practice monitoring program
- c. Compliance with the independence rules prescribed by Rule 101, *Independence* [sec. 101 par. .01]
- d. Compliance with applicable standards promulgated by Council-designated bodies (Rule 202, *Compliance With Standards* [sec. 202 par. .01]) and all other provisions of the Code, including section 91, *Applicability*

Taken in the context of all the above-mentioned safeguards of the public interest, if the CPAs who own the attest firm remain financially responsible, under applicable law or regulation, the member is considered to be in compliance with the financial interests provision of the Resolution.

[Effective December 31, 1998. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, June 2009.]

**.05 505-4—Misleading Firm Names** Rule 505 [sec. 505 par. .01] prohibits a member from practicing public accounting under a firm name that is misleading. A firm name would be considered misleading if the name contains any representation that would be likely to cause a reasonable person to misunderstand, or be confused about, the legal form of the firm or who the owners or members of the firm are, such as a reference to a type of organization or an abbreviation thereof that does not accurately reflect the form under which the firm is organized.

In addition, the member should consider the rules and regulations of his or her state board(s) of accountancy concerning misleading firm names that may be more restrictive than the requirements contained in this ethics interpretation.

[Effective August 31, 2012, by the Professional Ethics Executive Committee.]

**.06 505-5—Common Network Brand in Firm Name** Firms within a network sometimes share the use of a common brand or share common initials as part of the firm name. The sharing of a common brand name or common initials of a network as part of the member's firm name would not be considered misleading, provided the firm is a *network firm*, as defined in paragraph .24 of section 92.

The sharing of a common brand name or common initials of a network as the entire name of the member's firm would not be considered misleading, provided

the firm is a *network firm*, as defined in paragraph .24 of section 92, and shares one or more of the following characteristics with other firms in the network:

- Common control (as defined in Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*) among the firms through ownership, management, or other means
- Profits or costs, excluding costs of operating the network; costs of developing audit methodologies, manuals, and training courses; and other costs that are immaterial to the firm
- Common business strategy that involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the network's strategy and are held accountable for performance pursuant to that strategy
- Significant part of professional resources
- Common quality control policies and procedures that firms are required to implement and that are monitored by the network

Members should refer to Interpretation No. 101-17, "Networks and Network Firms," under Rule 101, *Independence* [ET sec. 101 par. .19], for independence requirements applicable to network firms.

[Effective August 31, 2012, by the Professional Ethics Executive Committee.]

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## ET Section 591

# *Ethics Rulings on Other Responsibilities and Practices*

### [1.] Retention of Records

[.001–.002] [Superseded by Interpretation No. 501-1.]

### [2.] Fees: Collection of Notes Issued in Payment

[.003–.004] [Deleted, November 2011.]

### 3. Employment by Non-CPA Firm

**.005 Question**—A member is considering employment with a public accounting firm made up of one or more non-CPA practitioners. If he or she is employed by such a firm, what are his or her responsibilities under the Rules of Conduct?

**.006 Answer**—A member so employed must comply with all the Rules of Conduct. If he or she becomes a partner in such a firm, he or she will then in addition be held responsible for compliance with the Rules of Conduct by all persons associated with him or her.

### [4.] Association Employee

[.007–.008] [Deleted, March 1978.]

### [5.] Association as an Agent

[.009–.010] [Deleted, March 1978.]

### [6.] Associations, Speaking Engagements

[.011–.012] [Deleted, March 1978.]

### [7.] Trading Pool

[.013–.014] [Deleted, March 1978.]

### [8.] Change of Control of Client Company

[.015–.016] [Deleted, September 1981.]

### [9.] Charity Solicitation by Phone

[.017–.018] [Deleted, March 1978.]

### [10.] Church Bulletin

[.019–.020] [Deleted, March 1978.]

**[11.] Attorney, Clients**

[.021-.022] [Deleted, March 1978.]

**[12.] Confirmation Requests**

[.023-.024] [Deleted, March 1978.]

**[13.] Confirmation Stickers**

[.025-.026] [Deleted, March 1978.]

**[14.] Estate Planning**

[.027-.028] [Deleted, March 1978.]

**[15.] Golf Outing**

[.029-.030] [Deleted, March 1978.]

**[16.] Letter on Behalf of Client**

[.031-.032] [Deleted, March 1978.]

**[17.] Letterhead for Estate Practice**

[.033-.034] [Deleted, March 1978.]

**[18.] Letterhead for Promotional Material**

[.035-.036] [Deleted, March 1978.]

**[19.] Mailings to Accountants**

[.037-.038] [Deleted, March 1978.]

**[20.] Trade Association Analysis**

[.039-.040] [Deleted, September 1981.]

**[21.] Trade Association Survey**

[.041-.042] [Deleted, September 1981.]

**[22.] Management Consultant**

[.043-.044] [Deleted, March 1978.]

**[23.] Tax Work Obtained Through Bookkeeper**

[.045-.046] [Deleted, March 1978.]

**[24.] Advertising on Tax Broadcast**

[.047-.048] [Deleted, March 1978.]

**[25.] Alumni Magazine Announcement**

[.049-.050] [Deleted, March 1978.]

**[26.] Brochure Showing Use of Equipment**

[.051-.052] [Deleted, March 1978.]

**[27.] Client Publishing Article on Member's Software Program**

[.053-.054] [Deleted, March 1978.]

- [28.] **Business Card on Newsletter**  
[.055–.056] [Deleted, March 1978.]
- [29.] **Computer Print-Out**  
[.057–.058] [Deleted, March 1978.]
- [30.] **Charitable Contribution**  
[.059–.060] [Deleted, March 1978.]
- [31.] **Congratulatory Message**  
[.061–.062] [Deleted, March 1978.]
- [32.] **Copyright for Wheel Computer and Tax Withholding Tables**  
[.063–.064] [Deleted, March 1978.]
- [33.] **Course Instructor**  
[.065–.066] [Deleted, November 2011.]
- [34.] **Course Promotional Circular**  
[.067–.068] [Deleted, March 1978.]
- [35.] **CPA-Author Credits**  
[.069–.070] [Deleted, March 1978.]
- [36.] **CPA-Author of Book Review**  
[.071–.072] [Deleted, March 1978.]
- [37.] **CPA-Authored Articles**  
[.073–.074] [Deleted, March 1978.]
- [38.] **CPA Title, Controller of Bank**  
[.075–.076] [Deleted March 2013, effective May 31, 2013.]
- [39.] **CPA Title Imprinted on Checks**  
[.077–.078] [Deleted, March 1978.]
- [40.] **CPA Title in Campaign for School Board Membership**  
[.079–.080] [Deleted, March 1978.]
- [41.] **CPA Title in Lecture Ad**  
[.081–.082] [Deleted, March 1978.]
- [42.] **CPA Title in Political Endorsement**  
[.083–.084] [Deleted, March 1978.]
- [43.] **CPA Designation in Speaker’s Qualifications**  
[.085–.086] [Deleted, March 1978.]

- [44.] **CPA Designation of Speaker Named in Tax Forum Ad**  
[.087-.088] [Deleted, March 1978.]
- [45.] **CPA Title on Agency Letterhead**  
[.089-.090] [Superseded, August 1975.]
- [46.] **CPA Title on Employment Agency Letterhead**  
[.091-.092] [Deleted, March 1978.]
- [47.] **Low-Income Taxpayers**  
[.093-.094] [Deleted, March 1978.]
- [48.] **CPA Title on Public Official's Match Folder**  
[.095-.096] [Deleted, March 1978.]
- [49.] **CPA Designation on Research Reports**  
[.097-.098] [Deleted, March 1978.]
- [50.] **Data Processing Program Ad in Technical Publications**  
[.099-.100] [Deleted, March 1978.]
- [51.] **Directories in Elevator**  
[.101-.102] [Deleted, March 1978.]
- [52.] **Directory, Alphabetical**  
[.103-.104] [Deleted, March 1978.]
- [53.] **Directory, Chamber of Commerce Buyer's Guide**  
[.105-.106] [Deleted, March 1978.]
- [54.] **Directory, Trade Association**  
[.107-.108] [Deleted, March 1978.]
- [55.] **Directory Listing, Bank Auditors**  
[.109-.110] [Deleted, March 1978.]
- [56.] **Directory Listing, Change in Telephone Number Announcements**  
[.111-.112] [Deleted, March 1978.]
- [57.] **Directory Listing, Fraternity**  
[.113-.114] [Deleted, March 1978.]
- [58.] **Directory Listing, "Lawyer-CPA-Tax Attorney"**  
[.115-.116] [Deleted, March 1978.]
- [59.] **Directory Listing, Membership Designation**  
[.117-.118] [Deleted, March 1978.]
- [60.] **Directory Listing, Multiple**  
[.119-.120] [Deleted, March 1978.]

- [61.] Directory Listings**  
[.121–.122] [Deleted, March 1978.]
- [62.] Directory Listing, Partners' Names**  
[.123–.124] [Deleted, March 1978.]
- [63.] Directory Listing, White Pages**  
[.125–.126] [Superseded, February 1976.]
- [64.] Directory, Trade Association**  
[.127–.128] [Deleted, March 1978.]
- [65.] Distribution of Firm Bulletin to Publisher**  
[.129–.130] [Deleted, March 1978.]
- [66.] Distribution of Firm Literature**  
[.131–.132] [Deleted, March 1978.]
- [67.] Firm Publications: Annual Financial Report**  
[.133–.134] [Deleted, March 1978.]
- [68.] Employment Ads: "Situations Wanted"**  
[.135–.136] [Deleted, March 1978.]
- [69.] Firm Name in Staff Training Manual**  
[.137–.138] [Deleted, March 1978.]
- [70.] CPA Title on License Plates**  
[.139–.140] [Deleted, March 1978.]
- [71.] Firm Name on Bowling Shirts**  
[.141–.142] [Deleted, March 1978.]
- [72.] Firm Name on Desk Calendars**  
[.143–.144] [Deleted, March 1978.]
- [73.] Firm Name on EDP Publication**  
[.145–.146] [Deleted, March 1978.]
- [74.] Firm Name on Tax Booklet**  
[.147–.148] [Deleted, September 1981.]
- [75.] Greeting Cards to Clients**  
[.149–.150] [Deleted, March 1978.]
- [76.] Letterhead**  
[.151–.152] [Deleted, March 1978.]
- [77.] Letterhead: Academic Degrees**  
[.153–.154] [Deleted, March 1978.]

**[78.] Letterhead: Lawyer-CPA**

[.155-.156] [Deleted March 2013, effective May 31, 2013.]

**[79.] Letterhead: Tax Specialization**

[.157-.158] [Deleted, March 1978.]

**[80.] Management Letter**

[.159-.160] [Deleted, March 1978.]

**[81.] Medicare Booklet**

[.161-.162] [Deleted, March 1978.]

**[82.] Newsletter**

[.163-.164] [Deleted, November 1997.]

**[83.] Nonpractitioner in Sales Brochure**

[.165-.166] [Deleted, March 1978.]

**[84.] Paid for by Others, Member's Testimonial Letter**

[.167-.168] [Deleted, March 1978.]

**[85.] Paid for by Others, Member's Testimonial Letter**

[.169-.170] [Deleted, March 1978.]

**[86.] Paid for by Others, Name in Client Ad**

[.171-.172] [Deleted, August 1989.]

**[87.] Paid for by Others, Radio Program Dedication**

[.173-.174] [Deleted, March 1978.]

**[88.] Political Endorsement**

[.175-.176] [Deleted, March 1978.]

**[89.] Postage Meter Machines**

[.177-.178] [Deleted, March 1978.]

**[90.] Open House**

[.179-.180] [Deleted, March 1978.]

**[91.] Press Release on Change in Staff**

[.181-.182] [Superseded, March 1975.]

**[92.] Press Release on Change in Staff**

[.183-.184] [Superseded, March 1975.]

**[93.] Press Release on Society Chapter Meeting**

[.185-.186] [Deleted, March 1978.]

- [94.] Professorship Named After CPA**  
[.187–.188] [Deleted, March 1978.]
- [95.] Qualifications as Attachment to Report**  
[.189–.190] [Deleted, March 1978.]
- [96.] Resume for Lender’s Information**  
[.191–.192] [Deleted, March 1978.]
- [97.] Seminar Announcement**  
[.193–.194] [Deleted, March 1978.]
- [98.] Signs on Office Premises**  
[.195–.196] [Deleted, March 1978.]
- [99.] Signs on Office Premises**  
[.197–.198] [Deleted, March 1978.]
- [100.] Specialization on Business Card**  
[.199–.200] [Deleted, March 1978.]
- [101.] Specialization, Acquisitions & Mergers**  
[.201–.202] [Deleted, June 1982.]
- [102.] Specialization: “Tax Accountant” Designation by Nonpractitioner**  
[.203–.204] [Deleted, March 1978.]
- [103.] Recruiting Ad in Employment Guide or Career Opportunity Guide**  
[.205–.206] [Deleted, March 1978.]
- [104.] Staff Recruiting in University Publication**  
[.207–.208] [Deleted, March 1978.]
- [105.] Announcement Card: Elected to Vice Presidency**  
[.209–.210] [Deleted, March 1978.]
- [106.] Information Under Telephone Directory Heading**  
[.211–.212] [Deleted, March 1978.]
- [107.] Member as Consultant for Client’s Customers**  
[.213–.214] [Deleted, March 1978.]
- [108.] Member Interviewed by the Press**  
[.215–.216] [Deleted, November 2011.]
- [109.] Compensation From Nonpractitioners**  
[.217–.218] [Deleted, June 1991.]

- [110.] Computer Service Franchise**  
[.219-.220] [Deleted, June 1991.]
- [111.] Purchase of Bookkeeping Practice**  
[.221-.222] [Deleted, June 1991.]
- [112.] Referral**  
[.223-.224] [Deleted, June 1991.]
- [113.] Member's Spouse as Insurance Agent**  
[.225-.226] [Deleted, June 1991.]
- [114.] Member's Firm Paying Employee Bonuses**  
[.227-.228] [Deleted, June 1991.]
- [115.] Actuary**  
[.229-.230] [Deleted, December 1992.]
- [116.] Bank Director**  
[.231-.232] [Superseded, June 1976.]
- [117.] Consumer Credit Company Director**  
[.233-.234] [Deleted, November 2011.]
- [118.] Employment Agency**  
[.235-.236] [Deleted, March 1978.]
- [119.] Finance Company**  
[.237-.238] [Deleted, March 1978.]
- [120.] Insurance Broker**  
[.239-.240] [Deleted, March 1978.]
- [121.] Insurance Salesman**  
[.241-.242] [Deleted, March 1978.]
- [122.] Investment Advisor**  
[.243-.244] [Deleted, March 1978.]
- [123.] Loan Broker**  
[.245-.246] [Deleted, March 1978.]
- [124.] Mutual Fund Salesman**  
[.247-.248] [Deleted, March 1978.]
- [125.] Private Investor in Business and Real Estate**  
[.249-.250] [Deleted, March 1978.]
- [126.] Real Estate Broker**  
[.251-.252] [Deleted, March 1978.]



**[127.] State Controller**

[.253–.254] [Deleted, August 1989.]

**[128.] State Secretary of Revenue**

[.255–.256] [Deleted, March 1978.]

**[129.] Travel Agency**

[.257–.258] [Deleted, March 1978.]

**[130.] Collection Agent**

[.259–.260] [Deleted, March 1978.]

**[131.] Bookkeeping Service as Feeder**

[.261–.262] [Deleted, March 1978.]

**[132.] Tax Practice: Conflict of Interest**

[.263–.264] [Deleted, August 1989.]

**[133.] Member Employed by Incorporated Law Firm**

[.265–.266] [Deleted, March 1978.]

**[134.] Association of Accountants Not Partners**

[.267–.268] [Deleted, August 2012.]

**[135.] Association of Firms Not Partners**

[.269–.270] [Deleted, April 2012.]

**136. Audit with Former Partner**

**.271 Question**—A member's firm consisting of one certified and one non-certified partner has been dissolved. One account was retained which the two practitioners plan to continue to service together. Should the audit report be submitted on partnership stationery?

**.272 Answer**—It would appear proper for the audit to be carried out jointly by the two former partners. The opinion should be presented on plain paper and signed somewhat as follows:

John Doe, Certified Public Accountant

Richard Roe, Accountant

Such a signature would leave no doubt as to whether a partnership existed, and the client and others would have the assurance that both accountants participated in the audit.

**137. Nonproprietary Partners**

**.273 Question**—A member's firm wishes to institute the designation "non-proprietary partner" to describe certain high-ranking staff who were former partners of merged firms who did not qualify for partnership in the merging firm. With this title, they would be eligible to participate in the firm's pension plan. In holding themselves out to the public they would be required to use this designation. Is there any impropriety in the proposed title?

**.274 Answer**—The use of the designation "partner" should be restricted to those members of the firm who are legally partners. Those who are not parties to the partnership agreement should not hold themselves out in any manner which might lead others to believe that they are partners. The use of the designation "nonproprietary partner" by one who is not in fact a partner is considered misleading and therefore is not permitted.

### **138. Partner Having Separate Proprietorship**

**.275 Question**—May a member be a partner of a firm of public accountants, all other members of which are noncertified, and at the same time retain for him or herself a practice of his or her own as a CPA?

**.276 Answer**—Rule 505 [sec. 505 par. .01] would not prohibit such a practice. However, clients and others interested should be advised about the dual position of the member to prevent any misunderstanding or misrepresentation.

### **[139.] Partnership with Non-CPA**

[.277–.278] [Deleted, December 1998.]

### **[140.] Political Election**

[.279–.280] [Deleted, November 2011.]

### **141. Responsibility for Non-CPA Partner**

**.281 Question**—Is a member who has formed a partnership with a noncertified public accountant ethically responsible for all the acts of the partnership?

**.282 Answer**—Yes. If the noncertified partner should violate the code, the member would be held accountable.

### **[142.] Retired Partners**

[.283–.284] [Deleted, March 1978.]

### **[143.] Partnership With Non-CPA**

[.285–.286] [Deleted, March 1978.]

### **[144.] Title: Partnership Roster**

[.287–.288] [Deleted, November 2011.]

### **145. Firm Name of Merged Partnerships**

**.289 Question**—When two partnerships merge, is it permissible for the newly merged firm to practice under a title which includes the name of a partner who had retired from one of the two firms prior to the merger?

**.290 Answer**—Rule 505 [sec. 505 par. .01] of the Code of Professional Conduct states that partnerships may practice under a firm title which includes the name or names of former partners. Since the retired partner was once a partner in one of the merged firms, it would be proper for his or her name to appear in the title of a newly created firm.

### **[146.] Membership Designation**

[.291–.292] [Deleted, September 1999.]

**[147.] Firm Designation**

[.293–.294] [Deleted, November 1989.]

**[148.] Firm Designation**

[.295–.296] [Deleted, November 1989.]

**[149.] Data Processing: Accounting and Bookkeeping Assistance**

[.297–.298] [Deleted, March 1978.]

**[150.] Data Processing: Billing Service**

[.299–.300] [Deleted, March 1978.]

**[151.] Data Processing: Computer Center**

[.301–.302] [Deleted, March 1978.]

**[152.] Data Processing: Computer Center**

[.303–.304] [Deleted, March 1978.]

**[153.] Data Processing: Computer Center**

[.305–.306] [Deleted, March 1978.]

**[154.] Data Processing: Computer Center, Service Bureau as Client**

[.307–.308] [Deleted, March 1978.]

**[155.] Data Processing: Computer Corporation**

[.309–.310] [Deleted, December 1992.]

**[156.] Data Processing: Consultant to Service Bureaus**

[.311–.312] [Deleted, December 1992.]

**[157.] Data Processing: Employee Not in Practice**

[.313–.314] [Deleted, March 1978.]

**[158.] Operation of Separate Data Processing Business by a Public Practitioner**

[.315–.316] [Deleted, December 1998.]

**[159.] Data Processing: Fees Paid to Other CPAs**

[.317–.318] [Deleted, June 1991.]

**[160.] Data Processing: Forwarding Fees**

[.319–.320] [Deleted, March 1978.]

**[161.] Time-Sharing Computer Programs Developed by Member's Firm**

[.321–.322] [Deleted, March 1978.]

**[162.] CPA Designation on Professional Organization Letterhead**

[.323–.324] [Superseded, August 1975.]

**[163.] Distribution of Firm Publications to News Media**

[.325–.326] [Deleted, March 1978.]

**[164.] Nonclients on Firm Publication Mailing List**

[.327–.328] [Deleted, March 1978.]

**[165.] Sale of Firm Publications**

[.329–.330] [Deleted, March 1978.]

**[166.] Announcement of Member's Withdrawal from Firm**

[.331–.332] [Deleted, March 1978.]

**[167.] Member Receiving Payment for Referral of Client to Others**

[.333–.334] [Deleted, June 1991.]

**[168.] Audit Guides Issued by Governmental Agencies**

[.335–.336] [Superseded by Interpretation No. 501-3.]

**[169.] Firm Publications, Distribution to Client's Board of Directors**

[.337–.338] [Deleted, March 1978.]

**[170.] Sponsor's Announcement of Member's Participation in Educational Seminar**

[.339–.340] [Deleted, March 1978.]

**[171.] CPA Designation on Professional Organization or Corporation Letterhead**

[.341–.342] [Deleted, March 1978.]

**[172.] Outside Review of Firm Publication**

[.343–.344] [Deleted, March 1978.]

**[173.] Use of Credit Cards for Payment of Professional Services**

[.345–.346] [Deleted, March 1978.]

**[174.] Directory Listing, White Pages**

[.347–.348] [Deleted, March 1978.]

**[175.] Bank Director**

[.349–.350] [Replaced by Ethics Ruling No. 85, "Bank Director," of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (sec. 191 par. .170–.171) and Ethics Ruling No. 18, "Bank Director," of section 391, *Ethics Rulings on Responsibilities to Clients* (sec. 391 par. .035–.036)]

**[176.] Member's Association With Newsletters and Publications**

[.351–.352] [Deleted, November 2011.]

**[177.] Data Processing: Billing Services**

[.353–.354] [Deleted, November 2011.]

**[178.] Location of Separate Business**

[.355–.356] [Deleted, December 1992.]

**[179.] Practice of Public Accounting Under Name of Association or Group**

[.357–.358] [Deleted, November 2011.]

**[180.] Side Business Which Offers Services of a Type Performed by CPAs**

[.359–.360] [Deleted, November 1993.]

**[181.] Sale of a Practice—Purchase of Accounts**

[.361–.362] [Deleted, June 1991.]

**[182.] Termination of Engagement Prior to Completion**

[.363–.364] [Deleted, April 2006.]

**183. Use of the AICPA Personal Financial Specialist Designation**

**.365 Question**—In what circumstances may a firm include the AICPA-awarded designation "Personal Financial Specialists" (PFS) on the firm's letterhead and in marketing materials?

**.366 Answer**—It is permissible under Rule 502 [sec. 502 par. .01] for the designation PFS to be used on a firm's letterhead and in marketing materials if all partners or shareholders of the firm currently have the AICPA-awarded designation. An individual member who holds the designation may use it after his or her name.

**184. Definition of the Receipt of a Contingent Fee or a Commission**

**.367 Question**—Rules 302, *Contingent Fees* [sec. 302 par. .01], and 503, *Commissions and Referral Fees* [sec. 503 par. .01], prohibit, among other acts, the receipt of contingent fees for the performance of certain services and the receipt of a commission for the referral of products or services under certain circumstances. When is a contingent fee or commission deemed to be received?

**.368 Answer**—A contingent fee or commission is deemed to be received when the performance of the related services is complete and the fee or the commission is determined. For example, if in one year a member sells a life insurance policy to a client and the member's commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year the policy is sold.

**185. Sale of Products to Clients**

**.369 Question**—May a member purchase a product from a third-party supplier and resell the product to a client without violating Rule 503 [sec. 503 par. .01]?

**.370 Answer**—Yes. If a member purchases a product and resells it to a client, any profit on the sale would not constitute a commission. Purchasing entails taking title to the product and having all the associated risks of ownership.

### 186. Billing for Subcontractor's Services

**.371 Question**—A member has contracted with a computer-hardware maintenance servicer to provide support for a client's computer operations. Would it be a violation of Rule 503 [sec. 503 par. .01] for that member to bill the client a higher service fee than that charged the member by the service provider?

**.372 Answer**—No. The increased fee would not constitute a commission.

### 187. Receipt of Contingent Fees or Commissions by Member's Spouse

**.373 Question**—May a member's spouse provide services to the member's attest client for a contingent fee or refer products or services for a commission to or from the member's attest client without causing the member to be in violation of Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01]?

**.374 Answer**—Yes, if the activities of the member's spouse are separate from the member's practice and the member is not significantly involved in those activities. The member, however, should consider whether a conflict of interest may exist as described in Rule 102, *Integrity and Objectivity* [sec. 102 par. .01], and Interpretation No. 102-2, "Conflicts of Interest," under Rule 102 [sec. 102 par. .03].

### 188. Referral of Products of Others

**.375 Question**—A member refers computer products of wholesalers to clients of the firm through distributors and agents. A payment is received by the member from the wholesaler if the clients purchase the computer products. Must the member consider Rule 503 [sec. 503 par. .01] in connection with this payment?

**.376 Answer**—Yes. Paragraph .02 of section 91, *Applicability*, of the Code of Professional Conduct provides that a member shall not permit others to perform acts on behalf of the member that, if carried out by the member, would place the member in violation of the rules. Therefore, the member would be held responsible for the actions of the distributors and agents.

Rule 503 [sec. 503 par. .01] provides that, if a member or the member's firm performs for a client a service described in Rule 503 [sec. 503 par. .01], the member may not recommend or refer to that client for a commission any product or service, or receive a commission for a recommendation or referral. This prohibition applies during the period in which the member is engaged to perform any of the services described in Rule 503 [sec. 503 par. .01] and during the period covered by any historical financial statements in such services.

If the products are referred on a commission basis to clients for which the member is not engaged to perform any of the services described in Rule 503 [sec. 503 par. .01], Rule 503 [sec. 503 par. .01] would not be violated as long as the commission is disclosed to the client. However, any subsequent performance of services described in Rule 503 [sec. 503 par. .01] during a period in which the

commission was received would constitute a violation of Rule 503 [sec. 503 par. .01].

### 189. Requests for Records Pursuant to Interpretation 501-1

**.377 Question**—Individuals associated with a client entity who are currently on opposing sides in an internal dispute have each issued separate requests calling for the member to supply them with records pursuant to Interpretation No. 501-1, "Response to Requests by Clients and Former Clients for Records," under Rule 501, *Acts Discreditable* [sec. 501 par. .02]. Does the member have to comply with all such requests?

**.378 Answer**—In providing professional services to individuals, partnerships, or corporations, a member will usually deal with an individual who has been designated or held out as the client's representative. Such a representative might include, for example, a general partner or a majority shareholder. A member who has provided the records to the individual designated or held out as the client's representative has no obligation to provide such records to other individuals associated with the client.

[Revised, effective April 30, 2006, by the Professional Ethics Executive Committee.]

### 190. Non-CPA Partner

**.379 Question**—May a member who is in partnership with non-CPAs sign reports with the firm name and below it affix his or her own signature with the designation "Certified Public Accountant"?

**.380 Answer**—This would not be improper, provided it is clear that the partnership itself is not being held out as composed entirely of CPAs.

[Formerly Ethics Ruling No. 7 under section 291. Transferred from paragraphs .013–.014 of section 291, April 1995.]

### 191. Member Removing Client Files From an Accounting Firm

**.381 Question**—If the relationship of a member who is not an owner of a firm is terminated, may he or she take or retain originals or copies from the firm's client files or proprietary information without the firm's permission?

**.382 Answer**—No, except where permitted by contractual arrangement.

[Revised, effective December 31, 1998, by the Professional Ethics Executive Committee.]

### 192. Commission and Contingent Fee Arrangements With Nonattest Client

**.383 Question**—A member or member's firm (member) provides for a contingent fee investment advisory services, or refers for a commission products or services of a nonclient or a nonattest client, to the owners, officers, or employees of an attest client or to a nonattest client employee benefit plan sponsored by an attest client. Would the member be considered to be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01]?

**.384 Answer**—No. The member would not be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01] provided that, with respect

to Rule 503 [sec. 503 par. .01], the member discloses the commission to the owners, officers, or employees or to the employee benefit plan. The member should also consider the applicability of Interpretation No. 102-2 under Rule 102 [sec. 102 par. 03], and his or her professional responsibility to clients under Rule 301, *Confidential Client Information* [sec. 301 par. .01].

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**ET**  
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## ET Appendix A

# ***Council Resolution Designating Bodies to Promulgate Technical Standards***

[As amended January 12, 1988; Revised April 1992, October 1999, May 2004, October 2007, May 2008, October 2012, and May 2013.]

### **Federal Accounting Standards Advisory Board**

RESOLVED: That the Federal Accounting Standards Advisory Board, with respect to its statements of federal accounting standards and concepts adopted and issued in March of 1993 and subsequently, in accordance with its rules of procedure, the memorandum of understanding and public notice designating the FASAB's standards and concepts as having substantial authoritative support, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for federal governmental entities pursuant to rule 203 [ET section 203.01].

[Added by Council, October 1999.]

### **Financial Accounting Standards Board**

WHEREAS: In 1959 the Council designated the Accounting Principles Board to establish accounting principles, and

WHEREAS: The Council is advised that the Financial Accounting Standards Board (FASB) has become operational, it is

RESOLVED: That as of the date hereof the FASB, in respect of statements of financial accounting standards finally adopted by such board in accordance with its rules of procedure and the bylaws of the Financial Accounting Foundation, be, and hereby is, designated by this Council as the body to establish accounting principles pursuant to rule 203 [ET section 203.01] and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 [ET section 202.01] of the Rules of the Code of Professional Conduct of the American Institute of Certified Public Accountants provided, however, any accounting research bulletins, or opinions of the accounting principles board issued or approved for exposure by the accounting principles board prior to April 1, 1973, and finally adopted by such board on or before June 30, 1973, shall constitute statements of accounting principles promulgated by a body designated by Council as contemplated in rule 203 [ET section 203.01] of the Rules of the Code of Professional Conduct unless and until such time as they are expressly superseded by action of the FASB.

### **Governmental Accounting Standards Board**

WHEREAS: The Governmental Accounting Standards Board (GASB) has been established by the board of trustees of the Financial Accounting Foundation (FAF) to issue standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities, and

WHEREAS: The American Institute of Certified Public Accountants is a signatory to the agreement creating the GASB as an arm of the FAF and has supported the GASB professionally and financially, it is

RESOLVED: That as of the date hereof, the GASB, with respect to statements of governmental accounting standards adopted and issued in July 1984 and subsequently in accordance with its rules of procedure and the bylaws of the FAF, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for state and local governmental entities pursuant to rule 203 [ET section 203.01], and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 [ET section 202.01].

### **Public Company Accounting Oversight Board**

WHEREAS: The Public Company Accounting Oversight Board (PCAOB) has been established pursuant to the Sarbanes-Oxley Act of 2002 (the Act), and

WHEREAS: The PCAOB has authority under the Act to establish or adopt, or both, by PCAOB rule, auditing and related attestation standards, quality control, ethics, independence and other standards relating to the preparation and issuance of audit reports for issuers as defined in the Act.

RESOLVED: That the PCAOB be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish standards relating to the preparation and issuance of audit reports for entities within its jurisdiction as defined by the Act pursuant to rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, May 2004.]

### **International Accounting Standards Board**

RESOLVED: That the International Accounting Standards Board (IASB) is hereby designated as the body to establish professional standards with respect to international financial accounting and reporting principles pursuant to Rule 202 [ET section 202.01] and Rule 203 [ET section 203.01]; and

BE IT FURTHER RESOLVED: That the Council shall reassess, no sooner than three years but no later than five years after the effective date of this resolution, whether continued recognition of the IASB as the body designated to establish professional standards with respect to international financial accounting and reporting principles under Rule 202 [ET section 202.01] and Rule 203 [ET section 203.01] is appropriate.

[Added by Council, May 18, 2008; readopted by Council, May 19, 2013.]

### **AICPA COMMITTEES AND BOARDS**

WHEREAS: The membership of the Institute has adopted rules 201 [ET section 201.01] and 202 [ET section 202.01] of the Rules of the Code of Professional Conduct, which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is

### **Accounting and Review Services Committee**

RESOLVED: That the AICPA accounting and review services committee is hereby designated to promulgate standards under rules 201 [ET section 201.01] and 202 [ET section 202.01] with respect to unaudited financial statements or

other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market.

### **Auditing Standards Board**

RESOLVED: That with respect to standards relating to the preparation and issuance of audit reports not included within the resolution on the Public Company Accounting Oversight Board, the AICPA auditing standards board is hereby designated as the body authorized under rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate auditing, attestation, and quality control standards and procedures.

RESOLVED: That the auditing standards board shall establish under statements on auditing standards the responsibilities of members with respect to standards for disclosure of financial information outside of the financial statements in published financial reports containing financial statements.

[Revised May 2004.]

### **Management Consulting Services Executive Committee**

RESOLVED: That the AICPA management consulting services executive committee is hereby designated to promulgate standards under rules 201 [ET section 201.01] and 202 [ET section 202.01] with respect to the offering of management consulting services, provided, however, that such standards do not deal with the broad question of what, if any, services should be proscribed.

AND FURTHER RESOLVED: That any Institute committee or board now or in the future authorized by the Council to issue enforceable standards under rules 201 [ET section 201.01] and 202 [ET section 202.01] must observe an exposure process seeking comment from other affected committees and boards, as well as the general membership.

[Revised April 1992.]

### **Attestation Standards**

RESOLVED: That the AICPA accounting and review services committee, auditing standards board, and management consulting services executive committee are hereby designated as bodies authorized under rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate attestation standards in their respective areas of responsibility.

[Added by Council, May 1988; revised April 1992.]

### **Tax Executive Committee**

RESOLVED: That the Tax Executive Committee is hereby designated as the body authorized under AICPA Rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate professional practice standards with respect to tax services.

[Added by Council, October 1999.]

### **Forensic and Valuation Services Executive Committee**

RESOLVED: That the Forensic and Valuation Services Executive Committee is hereby designated as the body to promulgate professional standards with respect to forensic and valuation services under Rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, October 2007.]

### **Personal Financial Planning Executive Committee**

RESOLVED: That the Personal Financial Planning Executive Committee is hereby designated as the body to promulgate professional standards with respect to personal financial planning services under Rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, October 2012.]

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## ET Appendix B

# ***Council Resolution Concerning Rule 505—Form of Organization and Name***

[As adopted May 23, 1994; revised May 1997, May 2000, May 2006, and August 2011.]

A. RESOLVED: That with respect to a member engaged in the practice accounting in a firm or organization that performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards (SASs), (2) any review of a financial statement performed in accordance with the Statements on Standards for Accounting and Review Services (SSARSs), or (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements, or that holds itself out as a firm of CPAs or uses the term "certified public accountant(s)" or the designation "CPA" in connection with its name, the characteristics of such a firm or organization under Rule 505, *Form of Organization and Name* [sec. 505 par. .01], are as set forth subsequently.

1. A majority of the ownership of the firm in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the firm or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the firm or its affiliates is against the public interest and continues to be prohibited.
2. There must be a CPA who has ultimate responsibility for all the services described in (A), compilation services, and other engagements governed by SASs or SSARSs and non-CPA owners could not assume ultimate responsibility for any such services or engagements.
3. Non-CPA owners would be permitted to use the title "principal," "owner," "officer," "member" or "shareholder," or any other title permitted by state law, but not hold themselves out to be CPAs.
4. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in the practice of public accounting whom the member has the authority or capacity to control.
5. Owners shall at all times own their equity in their own right and shall be the beneficial owners of the equity capital ascribed to them. Provision would have to be made for the ownership to be transferred, within a reasonable period of time, to the firm or to other qualified owners if the owner ceases to be actively engaged in the firm or its affiliates.
6. Non-CPA owners would not be eligible for regular membership in the AICPA unless they meet the requirements in subparagraph 2.2.1 of

BL section 220, 2.2 *Requirements for Admission to Membership* [BL sec. 220 par. .01].<sup>1</sup>

B. RESOLVED: The characteristics of all other firms or organizations are deemed to be whatever is legally permissible under applicable law or regulation except as otherwise provided in paragraph (C).

C. RESOLVED: That with respect to a member engaged in the practice of public accounting in a firm or organization that is not within the description of a firm or organization set forth in paragraph (A), but who performs compilations of financial statements performed in accordance with SSARs, the characteristics of such a firm or organization under Rule 505 [sec. 505 par. .01] are as set forth subsequently.

1. There must be a CPA who has ultimate responsibility for any financial statement compilation services provided by the firm and by each business unit performing such compilation services and non-CPA owners could not assume ultimate responsibility for any such services.
  2. Any compilation report must be signed individually by a CPA, and may not be signed in the name of the firm or organization.
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<sup>1</sup> The change to this appendix is an administrative change to conform to subparagraph 2.2.1 of BL section 220, 2.2 *Requirements for Admission to Membership* [BL sec. 220 par. .01], of the Bylaws of the American Institute of Certified Public Accountants.



# ET

## RULES COMPLIANCE GUIDE

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# ET Guide for Complying With Rules 102–505

## Notice to Readers

This guide is designed as educational and reference material for the members of the AICPA and others interested in the subject. It is not an authoritative document. It does not establish policy positions, standards, or preferred practices. This guide is distributed with the understanding that the AICPA is not rendering any ethical or legal advice.

This Code of Professional Conduct (Code) cannot address every possible relationship or circumstance a member may need to address in order to comply with the rules. Accordingly, in achieving compliance with the rules, members may need to make decisions unrelated to independence regarding relationships or circumstances that are not explicitly addressed by the interpretations and rulings. This guide describes an approach that members can use to evaluate those relationships or circumstances. Although use of this guide is not required by the Code, use of this guide often will be a prudent step in achieving compliance with the rules.

## Introduction

**.01** Members who provide professional services may hold various positions. For example, a member may be a salaried employee, a partner, a director (executive or nonexecutive), an owner-manager, a volunteer, or a consultant working for an employer, a firm, or for one or more clients. The legal relationship between the member, the employer, the firm, or the client does not affect the member's responsibility to comply with the ethical requirements of the AICPA Code of Professional Conduct (Code).

**.02** The Code provides members with principles for properly fulfilling their ethical responsibilities. The Rules of Conduct (the rules) set out in the Code govern the performance of professional services by members. The bylaws of the AICPA require that all members comply with these rules. Other sections of the Code contain additional authoritative guidance set forth in interpretations and rulings, which address the application of the rules to specific situations that members may encounter when providing professional services. ET section 100-1, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), provides authoritative guidance for members when making decisions on independence matters that are not explicitly addressed by the Code under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 100), and its interpretations and rulings.

**.03** The Code cannot address every possible relationship or circumstance a member may need to address in order to comply with the rules. Accordingly, in achieving compliance with the rules, members may need to make decisions unrelated to independence regarding relationships or circumstances that are not explicitly addressed by the interpretations and rulings. This guide describes an approach that members can use to evaluate those relationships or circumstances, and members are encouraged to use it for that purpose. Although use of this guide is not required by the Code, it can assist members in complying with the rules in those situations. Therefore, use of this guide will often be a prudent step in achieving compliance with the rules. Under no circumstances, however,

may this guide be used to justify noncompliance with the rules, interpretations, and rulings in the Code.

## Definitions

**.04 Acceptable level.** A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that compliance with the rules is not compromised.

**.05 Safeguards.** Actions or other measures that eliminate threats or reduce them to an acceptable level.

**.06 Threats.** The risk that relationships or circumstances could compromise a member's compliance with the rules.

## Rules of Conduct Covered by This Guide

**.07** In addition to Rule 101, the bylaws of the AICPA require that members comply with the following rules:

- a. Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 100)
- b. Rule 201, *General Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
- c. Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
- d. Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
- e. Rule 301, *Confidential Client Information* (AICPA, *Professional Standards*, vol. 2, ET sec. 300)
- f. Rule 302, *Contingent Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 300)
- g. Rule 501, *Acts Discreditable* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
- h. Rule 502, *Advertising and Other Forms of Solicitation* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
- i. Rule 503, *Commissions and Referral Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
- j. Rule 505, *Form of Organization and Name* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)

Each of these rules (that is, Rules 102–505), along with its related authoritative interpretations and rulings, can be accessed by selecting the link preceding the name of each rule in the preceding list.

## Threats and Safeguard Approach

**.08** The Code cannot address every situation in which a relationship or circumstance creates an unacceptable threat to a member's compliance with rules 102–505. Accordingly, the threats and safeguard approach<sup>1</sup> described in this

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<sup>1</sup> The Professional Ethics Executive Committee uses the threats and safeguard approach described in this guide when it develops ethics interpretations and rulings. Accordingly, reference to this guide may assist AICPA members and others in understanding the basis for those interpretations and rulings.

section can assist a member in complying with the rules when the guidance in the interpretations and rulings in the Code do not explicitly address the situation encountered. This method involves identifying threats to compliance with the rules and evaluating the significance of those threats. If the threats are not at an acceptable level, the threats and safeguards approach involves determining whether safeguards are available to eliminate the threats or reduce them to an acceptable level and, if so, applying such safeguards or, if not, avoiding the situation that creates the threats. Threats are identified and evaluated both individually and in the aggregate because they can have a cumulative effect on a member's compliance with the rules of conduct.

**.09 *Identifying Threats.*** The relationships or circumstances encountered by a member in various engagements and work assignments will often create different threats to complying with the rules. When a relationship or circumstance is encountered that is not specifically addressed by the interpretations or rulings in the Code, under this approach, members would determine whether the relationship or circumstance creates one or more threats, such as those identified in paragraph .13. The existence of a threat does not mean that the member is not in compliance with the rules; rather, the significance of the threat would be evaluated.

**.10 *Evaluating the Significance of a Threat.*** In evaluating the significance of a threat that has been identified in order to determine whether it is at an acceptable level, the standard of acceptable level is whether a reasonable and informed third party, weighing all the specific facts and circumstances, would be likely to conclude that the threat would compromise the member's compliance with the rules. Qualitative as well as quantitative factors are relevant when evaluating the significance of a threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. If the evaluation supports a conclusion that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the threat would not compromise a member's compliance with the rules, the threat is at an acceptable level. In that case, no further evaluation under this framework would be necessary.

**.11 *Identifying and Applying Safeguards.*** If the evaluation of the significance of an identified threat results in the member concluding that the threat is not at an acceptable level, safeguards would need to be applied in order to eliminate the threat or reduce it to an acceptable level. When identifying appropriate safeguards to apply, one safeguard may eliminate or reduce multiple threats, but in some cases multiple safeguards may be necessary to eliminate or reduce one threat to an acceptable level. Determining the nature of the safeguards to be applied requires the exercise of judgment because the effectiveness of safeguards will vary, depending on the circumstances. Again, the issue is whether a reasonable and informed third party, who has weighed all the specific facts and circumstances, would be likely to conclude the level of threat is acceptable. A threat has been reduced to an acceptable level by safeguards if, after application of the safeguards, a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that compliance with the rules is not compromised.

**.12** Some threats identified may be so significant that no safeguards will eliminate the threats or reduce them to an acceptable level. If a significant threat cannot be eliminated or reduced to an acceptable level by the application of safeguards, or if a member is unable to implement appropriate safeguards, providing the specific professional service will in all likelihood result in the member's noncompliance with the rules. Although declining or discontinuing the service would prevent this result, depending on the facts and circumstances,

it might be prudent for the member to also consider whether to resign from the client or the employer.

## Threats and Safeguards

### Threats

.13 Many threats fall into the following categories:

- a. **Self-review threat.** The threat that a member will not appropriately evaluate the results of a service performed by the member, or by an individual in the member's firm or employing organization, that the member will rely upon in forming a judgment as part of providing another service.
- b. **Advocacy threat.** The threat that a member will promote a client or employer's position or opinion to the point that his or her objectivity is compromised.
- c. **Adverse interest threat.** The threat that a member will not be objective because the member's interests are in opposition to the interests of a client or employer.
- d. **Familiarity threat.** The threat that because of a long or close relationship with a client or employer, a member will become too sympathetic to their interests or too accepting of their work.
- e. **Undue influence threat.** The threat that a member will subordinate his or her judgment to that of an individual associated with a client, employer, or other relevant third party because of the individual's (1) reputation or expertise, (2) aggressive or dominant personality, or (3) attempts to coerce or exercise excessive influence over the member.
- f. **Self-interest threat.** The threat that a member will act in a manner that is adverse to the legitimate interests of his or her firm, employer, client, or the public, as a result of the member or his or her immediate or close family member's financial interest in or other relationship with a client or the employer.

.14 The types of threats that are created will generally be the same for all members, although the circumstances that create threats will differ depending on whether the member is in public practice, business and industry, government, or academia. In addition, due to the nature of services provided by some members, such as employees of a governmental audit organization, the threats those members face can arise from the same or similar types of circumstances as for members in public practice.

Following are some examples of how threats may impact a member's compliance with certain of the rules:

- a. If a member is being pressured to become associated with misleading information, there is an undue influence threat to compliance with Rule 102 and Rule 201.
- b. If a member is reviewing work he or she previously performed that will be relied upon as part of providing a current professional service and the member discovers a significant error in the previous work, there is a self-interest threat to compliance with Rule 102 and Rule 201.
- c. If a member's firm provides nonattest services to an audit client where a member's brother-in-law is the CFO, there are self-interest and familiarity threats to compliance with Rule 102.

- d. If a member is directed to complete a task within an unrealistic time frame, there is an undue influence threat to compliance with Rule 102 and Rule 201.
- e. If a member has charged his or her employer with violating certain labor laws, there is an adverse interest threat to compliance with Rule 102.
- f. If the revenue received from a single client is significant to the firm, a self-interest threat to compliance with Rule 102 may be created.

## Safeguards

**.15** Safeguards fall into two broad categories:

- a. Safeguards created by the profession, legislation, or regulation
- b. Safeguards in the work environment

In addition, a member in public practice also may be able to consider safeguards implemented by the client in combination with the preceding safeguards when evaluating the significance of a threat.

**.16** To be effective, safeguards should eliminate a threat or reduce to an acceptable level the threat's potential to compromise the member's compliance with the rules. The effectiveness of safeguards depends on many factors, including the following:

- The facts and circumstances of a particular situation
- The proper identification of threats
- Whether the safeguard is suitably designed to meet its objectives
- The party or parties that will be subject to the safeguard
- How the safeguard is applied
- The consistency with which the safeguard is applied
- Who applies the safeguard

**.17** Certain safeguards may not need to be implemented by the member because they are already in place either by the member's firm (concurring partner review) or through the existence of professional requirements (peer review), legislation (preapproval of allowable nonaudit services by audit committees), or regulation (quality control reviews performed by a federal Office of Inspector General for OMB Circular A-133 engagements). Such safeguards may be effective in eliminating or reducing threats to an acceptable level and, therefore, may be considered in applying the framework approach.

**.18** Other safeguards that may be effective in eliminating or reducing threats to an acceptable level are those in a member's work environment. For example, work environments with strong internal controls can be very effective in eliminating or reducing the self-review, adverse interest, and self-interest threats. Additionally, the undue influence threat can be reduced when leadership of a firm or the organization that employs the member stresses the importance of ethical behavior and implements policies and procedures to empower and encourage employees to communicate to senior individuals within the firm or organization about any ethical issues that concern them without fear of retribution.

## Ethical Conflict Resolution

**.19** An ethical conflict arises when a member encounters obstacles to following an appropriate course of action due to internal or external pressures or because of conflicts within the professional standards. For example, a member may have encountered a fraud, the reporting of which could breach the member's responsibility to maintain client confidentiality. Once encountered, a member may be required to take steps to resolve the ethical conflict in order to comply with the rules.

**.20** To resolve an ethical conflict, a member should consider the following factors and select the course of action that will best enable him or her, after weighing the consequences of each, to comply with the rules:

- a.* Relevant facts and circumstances, including applicable rules, laws, or regulations
- b.* Ethical issues involved
- c.* Established internal procedures
- d.* Alternative courses of action

**.21** Before pursuing this course of action, the member may want to consult with appropriate persons within the firm or the organization that employs the member. If the conflict remains unresolved after pursuing the selected course of action, the member should consider consulting with those individuals for help in reaching a resolution.

**.22** The member also may wish to obtain advice from an appropriate professional body or legal counsel. The member should consider documenting the substance of the issue and details of any discussions held or decisions made concerning that issue.

**.23** If, after exhausting all reasonable possibilities, the ethical conflict remains unresolved, the member will in all likelihood be in noncompliance with the rules if he or she remains associated with the matter creating the conflict. Accordingly, the member may determine that, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the client, firm, or organization that employs the member.

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**CODE OF PROFESSIONAL CONDUCT—REVISED**

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*(Effective 12/15/14 Unless Early Implemented)*

This section includes the text of the revised and restructured *Code of Professional Conduct*, which is effective December 15, 2014. Early implementation is permitted.

For a feature-enhanced version of this content, visit <http://pub.aicpa.org/codeofconduct>.

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## ET Preface

### *Applicable to All Members*

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## 0.100 Overview of the Code of Professional Conduct

.01 The AICPA Code of Professional Conduct (the code) begins with this preface, which applies to all *members*. The term *member*, when used in part 1 of the code, applies to and means a *member in public practice*; when used in part 2 of the code, applies to and means a *member in business*; and when used in part 3 of the code, applies to and means all other *members*, such as those *members* who are retired or unemployed.

.02 A *member* may have multiple roles, such as a *member in business* and a *member in public practice*. In such circumstances, the *member* should consult all applicable parts of the code and apply the most restrictive provisions. [No prior reference: new content]

### **Effective Date**

.03 Effective December 15, 2014.

## 0.100.010 Principles and Rules of Conduct

.01 The AICPA membership adopted the Code of Professional Conduct (the code) to provide guidance and rules to all *members* in the performance of their professional responsibilities. The code consists of principles and rules as well as *interpretations* and other guidance which are discussed in 0.100.020. The principles provide the framework for the rules that govern the performance of their professional responsibilities.

.02 The AICPA bylaws require that *members* adhere to the rules of the code. Compliance with the rules depends primarily on *members'* understanding and voluntary actions; secondarily on reinforcement by peers and public opinion; and ultimately on disciplinary proceedings, when necessary, against *members* who fail to comply with the rules. *Members* must be prepared to justify departures from these rules.

## 0.100.020 Interpretations and Other Guidance

.01 *Interpretations* of the rules of conduct are adopted after exposure to the membership, state societies, state boards, and other interested parties. The *interpretations* of the rules of conduct, "Definitions" [0.400], "Application of the AICPA Code" [0.200.020], and "Citations" [0.200.030], provide guidelines about the scope and application of the rules but are not intended to limit such scope or application. A *member* who departs from the *interpretations* shall have the burden of justifying such departure in any disciplinary hearing. *Interpretations* that existed before the adoption of the code on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior committee.

.02 A *member* should also consult the following, if applicable:

- The ethical requirements of the *member's* state CPA society and authoritative regulatory bodies such as state board(s) of accountancy
- The Securities and Exchange Commission (SEC)
- The Public Company Accounting Oversight Board (PCAOB)
- The Government Accountability Office (GAO)
- The Department of Labor (DOL)
- Federal, state and local taxing authorities

- Any other body that regulates a *member* who performs *professional services* for an entity when the *member* or entity is subject to the rules and regulations of such regulatory body. [Prior reference: Introduction]

## 0.200 Structure and Application of the AICPA Code

### 0.200.010 Structure of the AICPA Code

.01 A variety of topics appear in parts 1–3 of the code. When applicable, topics are aligned with the relevant rule or rules of conduct. Topics may be further divided into subtopics, and some subtopics include one or more sections. Topics, subtopics, and sections interpret the rules of conduct (see "Interpretations and Other Guidance" [0.100.020]).

.02 Defined terms (see "Definitions" [0.400]) as well as the plurals and possessives thereof, are shown in *italics* throughout the code. When a defined term is used in the code but is not shown in *italics*, the definition in 0.400 should not be applied. [No prior reference: new content]

#### **Effective Date**

.03 Effective December 15, 2014.

### 0.200.020 Application of the AICPA Code

.01 The Code of Professional Conduct (the code) was originally adopted on January 12, 1988, and was periodically revised through June 1, 2014. On June 1, 2014, the AICPA issued a codification of the code's principles, rules, *interpretations* and rulings (revised code). The revised code will be effective December 15, 2014, excluding the Conceptual Framework sections. These sections, "Conceptual Framework for Members in Public Practice" [1.000.010] and "Conceptual Framework for Members in Business" [2.000.010], will be effective December 15, 2015. *Members* are permitted to implement the revised code prior to December 15, 2014, but a member may not implement the relevant Conceptual Framework prior to implementing the entire revised code. Revisions made subsequent to June 1, 2014, are identified in appendix C, the Revision History Table, which notes the month and year of the change, the effective date of the change, the purpose for the revision, and when possible, a link to the marked revision of the content that appeared in the *Journal of Accountancy*. If the interpretation or paragraph does not contain a specific effective date or a reference to the revision history table, then the content was effective prior to June 1, 2014. [No prior reference: new content.]

.02 When used in the preface of the code, the term *member* includes *members*, *associate members*, and *affiliate members*, as well as international associates of the AICPA.

- .03 The rules of conduct apply to all *professional services* performed, except
- a. when the wording of the rule indicates otherwise.
  - b. that a *member* who is practicing outside the United States will not be considered in violation of a particular rule for departing from any of the rules stated herein, as long as the *member's* conduct is in accordance with the rules of the organized accounting profession in the country in which he or she is practicing. However, when a *member* is associated with *financial statements* under circumstances that would lead the reader to assume that practices of

the United States were followed, the *member* must comply with the "Compliance With Standards Rule" [1.310.001 for *members in public practice* and 2.310.001 for *members in business*] and the "Accounting Principles Rule" [1.320.001 for *members in public practice* and 2.320.001 for *members in business*].

- c. that a *member* who is a member of a group engagement team (see the clarified Statement on Auditing Standards *Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors]* [AICPA, *Professional Standards*, AU-C sec. 600]) will not be considered in violation of a particular rule if a foreign component auditor (accountant) departed from any of the rules stated herein with respect to the audit or review of group *financial statements* or other *attest engagement*, as long as the foreign component auditor's (accountant's) conduct, at a minimum, is in accordance with the ethics and *independence* requirements set forth in the International Ethics Standards Board for Accountants' (IESBA's) Code of Ethics for Professional Accountants, and the members of the group engagement team are in compliance with the rules stated therein.
- d. that the *independence* of the *member's firm* will not be considered impaired if another *firm* or entity located outside the United States that is within the *member firm's network* departed from any of the rules stated herein, as long as the other *firm* or entity's conduct, at a minimum, is in accordance with the *independence* requirements set forth in the IESBA's Code of Ethics for Professional Accountants.

**.04** A *member* shall not knowingly permit a person whom the *member* has the authority or capacity to control to carry out on his or her behalf, either with or without compensation, acts that, if carried out by the *member*, would place the *member* in violation of the rules. Further, a *member* may be held responsible for the acts of all persons associated with the *member in public practice* whom the *member* has the authority or capacity to control.

**.05** The *independence* of a *member in public practice* or a *covered member* may be *impaired* with respect to a *client* as the result of the actions or relationships, as described in the "Independence Rule" [1.200.001] and its *interpretations*, of certain persons or entities whom the *member* or *covered member* does not have the authority or capacity to control. Even if the *member* is unable to control the actions or relationships of such persons or entities, the *member's independence* may still be *impaired*. [Prior reference: ET section 91]

### **Effective Date**

**.06** Paragraph .01 is effective December 15, 2014.

[See Revision History Table.]

## **0.200.030 Citations**

### **Prior ET Sections**

**.01** The code has been revised by codifying the principles, rules, *interpretations*, and rulings. These revisions are effective December 15, 2014. To facilitate implementation of the revised code, the prior ET references from the professional standards of the AICPA will be included for a four-year period (until December 15, 2018) in appendix D, "Mapping Document," and in bracketed text at the end of standards, where applicable.

### **Numeric Citations**

**.02** The numbering system for the code is "ET section X.XXX.XXX." The single digit that begins the citation identifies the part wherein the content resides. Accordingly, content from the preface begins with the single digit 0.XXX.XXX, whereas content for part 1 begins with a 1.XXX.XXX, part 2 with 2.XXX.XXX, and part 3 with a 3.XXX.XXX.

**.03** Next are two sets of three digit numbers that identify the topics and, when applicable, subtopics or sections. When a topic, subtopic or section appears in two or more parts of the code, the same number is used. For example, the "Acts Discreditable Rule" appears in parts 1, 2, and 3 and the citations for this rule are 1.400.001, 2.400.001, and 3.400.001, respectively. Accordingly, the two sets of three digit numbers remain the same with only the first digit changing.

**.04** When only two digits appear, those digits represent the paragraph number. For example, the complete citation for this paragraph would be 0.200.030.04.

**.05** All bracketed section references, such as [0.200.030.04] refer to sections within the Code of Professional Conduct. [No prior reference: new content]

### **Effective Date**

**.06** Effective December 15, 2014.

## **0.200.040 Transition Provisions**

**.01** The text of the transition provisions in effect as of May 31, 2013, has not been codified because the transition provisions apply to a limited number of situations. Nevertheless, these transition provisions are still authoritative. The texts of these transition provisions are available at <http://aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/Transition%20Periods.pdf>. [No prior reference: new content]

### **Effective Date**

**.02** Effective December 15, 2014.

## **0.200.050 Drafting Conventions**

**.01** The code utilizes certain drafting conventions to enhance the clarity of the interpretations and definitions. For example, when the term "should consider" is used in connection with a specified procedure or action, consideration of the procedure or action by the member is presumptively required. Actual performance of the action or procedure is up to the member, based upon the outcome of the member's consideration and the member's professional judgment. Other drafting conventions used in the code include use of the terms "consider," "evaluate," and "determine," as follows:

- a. "Consider" is used when the member is required to think about several matters.
- b. "Evaluate" is used when the member has to assess and weigh the significance of a matter.
- c. "Determine" is used when the member has to come to a conclusion and make a decision on a matter. [No prior reference: new content]

### **Effective Date**

**.02** Effective December 15, 2014.

A complete nonauthoritative guide, *Drafting Guide—Drafting Guidelines for Integrating the Conceptual Framework and Drafting Conventions and Style Guidance*, is also available at <http://aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/Drafting%20Guide.pdf>.

## 0.300 Principles of Professional Conduct

### 0.300.010 Preamble

**.01** Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a *member* assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

**.02** These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to *clients*, and to colleagues. They guide *members* in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage. [Prior reference: ET section 51]

### 0.300.020 Responsibilities

**.01** *Responsibilities principle*. In carrying out their responsibilities as professionals, *members* should exercise sensitive professional and moral judgments in all their activities.

**.02** As professionals, *members* perform an essential role in society. Consistent with that role, *members* of the American Institute of Certified Public Accountants have responsibilities to all those who use their *professional services*. *Members* also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all *members* are required to maintain and enhance the traditions of the profession. [Prior reference: ET section 52]

### 0.300.030 The Public Interest

**.01** *The public interest principle*. *Members* should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate a commitment to professionalism.

**.02** A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of *clients*, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of *members* to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on *members*. The public interest is defined as the collective well-being of the community of people and institutions that the profession serves.

**.03** In discharging their professional responsibilities, *members* may encounter conflicting pressures from each of those groups. In resolving those conflicts, *members* should act with integrity, guided by the precept that when

*members* fulfill their responsibility to the public, *clients'* and employers' interests are best served.

.04 Those who rely on *members* expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

.05 All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, *members* should seek to continually demonstrate their dedication to professional excellence. [Prior reference: ET section 53]

### 0.300.040 Integrity

.01 *Integrity principle.* To maintain and broaden public confidence, *members* should perform all professional responsibilities with the highest sense of integrity.

.02 Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a *member* must ultimately test all decisions.

.03 Integrity requires a *member* to be, among other things, honest and candid within the constraints of *client* confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and honest difference of opinion; it cannot accommodate deceit or subordination of principle.

.04 Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance or in the face of conflicting opinions, a *member* should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a *member* to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

.05 Integrity also requires a *member* to observe the principles of objectivity and independence and of due care. [Prior reference: ET section 54]

### 0.300.050 Objectivity and Independence

.01 *Objectivity and independence principle.* A *member* should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A *member* in public practice should be independent in fact and appearance when providing auditing and other attestation services.

.02 Objectivity is a state of mind, a quality that lends value to a *member's* services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. *Independence* precludes relationships that may appear to *impair* a *member's* objectivity in rendering attestation services.

.03 *Members* often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. *Members* in public practice render attest, tax, and management advisory services. Other *members* prepare *financial statements* in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those



who aspire to admission into the profession. Regardless of service or capacity, *members* should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

**.04** For a *member* in public practice, the maintenance of objectivity and *independence* requires a continuing assessment of *client* relationships and public responsibility. Such a *member* who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a *member* should maintain objectivity and avoid conflicts of interest.

**.05** Although *members* not in public practice cannot maintain the appearance of *independence*, they nevertheless have the responsibility to maintain objectivity in rendering *professional services*. *Members* employed by others to prepare *financial statements* or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as *members* in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with *members* in public practice. [Prior reference: ET section 55]

### 0.300.060 Due Care

**.01** *Due care principle*. A *member* should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the *member's* ability.

**.02** The quest for excellence is the essence of due care. Due care requires a *member* to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform *professional services* to the best of a *member's* ability, with concern for the best interest of those for whom the services are performed, and consistent with the profession's responsibility to the public.

**.03** Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a *member's* professional life. It is a *member's* individual responsibility. In all engagements and in all responsibilities, each *member* should undertake to achieve a level of competence that will assure that the quality of the *member's* services meets the high level of professionalism required by these Principles.

**.04** Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a *member* to render services with facility and acumen. It also establishes the limitations of a *member's* capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a *member* or a *member's firm*. Each *member* is responsible for assessing his or her own competence of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

**.05** *Members* should be diligent in discharging responsibilities to *clients*, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

**.06** Due care requires a *member* to plan and supervise adequately any professional activity for which he or she is responsible. [Prior reference: ET section 56]

### 0.300.070 Scope and Nature of Services

**.01** *Scope and nature of services principle.* A *member* in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

**.02** The public interest aspect of *members'* services requires that such services be consistent with acceptable professional behavior for *members*. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and *independence* require that *members* be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

**.03** Each of these Principles should be considered by *members* in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific *client*. No hard-and-fast rules can be developed to help *members* reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

**.04** In order to accomplish this, *members* should

- a. Practice in *firms* that have in place internal quality control procedures to ensure that services are competently delivered and adequately supervised.
- b. Determine, in their individual judgments, whether the scope and nature of other services provided to an audit *client* would create a conflict of interest in the performance of the audit function for that *client*.
- c. Assess, in their individual judgments, whether an activity is consistent with their role as professionals. [Prior reference: ET section 57]

### 0.400 Definitions

Pursuant to its authority under the bylaws (paragraph .01 [3.6.2.2] of BL section 360, *Committees* [AICPA, *Professional Standards*]) to interpret the code, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code.

**.01 Acceptable level.** In connection with *independence*, an acceptable level is a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's independence* is not *impaired*. When used in connection with any rule but the "Independence Rule" [1.200.001] an acceptable level is a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's* compliance with the rules is not compromised. [Prior reference: ET section 100-1 and new content]

#### **Effective Date**

When this definition is used in connection with any rule but the "Independence Rule" [1.200.001] it is effective December 15, 2014.

**.02 Affiliate.** The following entities are affiliates of a *financial statement attest client*:

- a. An entity (for example, subsidiary, partnership, or limited liability company [LLC]) that a *financial statement attest client* can control.
- b. An entity in which a *financial statement attest client* or an entity controlled by the *financial statement attest client* has a *direct financial interest* that gives the *financial statement attest client* *significant influence* over such entity and that is material to the *financial statement attest client*.
- c. An entity (for example, parent, partnership, or LLC) that *controls* a *financial statement attest client* when the *financial statement attest client* is material to such entity.
- d. An entity with a *direct financial interest* in the *financial statement attest client* when that entity has *significant influence* over the *financial statement attest client*, and the interest in the *financial statement attest client* is material to such entity.
- e. A sister entity of a *financial statement attest client* if the *financial statement attest client* and sister entity are each material to the entity that *controls* both.
- f. A trustee that is deemed to *control* a trust *financial statement attest client* that is not an investment company.
- g. The sponsor of a single employer employee benefit plan *financial statement attest client*.
- h. Any union or participating employer that has *significant influence* over a multiple or multiemployer employee benefit plan *financial statement attest client*.
- i. An employee benefit plan sponsored by either a *financial statement attest client* or an entity controlled by the *financial statement attest client*. A *financial statement attest client* that sponsors an employee benefit plan includes, but is not limited to, a union whose members participate in the plan and participating employers of a multiple or multiemployer plan.
- j. An investment adviser, a general partner, or a trustee of an investment company *financial statement attest client* (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either *control* or *significant influence* over the fund. When considering materiality, *members* should consider investments in, and fees received from, the fund.

[Prior reference: paragraph .20 of ET section 101]

**.03 Attest client.** A *client* that engages a *member* to perform an *attest engagement* or with respect to which a *member* performs an *attest engagement*. [No prior reference: new content]

### **Effective Date**

This definition is effective December 15, 2014.

**.04 Attest engagement.** An engagement that requires *independence*, as set forth in the AICPA Statements on Auditing Standards (SASs), Statements on Standards for Accounting and Review Services (SSARSs), and Statements on Standards for Attestation Engagements (SSAEs). [Prior reference: paragraph .01 of ET section 92]

**.05 Attest engagement team.** Those individuals participating in the *attest engagement*, including those who perform concurring and engagement

quality reviews. The attest engagement team includes all employees and contractors retained by the *firm* who participate in the *attest engagement*, regardless of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists, as discussed in AU-C section 620, *Using the Work of an Auditor's Specialist* (AICPA, *Professional Standards*), and individuals who perform only routine clerical functions, such as word processing and photocopying. [Prior reference: paragraph .02 of ET section 92]

**.06 Beneficially owned.** Describes a *financial interest* of which an individual or entity is not the record owner but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or disposition of the interest or to receive the economic benefits of the ownership of the interest. [Prior reference: paragraph .17 of ET section 101]

**.07 Client.** Any person or entity, other than the *member's* employer, that engages a *member* or *member's firm* to perform *professional services* and, if different, the person or entity with respect to which *professional services* are performed. For purposes of this definition, the term employer does not include the following:

- a. Person or entity engaged in *public practice*.
- b. Federal, state, and local government or component unit thereof, provided that the *member* performing *professional services* with respect to the entity is
  - i. directly elected by voters of the government or component unit thereof with respect to which *professional services* are performed;
  - ii. an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
  - iii. 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.

[Prior reference: paragraph .03 of ET section 92]

**.08 Close relative.** A parent, sibling, or nondependent child. [Prior reference: paragraph .04 of ET section 92]

**.09 Confidential client information.** Any information obtained from the *client* that is not available to the public. Information that is available to the public includes, but is not limited to, information

- a. in a book, periodical, newspaper, or similar publication;
- b. in a *client* document that has been released by the *client* to the public or that has otherwise become a matter of public knowledge;
- c. on publicly accessible websites, databases, online discussion forums, or other electronic media by which members of the public can access the information;
- d. released or disclosed by the *client* or other third parties in media interviews, speeches, testimony in a public forum, presentations made at seminars or trade association meetings, panel discussions, earnings press release calls, investor calls, analyst sessions, investor conference presentations, or a similar public forum;
- e. maintained by, or filed with, regulatory or governmental bodies that is available to the public; or
- f. obtained from other public sources.

Unless the particular *client* information is available to the public, such information should be considered confidential client information. *Members* are advised that federal, state, or local statutes, rules, or regulations concerning confidentiality of *client* information may be more restrictive than the requirements in the code. [Prior reference: paragraph .05 of ET section 92]

**.10 Control (s) (led).** As used in FASB *Accounting Standards Codification* (ASC) 810, *Consolidation*. When used in the "Client Affiliates" interpretation [1.224.010] of the "Independence Rule" [1.200.001], control depends upon the entity in question. For example, when used for not-for-profit entities, control is as used in FASB ASC 958-805-20; for commercial entities, control is as used in FASB ASC 810. [Prior reference: numerous ET sections; also see "Breakdown of the Term Control in the Code" at AICPA.org [www.aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/breakdown-of-the-term-control.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/breakdown-of-the-term-control.pdf)]

**.11 Council.** The AICPA Council. [Prior reference: paragraph .06 of ET section 92]

**.12 Covered member.** All of the following:

- a. an individual on the *attest engagement team*.
- b. an *individual in a position to influence the attest engagement*.
- c. a *partner, partner equivalent, or manager* who provides more than 10 hours of nonattest services to the *attest client* within any fiscal year. Designation as *covered member* ends on the later of (i) the date that the *firm* signs the report on the *financial statements* for the fiscal year during which those services were provided or (ii) the date he or she no longer expects to provide 10 or more hours of nonattest services to the *attest client* on a recurring basis.
- d. a *partner or partner equivalent* in the office in which the lead *attest engagement partner or partner equivalent* primarily practices in connection with the *attest engagement*.
- e. the *firm*, including the *firm's* employee benefit plans.
- f. an entity whose operating, financial, or accounting policies can be *controlled* by any of the individuals or entities described in items a–e or two or more such individuals or entities if they act together. [Prior reference: paragraph .07 of ET section 92]

### **Effective Date**

The addition of partner equivalents to this definition is effective for engagements covering periods beginning on or after December 15, 2014.

**.13 Direct financial interest.** A *financial interest* that is

- a. owned directly by an individual or entity, including those managed on a discretionary basis by others.
- b. under the control of an individual or entity, including those managed on a discretionary basis by others.
- c. *beneficially owned* through an investment vehicle, estate, trust, or other intermediary when the beneficiary
  - i. controls the intermediary or
  - ii. has the authority to supervise or participate in the intermediary's investment decisions.

When used in this definition, the term control includes situations in which the *covered member* has the ability to exercise such control, either individually or

acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*. [Prior reference: paragraph .17 of ET section 101]

**.14 Employing organization.** Any entity that employs the *member* or engages the *member* on a contractual or volunteer basis in an executive, a staff, a governance, an advisory, or an administrative capacity to provide *professional services*. [No prior reference: new content]

### **Effective Date**

This definition is effective December 15, 2014.

**.15 Financial interest.** An ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest. [Prior reference: paragraph .17 of ET section 101]

**.16 Financial statement attest client.** An entity whose *financial statements* are audited, reviewed, or compiled when the *member's* compilation report does not disclose a lack of *independence*. This term is used in the "Client Affiliates" interpretation [1.224.010] of the "Independence Rule" [1.200.001] and in the definition of an affiliate [0.400.02]. [Prior reference: paragraph .20 of ET section 101]

**.17 Financial statements.** A presentation of financial data, including accompanying disclosures, if any, intended to communicate an entity's economic resources or obligations, or both, at a point in time or the changes therein for a period of time, in accordance with the applicable financial reporting framework. Incidental financial data to support recommendations to a *client* or in (a) documents for which the reporting is governed by SSAEs and (b) 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. [Prior reference: paragraph .10 of ET section 92]

**.18 Firm.** A form of organization permitted by law or regulation whose characteristics conform to resolutions of the *Council* and that is engaged in *public practice*. A firm includes the individual *partners* thereof, except for purposes of applying the "Independence Rule" [1.200.001] and related *interpretations*. For purposes of applying the "Independence Rule," a firm includes a *network firm* when the engagement is either a *financial statement* audit or review engagement and the audit or review report is not restricted, as set forth in the AICPA SASs and SSARs (AICPA, *Professional Standards*). [Prior reference: paragraph .11 of ET section 92]

**.19 Immediate family.** A spouse, spousal equivalent, or dependent (regardless of whether the dependent is related). [Prior reference: paragraph .13 of ET section 92]

**.20 Impair(ed)(ing).** In connection with *independence*, to effectively extinguish *independence*. When a *member's independence* is impaired, the *member* is not independent. [Prior reference: paragraph .09 of ET section 100-1]

**.21 Independence.** Consists of two elements, defined as follows:

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

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

This definition should not be interpreted as an absolute. For example, the phrase "without being affected by influences that compromise professional judgment" is not intended to convey that the *member* must be free of any and all influences that might compromise objective judgment. Instead, the *member* should determine whether such influences, if present, create a *threat* that is not at an *acceptable level* that a *member* would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement or would be perceived as not being able to do so by a reasonable and informed third party with knowledge of all relevant information. [Prior reference: paragraphs .06–.08 of ET section 100-1]

**.22 Indirect financial interest.** A *financial interest beneficially owned* through an investment vehicle, an estate, a trust, or an other intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions. When used in this definition, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*. [Prior reference: paragraph .17 of ET section 101]

**.23 Individual in a position to influence the attest engagement.** 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*.

[Prior reference: paragraph .14 of ET section 92]

**.24 Institute.** The AICPA. [Prior reference: paragraph .15 of ET section 92]

**.25 Interpretation.** Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct. [Prior reference: paragraph .16 of ET section 92]

**.26 Joint closely held investment.** An investment in an entity or a property by the *member* and *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* the entity or property. [Prior reference: paragraph .17 of ET section 92]

**.27 Key position.** A position in which an individual has

- a. primary responsibility for significant accounting functions that support material components of the *financial statements*;

- b. primary responsibility for the preparation of the *financial statements*; or
- c. 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 previously described. [Prior reference: paragraph .18 of ET section 92]

**.28 Lending institution.** An entity that, as part of its normal business operations, makes *loans*. This definition is not meant to include an organization that might schedule payment for services for a client over a period of time. Examples of such entities are banks, credit unions, certain retailers, and insurance and finance companies. For example, for automobile leases addressed by the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule" [1.200.001], an entity is considered a lending institution if it leases automobiles as part of its normal business operations. [Prior reference: paragraph .09 of ET section 92]

### **Effective Date**

This revised definition is effective December 15, 2014.

**.29 Loan.** A contractual obligation to pay or right to receive money on demand or on a fixed or determinable date and includes a stated or implied rate of return to the lender. For purposes of this definition, loans include, among other things, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment. However, for purposes of this definition, a loan would not include debt securities (which are considered a *financial interest*) or lease arrangements. [Prior reference: paragraph .19 of ET section 92]

### **Effective Date**

This revised definition is effective December 15, 2014.

**.30 Manager.** A professional employee of the *firm* who has continuing responsibility for the planning and supervision of engagements for specified *clients*. [Prior reference: paragraph .20 of ET section 92]

**.31 Member.** A member, associate member, affiliate member, or international associate of the AICPA. When the term member is used in part 1 of the code, it means a member in *public practice*; when used in part 2 of the code, it means a *member in business*; and when used in part 3 of the code, it means all other members. [Prior reference: paragraph .21 of ET section 92]

**.32 Member(s) in business.** A *member* who is employed or engaged on a contractual or volunteer basis in a(n) executive, staff, governance, advisory, or administrative capacity in such areas as industry, the public sector, education, the not-for-profit sector, and regulatory or professional bodies. This does not include a *member* engaged in *public practice*. [Prior reference: paragraph .22 of ET section 92]

**.33 Network.** For purposes of the "Network and Network Firms" interpretation [1.220.010] of the "Independence Rule" [1.200.001], a network is an association of entities that includes one or more *firms* that (a) cooperate for the



purpose of enhancing the *firms'* capabilities to provide *professional services* and (b) share one or more of the following characteristics:

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

A network may comprise a subset of entities within an association only if that subset of entities cooperates and shares one or more of the characteristics set forth in the preceding list. [Prior reference: paragraph .23 of ET section 92]

**.34 Network firm.** A *firm* or other entity that belongs to a *network*. This includes any entity (including another *firm*) that the network firm, by itself or through one or more of its owners, *controls*, is *controlled* by, or is under common *control* with. [Prior reference: paragraph .24 of ET section 92]

**.35 Normal lending procedures, terms, and requirements.** In connection with a *covered member's loan* from a *lending institution*, lending procedures, terms, and requirements that are reasonably comparable with those relating to *loans* of a similar character committed to other borrowers during the period in which the *loan* to the *covered member* is committed. Accordingly, in making such comparison and evaluating whether a *loan* was made under normal lending procedures, terms, and requirements, the *covered member* should consider all the circumstances under which the *loan* was granted, including the following:

- a. The amount of the *loan* in relation to the value of the collateral pledged as security and the credit standing of the *covered member*
- b. Repayment terms
- c. Interest rate, including points
- d. Closing costs
- e. General availability of such *loans* to the public

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such *lending institutions*. Broker-dealers, for example, are subject to regulation by the SEC. [Prior reference: paragraph .25 of ET section 92]

**.36 Office.** A reasonably distinct subgroup within a *firm*, whether constituted by formal organization or informal practice, in which 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. [Prior reference: paragraph .26 of ET section 92]

**.37 Partner.** A proprietor, a shareholder, an equity or a nonequity partner, or any individual who assumes the risks and benefits of *firm* ownership or is otherwise held out by the *firm* to be the equivalent of any of the aforementioned. [Prior reference: paragraph .27 of ET section 92]

**.38 Partner equivalent.** A professional employee who is not a *partner* of the *firm* but who either

- a. has the ultimate responsibility for the conduct of an *attest engagement*, including the authority to sign or affix the *firm's* name to an attest report or issue, or authorize others to issue, an attest report on behalf of the *firm* without *partner* approval; or
- b. has the authority to bind the *firm* to conduct an *attest engagement* without *partner* approval. For example, the professional employee has the authority to sign or affix the *firm's* name to an *attest engagement* letter or contract to conduct an *attest engagement* without *partner* approval.

Firms may use different titles to refer to professional employees with this authority, although a title is not determinative of a partner equivalent. For purposes of this definition, *partner* approval does not include any partner approvals that are part of the *firm's* normal approval and quality control review procedures applicable to a partner.

This definition is solely for the purpose of applying the "Independence Rule" [1.200.001] and its *interpretations* and should not be used or relied upon in any other context, including the determination of whether the partner equivalent is an owner of the *firm*. [Prior reference: paragraph .28 of ET section 92.]

### **Effective Date**

This definition is effective for engagements covering periods beginning on or after December 15, 2014.

**.39 Period of the professional engagement.** The period 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 *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*. [Prior reference: paragraph .29 of ET section 92]

**.40 Professional services.** Include all services requiring accountancy or related skills that are performed by a *member* for a *client*, an employer, or on a volunteer basis. These services include, but are not limited to accounting, audit and other attest services, tax, bookkeeping, management consulting, financial management, corporate governance, personal financial planning, business valuation, litigation support, educational, and those services for which standards are promulgated by bodies designated by *Council*. [Prior reference: paragraph .31 of ET section 92]

**.41 Public interest entities.** All of the following:

- a. All listed entities, including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body.

- b. Any entity for which an audit is required by regulation or legislation to be conducted in compliance with the same *independence* requirements that apply to an audit of listed entities (for example, requirements of the SEC, the PCAOB, or other similar regulators or standard setters).

*Members* may wish to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered may include

- the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders;
- size; and
- number of employees.

*Members* should refer to the *independence* regulations of applicable authoritative regulatory bodies when a *member* performs attest services and is required to be independent of the *client* under such regulations. [Prior reference: paragraph .20 of ET section 100-1]

**.42 Public practice.** Consists of the performance of *professional services* for a *client* by a *member* or *member's firm*. [Prior reference: paragraph .30 of ET section 92]

**.43 Safeguards.** Actions or other measures that may eliminate a *threat* or reduce a *threat* to an *acceptable level*. [Prior reference: paragraph .20 of ET section 100-1]

**.44 Share-based compensation arrangements.** As defined in the FASB ASC glossary under the term share-based payment arrangements. [Prior reference: paragraph .02 ET section 101]

**.45 Significant influence.** As defined in FASB ASC 323-10-15. [Prior reference: paragraph .32 of ET section 92]

**.46 Source documents.** The documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports that do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Prior reference: footnote 17 in paragraph .05 of ET section 101]

**.47 Third-party service provider.** All of the following:

- a. An entity that the *member* does not *control*, individually or collectively with his or her *firm* or with *members* of his or her *firm*.
- b. An individual not employed by the *member* who assists the *member* in providing *professional services* to *clients* (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions). [Prior reference: paragraphs .224–.225 of ET section 191, .023–.024 of ET section 291, and .001–.002 of ET section 391]

**.48 Those charged with governance.** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

When an *interpretation* requires communicating with those charged with governance, the *member* should determine, considering the nature and importance of

the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the *member* communicates with a subgroup of those charged with governance (for example, an audit committee or an individual), the *member* should determine whether communication with all of those charged with governance is also necessary, so that they are adequately informed. [Prior reference: paragraph .33 of ET section 92]

### **Effective Date**

This definition is effective April 30, 2014.

**.49 Threat(s).** In connection with independence, threats are relationships or circumstances that could *impair independence*. In connection with any rule but the "Independence Rule" [1.200.001], threats are relationships or circumstances that could compromise a *member's* compliance with the rules. [Prior reference: paragraph .10 of ET section 100-1]

### **Effective Date**

When this definition is used in connection with any rule but the "Independence Rule" it is effective December 15, 2014.

## **0.500 Nonauthoritative Guidance**

**.01** The code is the only authoritative source of AICPA ethics rules and *interpretations*. The staff of the Professional Ethics Division has issued nonauthoritative guidance to assist *members* and others in their implementation of the code. Such guidance does not amend or override the code. Further, the guidance is not meant to be exhaustive and does not establish best practices, set standards, or serve as official pronouncements of the AICPA. These documents were not approved in accordance with normal due process, which requires proposed changes to be exposed to the public and requires consideration of *members'* and others' comments.

**.02** References to relevant nonauthoritative guidance, when available, are provided throughout the code in boxed text at the end of the applicable *interpretation*. [No prior reference: new content]

### **Effective Date**

**.03** Effective December 15, 2014.

## **0.600 New, Revised, and Pending Interpretations and Other Guidance**

### **0.600.010 New and Revised Interpretations and Other Guidance**

**.01** Periodically, new or revised authoritative ethics *interpretations* and other guidance are issued. Publication of the text of a new or revised pronouncement or a notice with a link to the text of a new or revised authoritative *interpretation* and other guidance in the *Journal of Accountancy* constitutes notice to *members*. Hence, the effective date of the *interpretation* and other guidance is the last day of the month in which the pronouncement or notice is published in the *Journal of Accountancy*, unless otherwise noted. The Professional Ethics Division takes into consideration the time that would have been reasonable for the *member* to comply with the pronouncement. This section lists the citation

and title of any new or revised *interpretation* or other guidance for a period of 12 months after its effective date. When an *interpretation* or other guidance is not yet effective, it will appear as a pending *interpretation* or other guidance (see "Pending Interpretations and Other Guidance" [0.600.020]).

- "Overview of the Code of Professional Conduct" [0.100]. (Issued June, 2014, Effective December 15, 2014.)
- "Structure of the AICPA Code" [0.200.010]. (Issued June 2014. Effective December 15, 2014.)
- "Application of the AICPA Code" [0.200.020.01]. (Issued June 2014. Effective December 15, 2014.)
- "Citations" [0.200.030]. (Issued June 2014. Effective December 15, 2014.)
- "Transition Provisions" [0.200.040]. (Issued June 2014. Effective December 15, 2014.)
- "Drafting Conventions" [0.200.050]. (Issued June 2014. Effective December 15, 2014.)
- "Acceptable level" under "Definitions" [0.400.01]. (Issued June 2014. When this definition is used in connection with any rule but the "Independence Rule" [1.200.001], it is effective December 15, 2014.)
- "Attest client" under "Definitions" [0.400.03]. (Issued June 2014. Effective December 15, 2014.)
- "Employing organization" under "Definitions" [0.400.14]. (Issued June 2014. Effective December 15, 2014.)
- "Lending institution" under "Definitions" [0.400.28] (Revised June 2014. Effective December 15, 2014)
- "Loan" under "Definitions" [0.400.29] (Revised June 2014. Effective December 15, 2014.)
- "Threats" under "Definitions" [0.400.49]. (Issued June 2014. When this definition is used in connection with any rule but the "Independence Rule," it is effective December 15, 2014.)
- "Nonauthoritative Guidance" [0.500]. (Issued June 2014. Effective December 15, 2014.)
- "New, Revised, and Pending Interpretations and Other Guidance" [0.600]. (Issued June 2014. Effective December 15, 2014.)
- "Deleted Interpretations and Other Guidance" [0.700]. (Issued June 2014. Effective December 15, 2014.)
- "Members in Public Practice—Introduction" [1.000]. (Issued June 2014. Effective December 15, 2014.)
- "Members in Public Practice—Ethical Conflicts" [1.000.020]. (Issued June 2014. Effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.100.005] of the "Integrity and Objectivity Rule" (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Director Positions" [1.110.020]. (Revised June 2014. Effective December 15, 2014.)

- "Application of the Conceptual Framework for Independence and Ethical Conflicts" interpretation [1.200.005.03] of the "Independence Rule." (Issued June 2014. Effective December 15, 2014)
- "Fees and Other Types of Remuneration" [1.230.020]. (Issued June 2014. Effective December 15, 2014.)
- "Trust Investments" [1.245.020]. (Revised June 2014. Effective December 15, 2014.)
- "Tax Services" [1.295.160.06]. (Revised June 2014. Effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.300.005] of the "General Standards Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.310.005] of the "Compliance with Standards Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.320.005] of the "Accounting Standards Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.400.005] of the "Acts Discreditable Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services" [1.400.090]. (Issued June 2014. Effective December 15, 2014.)
- "Removing Client Files or Proprietary Information From a Firm" [1.400.210]. (Revised June 2014. Effective December 15, 2014.)
- "Use of Confidential Information From Nonclient Sources" [1.400.240]. (Revised June 2014. Effective December 15, 2014.)
- "Unpaid Fees" [1.500.008]. (Issued June 2014. Effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.510.005] of the "Contingent Fees Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.520.005] of the "Commissions and Referral Fees Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Billing for a Subcontractor's Services" [1.520.070]. (Revised June 2014. Effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.600.005] of the "Advertising and Other Forms of Solicitation Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)

- "Use of AICPA-Awarded Designation" [1.600.030] (Revised June 2014. Effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.700.005] of the "Confidential Client Information Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Disclosing Client Information in Director Positions" [1.700.080]. (Revised June 2014. Effective December 15, 2014.)
- "Disclosing Confidential Client Information as a Result of a Subpoena or Summons" [1.700.100]. (Issued June 2014. Effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.800.005] of the "Form of Organization and Name Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Attest Engagement Performed With a Former Partner" [1.810.040]. (Revised June 2014. Effective December 15, 2014.)
- "Members in Business—Introduction" [2.000.01]. (Issued June 2014. Effective December 15, 2014.)
- "Members in Business—Ethical Conflicts" [2.000.020]. (Issued June 2014. Effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.100.005] of the "Integrity and Objectivity Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.300.005] of the "General Standards Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.310.005] of the "Compliance with Standards Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.320.005] of the "Accounting Standards Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.400.005] of the "Acts Discreditable Rule." (Issued June 2014. Paragraph .03 is effective December 15, 2014.)
- "Other Members—Introduction" [3.000.01]. (Issued June 2014. Effective December 15, 2014.)
- "Other Members—Applicability" [3.000.030]. (Issued June 2014. Effective December 15, 2014.)
- "False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services" [3.400.090]. (Issued June 2014. Effective December 15, 2014.)

- "Those charged with governance" under "Definitions" [0.400.48]. (Issued April 2014. Effective April 30, 2014.)
- "Cumulative Effect on Independence When Providing Multiple Nonattest Services" [1.295.020]. (Issued October 2013. Effective for engagements covering periods beginning on or after December 15, 2014.)
- "Covered member" under "Definitions" [0.400.12]. (Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.)
- "Partner equivalent" under "Definitions" [0.400.38]. (Issued March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.)
- "Conceptual Framework for Independence" [1.210.010.14b]. (Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.)
- "Close Relatives" [1.270.100]. (Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.)
- "Scope and Applicability of Nonattest Services" [1.295.010.06]. (Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.)
- "Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs" [1.297.020.04]. (Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.)
- "Client Affiliates" [1.224.010]. (Issued November 2011. Effective for engagements covering periods beginning on or after January 1, 2014.)

### **Effective Date**

.02 Paragraph .01, excluding the bulleted text, is effective December 15, 2014.

## **0.600.020 Pending Interpretations and Other Guidance**

.01 Periodically, new or revised authoritative ethics *interpretations* and other guidance are issued. This section lists the titles and citations of any pending new or revised *interpretations* or other guidance until they are effective and notes whether early application is permitted or encouraged. Once the *interpretation* or other guidance becomes effective, it will appear under the "New and Revised Interpretation and Other Guidance" section of the preface [0.600.010]:

- "Conflicts of Interest for Members in Public Practice" [1.110.010]. (Issued June 2014. Effective September 30, 2014.)
- "Conflicts of Interest for Members in Business" [2.110.010]. (Issued June 2014. Effective September 30, 2014.)
- "Conceptual Framework for Members in Public Practice" [1.000.010]. (Issued June 2014. Effective December 15, 2015. Early implementation is allowed provided the member has implemented the revised code.)



- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.100.005] of the "Integrity and Objectivity Rule" (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.300.005] of the "General Standards Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.310.005] of the "Compliance with Standards Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.320.005] of the "Accounting Standards Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.400.005] of the "Acts Discreditable Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.510.005] of the "Contingent Fees Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.520.005] of the "Commissions and Referral Fees Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.600.005] of the "Advertising and Other Forms of Solicitation Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.700.005] of the "Confidential Client Information Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)

- "Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts" interpretation [1.800.005] of the "Form of Organization and Name Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Conceptual Framework for Members in Business" [2.000.010]. (Issued June 2014. Effective December 15, 2015. Early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.100.005] of the "Integrity and Objectivity Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed if the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.300.005] of the "General Standards Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.310.005] of the "Compliance with Standards Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.320.005] of the "Accounting Standards Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)
- "Application of the Conceptual Framework for Members in Business and Ethical Conflicts" interpretation [2.400.005] of the "Acts Discreditable Rule." (Issued June 2014. Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code.)

### **Effective Date**

.02 Paragraph .01, excluding the bulleted text, is effective December 15, 2014.

## **0.700 Deleted Interpretations and Other Guidance**

.01 The following interpretations and other guidance were deleted from the code during the 10 years prior to the 2014 edition:

- Definition of *holding out* (ET sec. 92 par. .12) (Deleted March 2013, effective May 31, 2013)
- Ethics Ruling No. 65, "Use of the CPA Designation by Member Not in Public Practice" (ET sec. 191 par. .130) (Deleted March 2013, effective May 31, 2013)

- Ethics Ruling No. 38, "CPA Title, Controller of Bank" (ET sec. 591 par. .075-.076) (Deleted March 2013, effective May 31, 2013)
- Ethics Ruling No. 78, "Letterhead: Lawyer-CPA" (ET sec. 591 par. .155-.156) (Deleted March 2013, effective May 31, 2013)
- Ethics Ruling No. 134, "Association of Accountants Not Partners" (ET sec. 591 par. .267-.268) (Deleted August 2012)
- Ethics Ruling No. 74, "Audits, Reviews, or Compilations and a Lack of Independence" (ET sec. 191 par. .148-.149) (Deleted April 2012).
- Ethics Ruling No. 135, "Association of Firms Not Partners" (ET sec. 591 par. .269-.270) (Deleted April 2012).
- Interpretation No. 101-8, "Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Covered Member's Client" (ET sec. 101 par. .10) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18.***)
- Ethics Ruling No. 9, "Member as Representative of Creditor's Committee" (ET sec. 191 par. .017-.018) (Deleted November 2011)
- Ethics Ruling No. 10, "Member as Legislator" (ET sec. 191 par. .019-.020) (Deleted November 2011)
- Ethics Ruling No. 12, "Member as Trustee of Charitable Foundation" (ET sec. 191 par. .023-.024) (Deleted November 2011)
- Ethics Ruling No. 16, "Member on Board of Directors of Nonprofit Social Club" (ET sec. 191 par. .031-.032) (Deleted November 2011)
- Ethics Ruling No. 19, "Member on Deferred Compensation Committee" (ET sec. 191 par. .037-.038) (Deleted November 2011)
- Ethics Ruling No. 21, "Member as Director and Auditor of an Entity's Profit Sharing and Retirement Trust" (ET sec. 191 par. .041-.042) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 29, "Member as Bondholder" (ET sec. 191 par. .057-.058) (Deleted November 2011)
- Ethics Ruling No. 38, "Member as Co-Fiduciary With Client Bank" (ET sec. 191 par. .075-.076) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 48, "Faculty Member as Auditor of a Student Fund" (ET sec. 191 par. .095-.096) (Deleted November 2011)
- Ethics Ruling No. 60, "Employee Benefit Plans—Member's Relationships With Participating Employer," (ET sec. 191 par. .119-.120) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 69, "Investment With a General Partner" (ET sec. 191 par. .138-.139) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)

- Ethics Ruling No. 81, "Member's Investment in a Limited Partnership" (ET sec. 191 par. .162–.163) (Deleted November 2011). ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***
- Ethics Ruling No. 98, "Member's Loan From a Nonclient Subsidiary or Parent of an Attest Client" (ET sec. 191 par. .196–.197) (Deleted November 2011). ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***
- Ethics Ruling No. 103, "Attest Report on Internal Controls" (ET sec. 191 par. .206–.207) (Deleted November 2011)
- Ethics Ruling No. 106, "Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client" (ET sec. 191 par. .212–.213) (Deleted November 2011). ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***
- Ethics Ruling No. 111, "Employee Benefit Plan Sponsored by Client" (ET sec. 191 par. .222–.223) (Deleted November 2011). ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***
- Ethics Ruling No. 11, "Applicability of Rule 203 to Members Performing Litigation Support Services" (ET sec. 291 par. .021–.022) (Deleted November 2011)
- Ethics Ruling No. 2, "Fees: Collection of Notes Issued in Payment" (ET sec. 591 par. .003–.004) (Deleted November 2011)
- Ethics Ruling No. 33, "Course Instructor" (ET sec. 591 par. .065–.066) (Deleted November 2011)
- Ethics Ruling No. 108, "Member Interviewed by the Press" (ET sec. 591 par. .215–.216) (Deleted November 2011)
- Ethics Ruling No. 117, "Consumer Credit Company Director" (ET sec. 591 par. .233–.234) (Deleted November 2011)
- Ethics Ruling No. 140, "Political Election" (ET sec. 591 par. .279–.280) (Deleted November 2011)
- Ethics Ruling No. 144, "Title: Partnership Roster" (ET sec. 591 par. .287–.288) (Deleted November 2011)
- Ethics Ruling No. 176, "Member's Association With Newsletters and Publications" (ET sec. 591 par. .351–.352) (Deleted November 2011)
- Ethics Ruling No. 177, "Data Processing: Billing Services" (ET sec. 591 par. .353–.354) (Deleted November 2011)
- Ethics Ruling No. 179, "Practice of Public Accounting Under Name of Association or Group" (ET sec. 591 par. .357–.358) (Deleted November 2011)
- Ethics Ruling No. 101, "Client advocacy and Expert Witness Services" (ET sec. 191 par. .202–.203) (Deleted July 2007)
- Ethics Ruling No. 182, "Termination of Engagement Prior to Completion" (ET sec. 591 par. .363–.364) (Deleted April 2006).
- Ethics Ruling No. 1, "Acceptance of a Gift" (ET sec. 191 par. .001–.002) (Deleted January 2006).

- Ethics Ruling No. 35, "Stockholder in Mutual Funds" (ET sec. 191 par. .069–.070) (Deleted December 2005).
- Ethics Ruling No. 36, "Participant in Investment Club" (ET sec. 191 par. .071–.072) (Deleted December 2005).
- Ethics Ruling No. 79, "Member's Investment in a Partnership That Invests in Client" (ET sec. 191 par. .158–.159) (Deleted December 2005).
- Ethics Ruling No. 109, "Member's Investment in Financial Services Products that Invest in Clients" (ET sec. 191 par. .218–.219) (Deleted December 2005).
- Ethics Ruling No. 66, "Member's Retirement or Savings Plan Has Financial Interest in Client" (ET sec. 191 par. .132–.133) (Deleted December 2005).
- Ethics Ruling No. 68, "Blind Trust" (ET sec. 191 par. .136–.137) (Deleted December 2005).

The content of these deleted standards is available in a nonauthoritative document at <http://aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/Deletions.pdf>.



## ET Part 1

***Members in Public Practice***

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## 1.000 Introduction

**.01** Part 1 of the Code of Professional Conduct (the code) applies to *members in public practice*. Accordingly, when the term *member* is used in part 1 of the code, the requirements apply only to *members in public practice*. When a *member in public practice* is also a *member in business* (for example, serves as a member of an entity's board of directors), the *member* should also consult part 2 of the code, which applies to a *member in business*.

**.02** Government auditors within a government audit organization who audit federal, state, or local governments or component units thereof, that are structurally located within the government audit organization, are considered in *public practice* with respect to those entities provided the head of the audit organization meets one of the organizational structures described in paragraph .07b(i–iii) of the "Client" definition [0.400.07]. [No prior reference: new content]

### **Effective Date**

**.03** Effective December 15, 2014.

## 1.000.010 Conceptual Framework for Members in Public Practice

### **Introduction**

**.01** *Members* may encounter various relationships or circumstances that create *threats* to the *member's* compliance with the rules. The rules and *interpretations* seek to address many situations; however, they cannot address all relationships or circumstances that may arise. Thus, in the absence of an *interpretation* that addresses a particular relationship or circumstance, a *member* should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a *threat* to the *member's* compliance with the rules that is not at an *acceptable level*. When making that evaluation, the *member* should apply the conceptual framework approach as outlined in this interpretation.

**.02** The code specifies that in some circumstances no *safeguards* can reduce a *threat* to an *acceptable level*. For example, the code specifies that a *member* may not subordinate the *member's* professional judgment to others without violating the "Integrity and Objectivity Rule" [1.100.001]. A *member* may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in the code.

**.03** The "Conceptual Framework for Independence" interpretation [1.210.010] of the "Independence Rule" [1.200.001] provides authoritative guidance that *members* should use when making decisions on *independence* matters that are not explicitly addressed by the "Independence Rule" and its *interpretations*.

### **Definitions Used in Applying the Conceptual Framework**

**.04 Acceptable level.** A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's* compliance with the rules is not compromised.

**.05 Safeguards.** Actions or other measures that may eliminate a *threat* or reduce a *threat* to an *acceptable level*.

**.06 Threats.** Relationships or circumstances that could compromise a *member's* compliance with the rules.

### Conceptual Framework Approach

.07 Under the conceptual framework approach, *members* should identify *threats* to compliance with the rules and evaluate the significance of those threats. *Members* should evaluate identified *threats* both individually and in the aggregate because *threats* can have a cumulative effect on a *member's* compliance with the rules. *Members* should perform three main steps in applying the conceptual framework approach:

- a. *Identify threats.* The relationships or circumstances that a *member* encounters in various engagements and work assignments will often create different *threats* to complying with the rules. When a *member* encounters a relationship or circumstance that is not specifically addressed by a rule or an *interpretation*, under this approach, the *member* should determine whether the relationship or circumstance creates one or more *threats*, such as those identified in paragraphs .10–.16 that follow. The existence of a *threat* does not mean that the *member* is in violation of the rules; however, the *member* should evaluate the significance of the *threat*.
- b. *Evaluate the significance of a threat.* In evaluating the significance of an identified *threat*, the *member* should determine whether a *threat* is at an *acceptable level*. A *threat* is at an *acceptable level* when a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* would not compromise the *member's* compliance with the rules. *Members* should consider both qualitative and quantitative factors when evaluating the significance of a *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*. If the *member* evaluates the *threat* and concludes that a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* does not compromise a *member's* compliance with the rules, the *threat* is at an *acceptable level*, and the *member* is not required to evaluate the *threat* any further under this conceptual framework approach.
- c. *Identify and apply safeguards.* If, in evaluating the significance of an identified *threat*, the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. The *member* should apply judgment in determining the nature of the *safeguards* to be applied because the effectiveness of *safeguards* will vary, depending on the circumstances. When identifying appropriate *safeguards* to apply, one *safeguard* may eliminate or reduce multiple *threats*. In some cases, the *member* should apply multiple *safeguards* to eliminate or reduce one *threat* to an *acceptable level*. In other cases, an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* will be unable to implement effective *safeguards*. Under such circumstances, providing the specific *professional services* would compromise the *member's* compliance with the rules, and the *member* should determine whether to decline or discontinue the *professional services* or resign from the engagement.

## Threats

.08 Many *threats* fall into one or more of the following seven broad categories: adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.

.09 Examples of *threats* associated with a specific relationship or circumstance are identified in the *interpretations* of the code. Paragraphs .10–.16 of this section define and provide examples, which are not all inclusive, of each of these *threat* categories.

**.10 Adverse interest threat.** The *threat* that a *member* will not act with objectivity because the *member's* interests are opposed to the *client's* interests. Examples of adverse interest *threats* include the following:

- a. The *client* has expressed an intention to commence litigation against the *member*.
- b. A *client* or officer, director, or significant shareholder of the *client* participates in litigation against the *firm*.
- c. A subrogee asserts a claim against the *firm* for recovery of insurance payments made to the *client*.
- d. A class action lawsuit is filed against the *client* and its officers and directors and the *firm* and its professional accountants.

**.11 Advocacy threat.** The *threat* that a *member* will promote a *client's* interests or position to the point that his or her objectivity or *independence* is compromised. Examples of advocacy *threats* include the following:

- a. A *member* provides forensic accounting services to a *client* in litigation or a dispute with third parties.
- b. A *firm* acts as an investment adviser for an officer, a director, or a 10 percent shareholder of a *client*.
- c. A *firm* underwrites or promotes a *client's* shares.
- d. A *firm* acts as a registered agent for a *client*.
- e. A *member* endorses a *client's* services or products.

**.12 Familiarity threat.** The *threat* that, due to a long or close relationship with a *client*, a *member* will become too sympathetic to the *client's* interests or too accepting of the *client's* work or product. Examples of familiarity *threats* include the following:

- a. A *member's* immediate family or close relative is employed by the *client*.
- b. A *member's* close friend is employed by the *client*.
- c. A former *partner* or professional employee joins the *client* in a *key position* and has knowledge of the *firm's* policies and practices for the *professional services* engagement.
- d. Senior personnel have a long association with a *client*.
- e. A *member* has a significant close business relationship with an officer, a director, or a 10 percent shareholder of a *client*.

**.13 Management participation threat.** The *threat* that a *member* will take on the role of *client* management or otherwise assume management responsibilities, such may occur during an engagement to provide nonattest services.

**.14 Self-interest threat.** The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, a *client* or persons associated with the *client*. Examples of self-interest *threats* include the following:

- a. The *member* has a *financial interest* in a *client*, and the outcome of a *professional services* engagement may affect the fair value of that *financial interest*.
- b. The *member's* spouse enters into employment negotiations with the *client*.
- c. A *firm* enters into a contingent fee arrangement for a tax refund claim that is not a predetermined fee.
- d. Excessive reliance exists on revenue from a single *client*.

**.15 Self-review threat.** The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the *member* or an individual in the *member's firm* and that the *member* will rely on that service in forming a judgment as part of another service. Examples of self-review *threats* include the following:

- a. The *member* relies on the work product of the *member's firm*.
- b. The *member* performs bookkeeping services for a *client*.
- c. A *partner* in the *member's office* was associated with the *client* as an employee, an officer, a director, or a contractor.

**.16 Undue influence threat.** The *threat* that a *member* will subordinate his or her judgment to an individual associated with a *client* or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

- a. The *firm* is threatened with dismissal from a *client* engagement.
- b. The *client* indicates that it will not award additional engagements to the *firm* if the *firm* continues to disagree with the *client* on an accounting or tax matter.
- c. An individual associated with a *client* or any relevant third party threatens to withdraw or terminate a *professional service* unless the *member* reaches certain judgments or conclusions.

## Safeguards

**.17 Safeguards** may partially or completely eliminate a *threat* or diminish the potential influence of a *threat*. The nature and extent of the *safeguards* applied will depend on many factors. To be effective, *safeguards* should eliminate the *threat* or reduce it to an *acceptable level*.

**.18 Safeguards** that may eliminate a *threat* or reduce it to an *acceptable level* fall into three broad categories:

- a. *Safeguards* created by the profession, legislation, or regulation.
- b. *Safeguards* implemented by the *client*. It is not possible to rely solely on *safeguards* implemented by the *client* to eliminate or reduce significant *threats* to an *acceptable level*.
- c. *Safeguards* implemented by the *firm*, including policies and procedures to implement professional and regulatory requirements.

**.19** The effectiveness of a *safeguard* depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of *threats*
- c. Whether the *safeguard* is suitably designed to meet its objectives
- d. The party(ies) who will be subject to the *safeguard*
- e. How the *safeguard* is applied
- f. The consistency with which the *safeguard* is applied
- g. Who applies the *safeguard*
- h. How the *safeguard* interacts with a *safeguard* from another category
- i. Whether the *client* is a *public interest entity*

**.20** Examples of *safeguards* within each category are presented in the following paragraphs. Because these are only examples and are not intended to be all inclusive, it is possible that *threats* may be sufficiently mitigated through the application of other *safeguards* not specifically identified herein.

**.21** The following are examples of *safeguards* created by the profession, legislation, or regulation:

- a. Education and training requirements on *independence* and ethics rules
- b. Continuing education requirements on *independence* and ethics
- c. Professional standards and the threat of discipline
- d. External review of a *firm's* quality control system
- e. Legislation establishing prohibitions and requirements for a *firm* or a *firm's* professional employees
- f. Competency and experience requirements for professional licensure
- g. Professional resources, such as hotlines, for consultation on ethical issues

**.22** Examples of *safeguards* implemented by the *client* that would operate in combination with other *safeguards* are as follows:

- a. The *client* has personnel with suitable skill, knowledge, or experience who make managerial decisions about the delivery of *professional services* and makes use of third-party resources for consultation as needed.
- b. The tone at the top emphasizes the *client's* commitment to fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.
- c. Policies and procedures are in place to achieve fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.
- d. Policies and procedures are in place to address ethical conduct.
- e. A governance structure, such as an active audit committee, is in place to ensure appropriate decision making, oversight, and communications regarding a *firm's* services.
- f. Policies are in place that bar the entity from hiring a *firm* to provide services that do not serve the public interest or that would cause the *firm's independence* or objectivity to be considered *impaired*.

**.23** The following are examples of *safeguards* implemented by the *firm*:

- a. *Firm* leadership that stresses the importance of complying with the rules and the expectation that engagement teams will act in the public interest.
- b. Policies and procedures that are designed to implement and monitor engagement quality control.
- c. Documented policies regarding the identification of *threats* to compliance with the rules, the evaluation of the significance of those *threats*, and the identification and application of *safeguards* that can eliminate identified *threats* or reduce them to an *acceptable level*.
- d. Internal policies and procedures that are designed to monitor compliance with the *firm's* policies and procedures.
- e. Policies and procedures that are designed to identify interests or relationships between the *firm* or its *partners* and professional staff and the *firm's clients*.
- f. The use of different *partners*, *partner equivalents*, and engagement teams from different offices or that report to different supervisors.
- g. Training on, and timely communication of, a *firm's* policies and procedures and any changes to them for all *partners* and professional staff.
- h. Policies and procedures that are designed to monitor the *firm's*, *partner's*, or *partner equivalent's* reliance on revenue from a single *client* and that, if necessary, trigger action to address excessive reliance.
- i. Designation of someone from senior management as the person responsible for overseeing the adequate functioning of the *firm's* quality control system.
- j. A means for informing *partners* and professional staff of *attest clients* and related entities from which they must be independent.
- k. A disciplinary mechanism that is designed to promote compliance with policies and procedures.
- l. Policies and procedures that are designed to empower staff to communicate to senior members of the *firm* any engagement issues that concern them without fear of retribution.
- m. Policies and procedures relating to *independence* and ethics communications with audit committees or others charged with *client* governance.
- n. Discussion of *independence* and ethics issues with the audit committee or others responsible for the *client's* governance.
- o. Disclosures to the audit committee or others responsible for the *client's* governance regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged.
- p. The involvement of another professional accountant who (a) reviews the work that is done for a *client* or (b) otherwise advises the engagement team. This individual could be someone from outside the *firm* or someone from within the *firm* who is not otherwise associated with the engagement.
- q. Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant.



- r. Rotation of senior personnel who are part of the engagement team.
- s. Policies and procedures that are designed to ensure that members of the engagement team do not make or assume responsibility for management decisions for the *client*.
- t. The involvement of another *firm* to perform part of the engagement.
- u. Having another *firm* to reperform a nonattest service to the extent necessary for it to take responsibility for that service.
- v. The removal of an individual from an *attest engagement team* when that individual's *financial interests* or relationships pose a *threat* to *independence* or objectivity.
- w. A consultation function that is staffed with experts in accounting, auditing, *independence*, ethics, and reporting matters who can help engagement teams
  - i. assess issues when guidance is unclear or when the issues are highly technical or require a great deal of judgment; and
  - ii. resist undue pressure from a *client* when the engagement team disagrees with the *client* about such issues.
- x. *Client* acceptance and continuation policies that are designed to prevent association with *clients* that pose a *threat* that is not at an *acceptable level* to the *member's* compliance with the rules.
- y. Policies that preclude audit *partners* or *partner equivalents* from being directly compensated for selling nonattest services to the *attest client*.
- z. Policies and procedures addressing ethical conduct and compliance with laws and regulations. [No prior reference: new content]

### **Effective Date**

**.24** Effective December 15, 2015. Early implementation is allowed provided the member has implemented the revised code.

### **1.000.020 Ethical Conflicts**

**.01** An ethical conflict arises when a *member* encounters one or both of the following:

- a. Obstacles to following an appropriate course of action due to internal or external pressures
- b. Conflicts in applying relevant professional standards or legal standards

For example, a *member* suspects a fraud may have occurred, but reporting the suspected fraud would violate the *member's* responsibility to maintain *client* confidentiality.

**.02** Once an ethical conflict is encountered, a *member* may be required to take steps to best achieve compliance with the rules and law. In weighing alternative courses of action, the *member* should consider factors such as the following:

- a. Relevant facts and circumstances, including applicable rules, laws, or regulations
- b. Ethical issues involved

c. Established internal procedures

**.03** The *member* should also be prepared to justify any departures that the *member* believes were appropriate in applying the relevant rules and law. If the *member* was unable to resolve the conflict in a way that permitted compliance with the applicable rules and law, the *member* may have to address the consequences of any violations.

**.04** Before pursuing a course of action, the *member* should consider consulting with appropriate persons within the *firm* or the organization that employs the *member*.

**.05** If a *member* decides not to consult with appropriate persons within the *firm* or the organization that employs the *member* and the conflict remains unresolved after pursuing the selected course of action, the *member* should consider either consulting with other individuals for help in reaching a resolution or obtaining advice from an appropriate professional body or legal counsel. The *member* also should consider documenting the substance of the issue, the parties with whom the issue was discussed, details of any discussions held, and any decisions made concerning the issue.

**.06** If the ethical conflict remains unresolved, the *member* will in all likelihood be in violation of one or more rules if he or she remains associated with the matter creating the conflict. Accordingly, the *member* should consider his or her continuing relationship with the engagement team, specific assignment, *client*, *firm*, or employer. [No prior reference: new content.]

### **Effective Date**

**.07** Effective December 15, 2014.

## **1.100 Integrity and Objectivity**

### **1.100.001 Integrity and Objectivity Rule**

**.01** In the performance of any *professional service*, a *member* shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others. [Prior reference: paragraph .01 of ET section 102]

### **Interpretations Under the Integrity and Objectivity Rule**

#### **1.100.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts**

**.01** In the absence of an *interpretation* of the "Integrity and Objectivity Rule" [1.100.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

**.02** A *member* would be considered in violation of the "Integrity and Objectivity Rule" [1.100.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

**.03** A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such

obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

### **Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

## **1.110 Conflicts of Interest**

### **1.110.010 Conflicts of Interest for Members in Public Practice**

.01 A *member* or his or her *firm* may be faced with a conflict of interest when performing a *professional service*. In determining whether a *professional service*, relationship or matter would result in a conflict of interest, a *member* should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

.02 A conflict of interest creates adverse interest and self-interest *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001]. For example, *threats* may be created when

- a. the *member* or the *member's firm* provides a *professional service* related to a particular matter involving two or more *clients* whose interests with respect to that matter are in conflict, or
- b. the interests of the *member* or the *member's firm* with respect to a particular matter and the interests of the *client* for whom the *member* or the *member's firm* provides a *professional service* related to that matter are in conflict.

.03 Certain professional engagements, such as audits, reviews and other attest services require *independence*. *Independence* impairments under the "Independence Rule" [1.200.001], its *interpretations*, and rulings cannot be eliminated by the *safeguards* provided in this interpretation or by disclosure and consent.

.04 The following are examples of situations in which conflicts of interest may arise:

- a. Providing corporate finance services to a *client* seeking to acquire an audit *client* of the *firm*, when the *firm* has obtained confidential information during the course of the audit that may be relevant to the transaction
- b. Advising two *clients* at the same time who are competing to acquire the same company when the advice might be relevant to the parties' competitive positions
- c. Providing services to both a vendor and a purchaser who are *clients* of the *firm* in relation to the same transaction
- d. Preparing valuations of assets for two *clients* who are in an adversarial position with respect to the same assets
- e. Representing two *clients* at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership

- f. Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement
- g. Advising a *client* to invest in a business in which, for example, the *immediate family* member of the *member* has a *financial interest* in the business
- h. Providing strategic advice to a *client* on its competitive position while having a joint venture or similar interest with a competitor of the *client*
- i. Advising a *client* on the acquisition of a business which the *firm* is also interested in acquiring
- j. Advising a *client* on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service
- k. Providing forensic investigation services to a *client* for the purpose of evaluating or supporting contemplated litigation against another *client* of the *firm*
- l. Providing tax or personal financial planning services for several members of a family whom the *member* knows to have opposing interests
- m. Referring a personal financial planning or tax *client* to an insurance broker or other service provider, which refers *clients* to the *member* under an exclusive arrangement

### **Identification of a Conflict of Interest**

**.05** Before accepting a new *client* relationship, engagement, or business relationship, a *member* should take reasonable steps to identify circumstances that might create a conflict of interest including identification of

- a. the nature of the relevant interests and relationships between the parties involved and
- b. the nature of the service and its implication for relevant parties.

**.06** The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a *member* is asked to conduct an engagement for a *client* in a situation that may become adversarial with respect to another *client* or the *member* or *member's firm*, even though the parties who engage the *member* may not initially be involved in a dispute. A *member* should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

**.07** For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a *member* in identifying actual or potential conflicts of interest that may create significant *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example *clients* or potential *client*. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a *member* being able to apply *safeguards* to eliminate or reduce significant *threats* to an *acceptable level*. The process to identify actual or potential conflicts of interest will depend on such factors as

- a. the nature of the *professional services* provided,

- b. the size of the *firm*,
- c. the size and nature of the *client* base, and
- d. the structure of the *firm*, for example the number and geographic location of offices.

.08 If the *firm* is a member of a *network*, the *member* is not required to take specific steps to identify conflicts of interest of other *network firms*; however, if the *member* knows or has reason to believe that such conflicts of interest may exist or might arise due to interests and relationships of a *network firm*, the *member* should evaluate the significance of the *threat* created by such conflicts of interest as described below.

### **Evaluation of a Conflict of Interest**

.09 When an actual conflict of interest has been identified, the *member* should evaluate the significance of the *threat* created by the conflict of interest to determine if the *threat* is at an *acceptable level*. Members should consider both qualitative and quantitative factors when evaluating the significance of the *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*. In evaluating the significance of an identified *threat*, *members* should consider both of the following:

- a. The significance of relevant interests or relationships.
- b. The significance of the *threats* created by performing the *professional service* or services. In general, the more direct the connection between the *professional service* and the matter on which the parties' interests are in conflict, the more significant the *threat* to compliance with the rule will be.

.10 If the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. Examples of *safeguards* include the following:

- a. Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing *professional services* related to a particular matter for two or more *clients* whose interests with respect to that matter are in conflict. This could include
  - i. using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
  - ii. creating separate areas of practice for specialty functions within the *firm*, which may act as a barrier to the passing of *confidential client information* from one practice area to another within a *firm*;
  - iii. establishing policies and procedures to limit access to *client* files, the use of confidentiality agreements signed by employees and *partners* of the *firm* and the physical and electronic separation of confidential information.
- b. Regularly reviewing the application of *safeguards* by a senior individual not involved with the *client* engagement or engagements.
- c. Having a member of the *firm* who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
- d. Consulting with third parties, such as a professional body, legal counsel, or another professional accountant.

.11 In cases where an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* is unable to implement effective *safeguards*, the *member* should (a) decline to perform or discontinue the *professional services* that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the *threat* or reduce it to an *acceptable level*.

### **Disclosure of a Conflict of Interest and Consent**

.12 When a conflict of interest exists, the *member* should disclose the nature of the conflict of interest to *clients* and other appropriate parties affected by the conflict and obtain their consent to perform the *professional services*. The *member* should disclose the conflict of interest and obtain consent even if the *member* concludes that *threats* are at an *acceptable level*.

.13 Disclosure and consent may take different forms. The following are examples:

- a. General disclosure to *clients* of circumstances in which the *member*, in keeping with common commercial practice, does not provide services exclusively for any one *client* (for example, in a particular service in a particular market sector) in order for the *client* to provide general consent accordingly. Such disclosure might be made in a *member's* standard terms and conditions for the engagement.
- b. Specific disclosure to affected *clients* of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the *client* to make an informed decision with respect to the matter and to provide specific consent.

.14 The *member* should determine whether the nature and significance of the conflict of interest is such that specific disclosure and specific consent are necessary, as opposed to general disclosure and general consent. For this purpose, the *member* should exercise professional judgment in evaluating the circumstances that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

.15 When a *member* has requested specific consent from a *client* and that consent has been refused by the *client*, the *member* should (a) decline to perform or discontinue *professional services* that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the *threat* or reduce it to an *acceptable level*, such that consent can be obtained, after applying any additional *safeguards*, if necessary.

.16 The *member* is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the *safeguards* applied to eliminate or reduce the *threats* to an *acceptable level*, and the consent obtained.

.17 When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a *member* should remain alert to the requirements of the "Confidential Client Information Rule" [1.700.001] and the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] of the "Acts Discreditable Rule" [1.400.001]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of *client* information may be more restrictive than the requirements contained in the Code of Professional Conduct.

.18 When practicing before the IRS or other taxing authorities, *members* should ensure compliance with any requirements that are more restrictive. For example, Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, provides more restrictive requirements concerning written consent by the *client* when a conflict of interest exists.

[See Revision History Table.]

A nonauthoritative question and answer regarding independent contractors retained by the firm who are simultaneously employed or associated with an attest client is available in the FAQ at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).

### 1.110.020 Director Positions

.01 When a *member* serves as a director of an entity, such as a bank, the *member's* fiduciary responsibilities to the entity may create *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Client Information Rule" [1.700.001]. For example, an adverse interest *threat* to the *member's* objectivity may exist if the *member's clients* are customers of the entity or likely to engage in significant transactions with the entity. A *member's* general knowledge and experience may be very helpful to an entity in formulating policies and making business decisions. Nevertheless, if the *member's clients* are likely to engage in significant transactions with the entity, it would be more appropriate for the *member* to serve as a consultant to the board. Under such an arrangement, the *member* could limit activities to those that do not *threaten* the *member's* compliance with these rules. If, however, the *member* serves as a board member, the *member* should evaluate the significance of any *threats* and apply *safeguards*, when necessary, to eliminate or reduce the *threats* to an *acceptable level*.

.02 Refer to the "Disclosing Client Information in Director Positions" interpretation [1.700.080] of the "Confidential Client Information Rule" [1.700.001] for additional guidance. [Prior reference: paragraphs .170–.171 of ET section 191]

#### **Effective Date**

.03 This revised interpretation is effective December 15, 2014.

## 1.120 Gifts and Entertainment

### 1.120.010 Offering or Accepting Gifts or Entertainment

.01 For purposes of this interpretation, a client includes the *client*, an individual in a *key position* with the *client*, or an individual owning 10 percent or more of the *client's* outstanding equity securities or other ownership interests.

.02 When a *member* offers to a client or accepts gifts or entertainment from a client, self-interest, familiarity, or undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist.

.03 *Threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an *acceptable level* and could not be reduced to

an *acceptable level* by the application of *safeguards* and the *member* would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

- a. The *member* offers to a client or accepts gifts or entertainment from a client that violate the member's or client's policies or applicable laws, rules, and regulations; and
- b. The *member* knows of the violation or demonstrates recklessness in not knowing.

**.04** A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* when gifts or entertainment are reasonable in the circumstances. The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:

- a. The nature of the gift or entertainment
- b. The occasion giving rise to the gift or entertainment
- c. The cost or value of the gift or entertainment
- d. The nature, frequency, and value of other gifts and entertainment offered or accepted
- e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f. Whether other clients also participated in the entertainment
- g. The individuals from the client and *member's firm* who participated in the entertainment

**.05** *Threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a *member* offers to a client or accepts gifts or entertainment from a client that is not reasonable in the circumstances. The *member* would be presumed to lack objectivity in violation of the "Integrity and Objectivity Rule" under these circumstances.

**.06** Refer to the "Offering or Accepting Gifts or Entertainment" interpretation [1.285.010] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraphs .226–.227 of ET section 191]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts\\_Basis\\_Document.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts_Basis_Document.pdf).

A nonauthoritative question and answer regarding campaign contributions is available at the following address. The subject is member contributions made to the campaign of an individual who holds a key position with or has a financial interest in an attest client. [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).



## 1.130 Preparing and Reporting Information

### 1.130.010 *Knowing Misrepresentations in the Preparation of Financial Statements or Records*

**.01** *Threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and the *member* would be considered to have knowingly misrepresented facts in violation of the "Integrity and Objectivity Rule," if the *member*

- a. makes, or permits or directs another to make, materially false and misleading entries in an entity's *financial statements* or records;
- b. fails to correct an entity's *financial statements* or records that are materially false and misleading when the *member* has the authority to record the entries; or
- c. signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .02 of ET section 102]

### 1.130.020 *Subordination of Judgment*

**.01** The "Integrity and Objectivity Rule" [1.100.001] prohibits a *member* from knowingly misrepresenting facts or subordinating his or her judgment when performing *professional services* for a *client*, for an employer, or on a volunteer basis. This interpretation addresses differences of opinion between a *member* and his or her supervisor or any other person within the *member's* organization.

**.02** Self-interest, familiarity, and undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist when a *member* and his or her supervisor or any other person within the *member's* organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.

**.03** A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* if the *member* concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If *threats* are not at an *acceptable level*, the *member* should apply the *safeguards* in paragraphs .05–.07 to eliminate or reduce the *threat(s)* to an *acceptable level* so that the *member* does not subordinate his or her judgment.

**.04** In evaluating the significance of any identified *threats*, the *member* should determine, after appropriate research or consultation, whether the result of the position taken by the supervisor or other person

- a. fails to comply with professional standards, when applicable;
- b. creates a material misrepresentation of fact; or
- c. may violate applicable laws or regulations.

**.05** If the *member* concludes that *threats* are at an *acceptable level* the *member* should discuss his or her conclusions with the person taking the position. No further action would be needed under this interpretation.

**.06** If the *member* concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then *threats* would not be at an *acceptable level*. In such circumstances, the *member* should discuss his or her concerns with the supervisor.

**.07** If the difference of opinion is not resolved after discussing the concerns with the supervisor, the *member* should discuss his or her concerns with the appropriate higher level(s) of management within the *member's* organization (for example, the supervisor's immediate superior, senior management, and *those charged with governance*).

**.08** If after discussing the concerns with the supervisor and appropriate higher level(s) of management within the *member's* organization, the *member* concludes that appropriate action was not taken, then the *member* should consider, in no specific order, the following *safeguards* to ensure that *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] are eliminated or reduced to an *acceptable level*:

- a. Determine whether the organization's internal policies and procedures have any additional requirements for reporting differences of opinion.
- b. Determine whether he or she is responsible for communicating to third parties, such as regulatory authorities or the organization's (former organization's) external accountant. In considering such communications, the *member* should be cognizant of his or her obligations under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] of the "Acts Discreditable Rule" [1.400.001].
- c. Consult with his or her legal counsel regarding his or her responsibilities.
- d. Document his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

**.09** If the *member* concludes that no *safeguards* can eliminate or reduce the *threats* to an *acceptable level* or if the *member* concludes that appropriate action was not taken, then he or she should consider the continuing relationship with the *member's* organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

**.10** Nothing in this interpretation precludes a *member* from resigning from the organization at any time. However, resignation may not relieve the *member* of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

**.11** A *member* should use professional judgment and apply similar *safeguards*, as appropriate, to other situations involving a difference of opinion as described in this interpretation so that the *member* does not subordinate his or her judgment. [Prior reference: paragraph .05 of ET section 102]

## 1.140 Client Advocacy

### 1.140.010 Client Advocacy

**.01** An advocacy *threat* to compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist when a *member* or the *member's firm* is engaged to perform nonattest services, such as tax and consulting services, that involve acting as an advocate for the *client* or to support a *client's* position on accounting or financial reporting issues either within the *firm* or outside the *firm* with standard setters, regulators, or others.

**.02** The code governs these types of *professional services*, and the *member* shall perform such services in compliance with the "General Standards Rule" [1.300.001], the "Compliance With Standards Rule" [1.310.001], the "Accounting Principles Rule" [1.320.001], and any *interpretations* thereof. The *member* shall also comply with the "Integrity and Objectivity Rule" [1.100.001] that requires maintaining objectivity and integrity and prohibits subordinating one's judgment to others.

**.03** Some *professional services* involving *client* advocacy may stretch the bounds of performance standards, go beyond sound and reasonable professional practice, or compromise credibility, thereby creating *threats* to the *member's* compliance with the rules and damaging the reputation of the *member* and the *member's firm*. If such circumstances exist, the *member* and *member's firm* should determine whether it is appropriate to perform the *professional services*.

**.04** When performing *professional services* requiring *independence*, a *member* shall also comply with the "Independence Rule" [1.200.001]. [Prior reference: paragraph .07 of ET section 102]

## 1.150 Use of a Third-Party Service Provider

### 1.150.040 Use of a Third-Party Service Provider

**.01** When a *member* uses a *third-party service provider* to assist the *member* in providing *professional services*, *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist.

**.02** *Clients* might not have an expectation that a *member* would use a *third-party service provider* to assist the *member* in providing the *professional services*. Therefore, before disclosing *confidential client information* to a *third-party service provider*, the *member* should inform the *client*, preferably in writing, that the *member* may use a *third-party service provider*. If the *client* objects to the *member's* use of a *third-party service provider*, the *member* either should not use the *third-party service provider* to perform the *professional services* or should decline to perform the engagement.

**.03** A *member* is not required to inform the *client* when he or she uses a *third-party service provider* to provide administrative support services to the *member* (for example, record storage, software application hosting, or authorized e-file tax transmittal services).

**.04** Refer to the "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001] and the "Disclosing Information to a Third-Party Service Provider" interpretation [1.700.040] of the "Confidential Client Information Rule" [1.700.001] for additional guidance. [Prior reference: paragraphs .224–.225 of ET section 191]

A nonauthoritative basis for conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsOutsourcing.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsOutsourcing.pdf).

In addition, nonauthoritative sample client disclosure language a member could use to fulfill the requirement discussed in this interpretation is also available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Sample\\_Disclosure\\_Notification.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Sample_Disclosure_Notification.pdf).

## 1.200 Independence

### 1.200.001 Independence Rule

**.01** A *member* in public practice shall be independent in the performance of *professional services* as required by standards promulgated by bodies designated by *Council*. [Prior reference: paragraph .01 of ET section 101]

### Interpretations Under the Independence Rule

#### 1.200.005 Application of the Conceptual Framework for Independence and Ethical Conflicts

**.01** In the absence of an *interpretation* of the "Independence Rule" [1.200.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Independence" interpretation [1.210.010].

**.02** A *member* would be considered in violation of the "Independence Rule" [1.200.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*. [Prior reference: "Other Considerations" section of paragraph .02 of ET section 101]

**.03** A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

#### **Effective Date**

**.04** Paragraph .03 is effective December 15, 2014.

## 1.210 Conceptual Framework Approach

### 1.210.010 Conceptual Framework for Independence

#### **Introduction**

**.01** It is impossible to enumerate all relationships or circumstances in which the appearance of *independence* might be questioned. Thus, in the

absence of an *independence interpretation* that addresses a particular relationship or circumstance, a *member* should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a *threat* to either the *member's* or *firm's independence*, or both, that is not at an *acceptable level*. When making that evaluation, a *member* should apply the conceptual framework approach as outlined in this interpretation to analyze *independence* matters. A *member* may also wish to consider the conceptual framework approach described in this interpretation to gain a better understanding of the conclusions reached in other *interpretations* in ET section 1.200, "Independence." [Prior reference: "Other Considerations" section of paragraph .02 of ET section 101]

**.02** The code specifies that in some circumstances no *safeguards* can reduce an *independence threat* to an *acceptable level*. For example, the code specifies that a *covered member* may not own even an immaterial *direct financial interest* in an *attest client* because there is no *safeguard* to reduce the self-interest *threat* to an *acceptable level*. A *member* may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in an *independence interpretation*.

### **Definitions Used in Applying the Conceptual Framework for Independence**

**.03 Acceptable level.** A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's independence* is not *impaired*.

**.04 Impair(ed).** In connection with *independence*, to effectively extinguish *independence*. When a *member's independence* is *impaired*, the *member* is not independent.

**.05 Safeguards.** Actions or other measures that may eliminate a *threat* or reduce a *threat* to an *acceptable level*.

**.06 Threats.** Relationships or circumstances that could *impair independence*.

### **Conceptual Framework Approach**

**.07** The conceptual framework approach entails identifying *threats* and evaluating the *threat* that the *member* would not be independent or would be perceived by a reasonable and informed third party who is aware of the relevant information as not being independent. The *member* must eliminate or reduce that *threat* to an *acceptable level* to conclude that the *member* is independent. *Threats* are at an *acceptable level* either because of the types of *threats* and their potential effect or because *safeguards* have eliminated or reduced the *threat*, so that a reasonable and informed third party who is aware of the relevant information would perceive that the *member's* professional judgment is not compromised.

**.08** Refer to paragraph .07 of the "Conceptual Framework for Members in Public Practice" [1.000.010.07] for a detailed description of the conceptual framework approach. [Prior reference: ET section 100-1]

### **Documentation**

**.09** When the *member* applies *safeguards* to eliminate or reduce significant *threats* to an *acceptable level*, as described in paragraph .07c of the "Conceptual Framework for Members in Public Practice" [1.000.010.07], the *member* should document the identified *threats* and *safeguards* applied. Failure to

prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001] rather than the "Independence Rule" [1.200.001] if the *member* can demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*. [Prior reference: "Other Considerations" section of paragraph .02 of ET section 101]

### **Threats**

**.10** Many different relationships or circumstances (or combinations of relationships or circumstances) can create *threats* to compliance with the "Independence Rule" [1.200.001]. It is impossible to identify every relationship or circumstance that creates a *threat*. Many *threats* fall into one or more of the following seven broad categories: adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.

**.11** Examples of *threats* associated with a specific relationship or circumstance are identified in the *interpretations* of the code. Paragraphs .12–.18 in this section define and provide examples, which are not all inclusive, of each of these *threat* categories. In certain circumstances, the code specifies that because of the type of *threat* and its potential effect, either no *safeguards* can eliminate or reduce the *threat* to an *acceptable level*, or a *member* would need to apply specific *safeguards* to eliminate or reduce an *independence threat* to an *acceptable level*. When *independence interpretations* in the code address one of these examples, a specific reference to the *independence interpretation* is provided in brackets after that example. If an example does not contain a specific reference to an *independence interpretation*, a *member* should use this "Conceptual Framework for Independence" interpretation to evaluate whether a *threat* is significant.

**.12** *Adverse interest threat*. The *threat* that a *member* will not act with objectivity because the *member's* interests are in opposition to the interests of an *attest client*. An example is either the *attest client* or the *member* commencing litigation against the other or expressing the intent to commence litigation. [1.290.010]

**.13** *Advocacy threat*. The *threat* that a *member* will promote an *attest client's* interests or position to the point that his or her *independence* is compromised. Examples of *advocacy threats* include the following:

- a. A *member* promotes the *attest client's* securities as part of an initial public offering. [1.295.130]
- b. A *member* provides expert witness services to an *attest client*. [1.295.140]
- c. A *member* represents an *attest client* in U.S. tax court or other public forum. [1.295.160]

**.14** *Familiarity threat*. The *threat* that, because of a long or close relationship with an *attest client*, a *member* will become too sympathetic to the *attest client's* interests or too accepting of the *attest client's* work or product. Examples of *familiarity threats* include the following:

- a. A member of the *attest engagement team* has an *immediate family member* or *close relative* in a *key position* at the *attest client*, such as the *attest client's* CEO. [1.270.020 and 1.270.100]
- b. A *partner* or *partner equivalent* of the *firm* has been a member of the *attest engagement team* for a prolonged period.
- c. A member of the *firm* has recently been a director or an officer of the *attest client*. [1.277.010]

- d. A member of the *attest engagement team* has a close friend who is in a *key position* at the *attest client*.

**.15** *Management participation threat.* The *threat* that a *member* will take on the role of *attest client* management or otherwise assume management responsibilities for an *attest client*. Examples of management participation *threats* include the following:

- a. A *member* serves as an officer or a director of the *attest client*. [1.275.005]
- b. A *member* accepts responsibility for designing, implementing, or maintaining internal controls for the *attest client*. [1.295.030]
- c. A *member* hires, supervises, or terminates the *attest client's* employees. [1.295.135]

**.16** *Self-interest threat.* The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, an *attest client* or persons associated with the *attest client*. Examples of self-interest *threats* include the following:

- a. A *member* has a *direct financial interest* or material *indirect financial interest* in the *attest client*. [1.240.010]
- b. A *member* has a *loan* from the *attest client*, an officer or a director of the *attest client*, or an individual who owns 10 percent or more of the *attest client's* outstanding equity securities. [1.260.010]
- c. A *member* or his or her *firm* relies excessively on revenue from a single *attest client*.
- d. A *member* or *member's firm* has a material joint venture or other material joint business arrangement with the *attest client*. [1.265]

**.17** *Self-review threat.* The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made, or service performed or supervised by the *member* or an individual in the *member's firm* and that the *member* will rely on that service in forming a judgment as part of an *attest engagement*. Certain self-review *threats*, such as preparing source documents used to generate the *attest client's financial statements* [1.295.120], pose such a significant self-review *threat* that no *safeguards* can eliminate or reduce the *threats* to an *acceptable level*.

**.18** *Undue influence threat.* The *threat* that a *member* will subordinate his or her judgment to that of an individual associated with an *attest client* or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

- a. Management threatens to replace the *member* or *member's firm* over a disagreement on the application of an accounting principle.
- b. Management pressures the *member* to reduce necessary audit procedures in order to reduce audit fees.
- c. The *member* receives a gift from the *attest client*, its management, or its significant shareholders. [1.285.010]

## Safeguards

**.19** *Safeguards* may partially or completely eliminate a *threat* or diminish the potential influence of a *threat*. The nature and extent of the *safeguards* applied will depend on many factors, including the size of the *firm* and whether the *attest client* is a *public interest entity*. To be effective, *safeguards* should eliminate the *threat* or reduce it to an *acceptable level*.

**.20** The following are three broad categories of *safeguards*:

- a. *Safeguards* created by the profession, legislation, or regulation.
- b. *Safeguards* implemented by the *attest client*. It is not possible to rely solely on *safeguards* implemented by the *attest client* to eliminate or reduce significant *threats* to an *acceptable level*.
- c. *Safeguards* implemented by the *firm*, including policies and procedures to implement professional and regulatory requirements.

**.21** The effectiveness of a *safeguard* depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of *threats*
- c. Whether the *safeguard* is suitably designed to meet its objectives
- d. The party(ies) that will be subject to the *safeguard*
- e. How the *safeguard* is applied
- f. The consistency with which the *safeguard* is applied
- g. Who applies the *safeguard*
- h. How the *safeguard* interacts with a *safeguard* from another category
- i. Whether the *attest client* is a *public interest entity*

**.22** Examples of various *safeguards* within each category are presented in paragraphs .21–.23 of the "Conceptual Framework for Members in Public Practice" [1.000.010]. The examples presented in these paragraphs are not intended to be all inclusive. In addition, *threats* may be sufficiently mitigated through the application of other *safeguards* not specifically identified in these paragraphs. [Prior reference: ET section 100-1]

### **Effective Date**

**.23** The addition of *partner equivalents* to paragraph .14b is effective for engagements covering periods beginning on or after December 15, 2014.

## **1.220 Accounting Firms**

A nonauthoritative question and answer regarding letter of intent to purchase practice is available in the Ethics FAQ at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).

### **1.220.010 Network and Network Firms**

#### **General**

**.01** To enhance their capabilities to provide *professional services*, *firms* frequently join larger groups, which typically are membership associations that are separate legal entities and otherwise unrelated to their members. The associations facilitate their members' use of association services and resources. They do not themselves typically engage in *public practice* or provide *professional services* to their members' *clients* or other third parties.



**.02** *Firms* and other entities in the association cooperate with the *firms* and other entities that are members of the association to enhance their capabilities to provide *professional services*. For example, a *firm* may become a member of an association in order to refer work to, or receive referrals from, other association members. That characteristic alone would not be sufficient for the association to constitute a *network* or for the *firm* to be considered a *network firm*.

**.03** However, an association would be considered a *network* if, in addition to cooperation among member *firms* and other entities to enhance their capabilities to provide *professional services*, member *firms* and other entities share one or more additional characteristics described in paragraphs .07–.18 of this section. If an association is considered a *network* and an entity is considered a *network firm* the classification should be applied consistently by all members of the association. When determining if one or more additional characteristics exist, *members* should give due consideration to what a reasonable and informed third party who is aware of the relevant information would be expected to conclude.

**.04** A *network firm* is required to comply with the "Independence Rule" [1.200.001] with respect to the *financial statement* audit and review *clients* of the other *network firms* if the use of the audit or review report for the *client* is not restricted, as defined by professional standards. For all other *attest clients*, the *covered member* should consider any *threats* that the *covered member* knows or has reason to believe may be created by another *network firm's* interests and relationships. If those *threats* are not at an *acceptable level*, the *covered member* should apply *safeguards* to eliminate the *threats* or reduce them to an *acceptable level*. If *safeguards* cannot be applied to eliminate or reduce the *threats* to an *acceptable level*, *independence* will be *impaired*. Entities within the *network* that meet the definition of a *network firm* are subject to the "Independence Rule."

**.05** The determination that a *firm* or other entity or an association of *firms* or other entities meets the definition of a *network firm* and *network* is solely for purposes of this interpretation and may not be used or relied upon in any other context. In particular, determining whether a *firm* or other entity is a *network firm* or whether an association of *firms* or other entities is a *network* for purposes of defining legal responsibilities from one *firm* to the other or to third parties is beyond the scope of this interpretation.

### **Characteristics of a Network**

**.06** When an association is formed for the purpose of cooperating to enhance the *firms'* capabilities to provide *professional services*, and one of the characteristics described in paragraphs .07–.18 of this section also applies, the association is considered to be a *network*.

**.07** *Sharing a common brand name*. This characteristic exists when the association's members or entities *controlled* by the association's members share the use of a common brand name or share common initials as part of the *firm* name.

**.08** A *firm* that does not use a common brand name as part of its *firm* name but makes reference in its stationery or promotional materials to being a member of an association of *firms* should carefully consider how it describes that membership and take steps to avoid the perception that it belongs to a *network*. The *firm* may wish to avoid such perception by clearly describing the nature of its membership in the association (for example, by stating on its stationery or promotional material that it is "an independently owned and operated member firm of XYZ Association").

**.09 *Sharing common control.*** This characteristic exists when entities within the association are under common *control* with other firms in the association through ownership, management, or other means (for example, by contract). However, compliance with association requirements as a condition of membership does not indicate that members are under common *control*; rather, it reflects the type of cooperation that is expected when an entity joins the association.

**.10 *Sharing profits or costs.*** This characteristic exists when entities within the association share profits or costs. Following are examples of profit and cost sharing that would not create a *network*:

- a. Sharing immaterial costs
- b. Sharing costs related to operating the association
- c. Sharing costs related to the development of audit methodologies, manuals, and training courses
- d. Arrangements between a *firm* and an otherwise unrelated entity to jointly provide a service or develop a product

**.11 *Sharing a common business strategy.*** This characteristic exists when entities within the association share a common business strategy. Sharing a common business strategy involves ongoing collaboration among the *firms* whereby the *firms* are responsible for implementing the association's strategy and held accountable for performance pursuant to that strategy. An entity's ability to pursue an alternative strategy may be limited by the common business strategy because, as a member, it must act in accordance with the common business strategy and, therefore, in the best interest of the association.

**.12** An entity is not considered to be a *network firm* merely because it cooperates with another entity solely to market *professional services* or responds jointly to a request for a proposal for the provision of a *professional service*.

**.13 *Sharing significant professional resources.*** This characteristic exists when entities within the association share a significant part of professional resources. *Members* should consider both qualitative and quantitative factors in determining whether the shared professional resources are significant.

**.14** Examples of professional resources include the following:

- a. Common systems that enable *firms* to exchange information, such as *client* data, billing, and time records
- b. *Partners* and staff
- c. Technical departments to consult on technical or industry-specific issues, transactions, or events for assurance engagements
- d. Audit methodology or audit manuals
- e. Training courses and facilities

**.15** When shared professional resources involve the exchange of *client* information or personnel, such as when staff are drawn from a shared pool or a common technical department is created within the association to provide participating *firms* with technical advice that the *firms* are required to follow, a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the shared professional resources are significant.

**.16** When the entities within the association do not share a significant amount of human resources (for example, a *firm* occasionally uses personnel of another member *firm* to assist with an engagement, such as observing a *client's* physical inventory count) or significant *client* information (for example,

*client* data, billing, and time records) and have the ability to make independent decisions regarding technical matters, audit methodology, training, and the like, the entities are not considered to be sharing a significant part of professional resources.

**.17** When the shared professional resources are limited to a common audit methodology, audit manuals, training courses, or facilities and do not include a significant amount of human resources or *clients* or markets, the shared professional resources are not considered significant.

**.18** *Sharing common quality control policies and procedures.* This characteristic exists when entities within the association are required to follow common quality control policies and procedures that the association monitors. Monitoring is the ongoing consideration and evaluation of the *firms'* systems of quality control, which enables the association to obtain reasonable assurance that the *firms'* systems of quality control are designed appropriately and operating effectively.

**.19** Refer to paragraph .03*d* of the "Application of the AICPA Code" [0.200.020] for additional guidance. [Prior reference: paragraph .19 of ET section 101]

Nonauthoritative implementation guidance can be found at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics%20Division%20Network%20Firm%20Implementation%20Guidance.docx](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics%20Division%20Network%20Firm%20Implementation%20Guidance.docx).

Nonauthoritative frequently asked questions (FAQ) and case studies can be found at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/2011AugustNetworkFirmFAQandCaseStudies.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/2011AugustNetworkFirmFAQandCaseStudies.pdf)

### **1.220.020 Alternative Practice Structures**

**.01** *Members* practicing public accounting in nontraditional practice structures (alternative practice structures [APS]) should apply this interpretation to determine whether they are in compliance with the "Independence Rule" [1.200.001].

**.02** All such structures must be organized in a form that complies with applicable laws, rules, and regulations, the "Form of Organization and Name Rule" [1.800.001] and the related "Alternative Practice Structures" interpretation [1.810.050] of the "Form of Organization and Name Rule."

**.03** For example, in an APS, a substantial piece of the nonattest portion of a *member's* practice may be conducted under public or private ownership, and the attest portion of the practice may be conducted through a separate *firm* that the *member* owns and *controls*.

#### **Terminology**

**.04** The following terms are defined solely for the purpose of applying this interpretation:

- a.* APS is a form of organization in which a *firm* that provides attest services is closely aligned with another public or private organization that performs other *professional services*.

- b. A covered member includes both employed and leased individuals who meet the definition of a *covered member*.
- c. The term direct superiors includes those persons so closely associated with a *partner* or *manager* who is a covered member that such persons can directly control the *partner's* or *manager's* activities. For this purpose, a person who can directly control is the immediate superior of the *partner* or *manager* who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the direct superior can exercise significant influence) derive a benefit from that person's activities. An example is the person who has day-to-day responsibility for the activities of the *partner* or *manager* and is in a position to recommend promotions and compensation levels. This group of persons is so closely aligned through direct reporting relationships that their interests seem to be inseparable.
- d. Indirect superiors are not connected with *partners* and *managers* who are covered members through direct reporting relationships; rather, they are one or more levels above direct superiors of covered members (that is, there always is a level in between). Generally, this starts with persons in an organization structure to whom direct superiors report and go up the line from there. Indirect superiors also include the *immediate family* of indirect superiors.
- e. Other public company entities include the public company and all entities consolidated in the public company *financial statements* that are not subject to the "Independence Rule" [1.200.001] and its *interpretations* in their entirety.
- f. Significant influence is having the ability to exercise significant influence over the financial, operating, or accounting policies of the entity by, for example
  - i. being connected with the entity as a promoter, an underwriter, a voting trustee, a general partner, or a director;
  - ii. being in a policy-making position, such as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer; or
  - iii. meeting the criteria in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity.

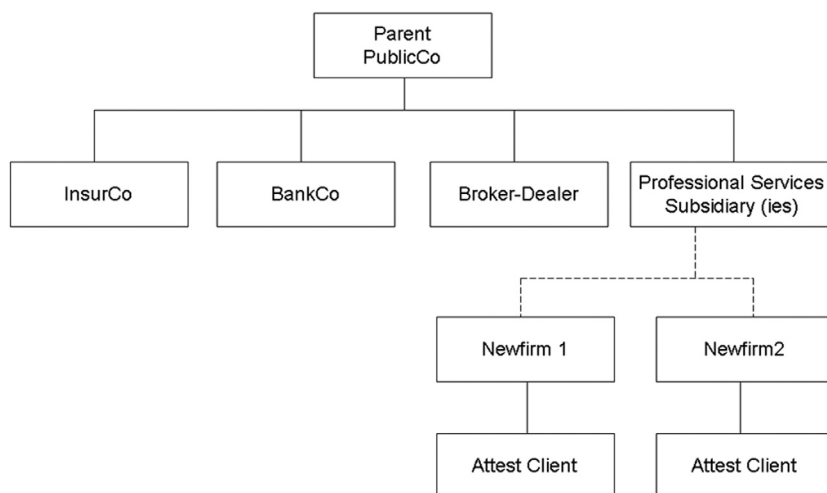
### APS Model

.05 The APS described in paragraphs .06–.07 in this section and the related chart provides an example of a structure in use at the time that this interpretation was developed. Many of the references in this interpretation are to the example, but *members* should apply the concepts in spirit and substance to variations of the example structure as they develop.

.06 The example APS in this interpretation is one in which an existing CPA practice (Oldfirm) is sold by its owners to another (possibly public) entity (PublicCo). PublicCo has subsidiaries or divisions, such as a bank, an insurance company, or a broker-dealer. It also has one or more professional service subsidiaries (PSS) or divisions that offer nonattest services (for example, tax, personal financial planning, and management consulting) to *clients*. The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries

or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA *firm* (Newfirm) to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (with regard to voting and financial interests). Attest services are performed by Newfirm and supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space, and equipment; the performance of back-office functions, such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

**.07** The chief executive of the local office of the PSS where the *partners* of Newfirm are employed would be a direct superior. The chief executive of the PSS itself would be an indirect superior, and there may be indirect superiors in between, such as a regional chief executive of all PSS offices within a geographic area.



### Interpretation

**.08** The "Independence Rule" [1.200.001] and *interpretations* normally extend only to those persons and entities included in the definition of *covered members*. However, in an APS environment, the self-interest, management participation, self-review, advocacy, or undue influence *threats* to a covered member's compliance with the "Independence Rule" may not be at an *acceptable level* unless certain *safeguards* are implemented by other individuals or entities.

**.09** *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* when the following individuals or entities fail to apply the "Independence Rule" and *interpretations* with respect to *attest clients* of Newfirm:

- a. Covered members of Newfirm
- b. Direct superiors of any *partner* or *manager* who is a covered member of Newfirm and entities within the APS over which such individuals can exercise *significant influence*

**.10** In addition, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* in the following circumstances:

- a. Indirect superiors and other public company entities have a material relationship with an *attest client* of Newfirm that is prohibited by the "Overview of Financial Interests" interpretation [1.240.010], the "Trustee or Executor" interpretation [1.245.010], the "Loans" interpretation [1.260.010], or the "Joint Closely Held Investments" interpretation [1.265.020] of the "Independence Rule" (for example, investments, *loans*, and so on). In making the test for materiality for financial relationships of an indirect superior, all the financial relationships with an *attest client* held by that person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of other public company entities, all the financial relationships with an *attest client* held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated *financial statements* of PublicCo.
- b. Any other public company entity over which an indirect superior has direct responsibility has a financial relationship with an *attest client* during the *period of the professional engagement* that is material in relation to the other public company entity's *financial statements*.
- c. Financial relationships of indirect superiors or other public company entities allow such persons or entities to exercise significant influence over the *attest client* during the *period of the professional engagement*. In making the test for significant influence, financial relationships of all indirect superiors and other public company entities should be aggregated.
- d. Other public company entities or any of their employees are connected with an *attest client* of Newfirm as a promoter, an underwriter, a voting trustee, a director, or an officer during the *period of the professional engagement* or during the period covered by the *financial statements*.

**.11** Indirect superiors and other public company entities may provide services to an *attest client* of Newfirm that would *impair independence* if performed by Newfirm, except as noted in paragraph .10d.

**.12** When Newfirm and its *partners* and professional employees perform *attest engagements* for PublicCo or any of its subsidiaries or divisions, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, *independence* would be *impaired*.

**.13** If an *attest client* of Newfirm holds an investment in PublicCo that is material to the *attest client* or that allows the *attest client* to exercise significant influence over PublicCo during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, *independence* would be *impaired*.

**.14** When making referrals of services between Newfirm and any of the entities within PublicCo, a *member* should consider the provisions of the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule"

[1.100.001] and the "Alternative Practice Structures" interpretation [1.810.050] of the "Form of Organization and Name Rule" [1.800.001]. [Prior reference: paragraph .16 of ET section 101]

### **1.220.030 Use of a Nonindependent CPA Firm on an Engagement**

.01 If *partners* or professional employees from another *firm* that was not independent of an *attest client* participate on the *attest engagement team*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, the *firm's independence* would be *impaired*.

.02 However, the *firm* may use the work of such individuals in a manner similar to internal auditors, provided that the *firm* complies with AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*). [Prior reference: paragraphs .142–.143 of ET section 191]

## **1.224 Affiliates, Including Governmental Units**

### **1.224.010 Client Affiliates**

.01 *Financial interests* in, and other relationships with, *affiliates* of a *financial statement attest client* may create *threats* to a *member's* compliance with the "Independence Rule" [1.200.001].

.02 When a *client* is a *financial statement attest client*, *members* should apply the "Independence Rule" [1.200.001] and related *interpretations* applicable to the *financial statement attest client* to their *affiliates*, except in the following situations:

- a. A *covered member* may have a *loan* to or from an individual who is an officer, a director, or a 10 percent or more owner of an *affiliate* of a *financial statement attest client* during the *period of the professional engagement* unless the *covered member* knows or has reason to believe that the individual is in such a position with the *affiliate*. If the *covered member* knows or has reason to believe that the individual is an officer, a director, or a 10 percent or more owner of the *affiliate*, the *covered member* should evaluate the effect that the relationship would have on the *covered member's independence* by applying the "Conceptual Framework for Independence" [1.210.010].
- b. A *member* or the *member's firm* may provide prohibited nonattest services to entities described under items *c–j* of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided that it is reasonable to conclude that the services do not create a self-review *threat* with respect to the *financial statement attest client* because the results of the nonattest services will not be subject to *financial statement attest* procedures. For any other *threats* that are created by the provision of the nonattest services that are not at an *acceptable level* (in particular, those relating to management participation), the *member* should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*.

- c. A *firm* will only have to apply the "Subsequent Employment or Association With an Attest Client" interpretation [1.279.020] of the "Independence Rule" if the former employee, by virtue of his or her employment at an entity described under items c–j of the definition of *affiliate*, is in a *key position* with respect to the *financial statement attest client*. *Individuals in a position to influence the attest engagement* and on the *attest engagement team* who are considering employment with an *affiliate* of a *financial statement attest client* will still need to report consideration of employment to an appropriate person in the *firm* and remove themselves from the *financial statement attest engagement*, even if the position with the *affiliate* is not a *key position*.
- d. A *covered member's immediate family members* and *close relatives* may be employed in a *key position* at an entity described under items c–j of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided they are not in a *key position* with respect to the *financial statement attest client*.

**.03** A *member* must expend best efforts to obtain the information necessary to identify the *affiliates* of a *financial statement attest client*. If, after expending best efforts, a *member* is unable to obtain the information to determine which entities are *affiliates* of a *financial statement attest client*, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the *member* (a) discusses the matter, including the potential impact on *independence*, with *those charged with governance*; (b) documents the results of that discussion and the efforts taken to obtain the information; and (c) obtains written assurance from the *financial statement attest client* that it is unable to provide the *member* with the information necessary to identify the *affiliates* of the *financial statement attest client*.

**.04** This interpretation does not apply to a *financial statement attest client* that is covered by the "Entities Included in State and Local Government Financial Statements" interpretation [1.224.020] of the "Independence Rule" [1.200.001]. [Prior reference: paragraph .20 of ET section 101]

### **Effective Date**

**.05** This interpretation is effective for engagements covering periods beginning on or after January 1, 2014. Early implementation is allowed.

### **1.224.020 Entities Included In State and Local Government Financial Statements**

**.01** For purposes of this interpretation, a financial reporting entity's basic *financial statements* issued in conformity with generally accepted accounting principles (GAAP) include the following:

- a. The government-wide *financial statements* (consisting of the entity's governmental activities, business-type activities, and discretely presented component units)
- b. The fund *financial statements* (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds)
- c. Other entities disclosed in the notes to the basic *financial statements*. Examples of other entities that should be disclosed include the following:



- i. Related organizations
- ii. Joint ventures
- iii. Jointly governed organizations
- iv. Component units of another government with characteristics of a joint venture or jointly governed organization

.02 Certain terminology used in this interpretation is specifically defined by the Governmental Accounting Standards Board (GASB).

.03 When a *covered member* audits the basic *financial statements* of a financial reporting entity or the *financial statements* of a major fund, a nonmajor fund, an internal service fund, a fiduciary fund, or a component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic *financial statements*, the *covered member* must be independent of the entity, fund, or component unit that the *covered member* is auditing, as discussed in this interpretation.

### ***Auditor of the Financial Reporting Entity***

.04 When a *covered member* audits the basic *financial statements* of the financial reporting entity, the *covered member* must also be independent of any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the basic *financial statements* unless the primary auditor explicitly states reliance on other auditors' reports.

.05 *Independence* is not required with respect to an entity disclosed in the notes to the basic *financial statements* if the financial reporting entity is not financially accountable for the entity and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require the *covered member* to be independent of that entity.

.06 Regardless of the exceptions in paragraph .05, if a *covered member* or a *covered member's immediate family* holds a *key position* in any of the following entities during the *period of the professional engagement* or during the period covered by the *financial statements*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and the *covered member's independence* would be *impaired*:

- a. Major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity
- b. Other entity that should be disclosed in the notes to the basic *financial statements*

### ***Auditor Does Not Audit the Primary Government***

.07 When a *covered member* does not audit the primary government but audits the *financial statements* of the following entities, the *covered member* is not required to be independent of entities that the *covered member* does not audit:

- a. A major fund, a nonmajor fund, an internal service fund, a fiduciary fund, or a component unit of the financial reporting entity
- b. An entity that should be disclosed in the notes to the basic *financial statements* of the financial reporting entity

.08 However, if a *covered member* or a *covered member's immediate family* holds a *key position* within the primary government during the *period of the*

*professional engagement* or during the period covered by the *financial statements*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, the *covered member's independence* would be *impaired*. For purposes of this interpretation, a *covered member* and the *covered member's immediate family* would not be considered employed by the primary government if the exceptions provided for in paragraph .07b of the "Client" definition [0.400.07] were met. [Prior reference: paragraph .12 of ET section 101]

## 1.226 Reissued Reports

### 1.226.010 Consenting to the Use of a Previously Issued Report

.01 A *member* or *member's firm* who was in compliance with the "Independence Rule" [1.200.001] when initially issuing a report may reissue the previously issued report or consent to, or acknowledge the inclusion or incorporation by reference of, the report when the *member* or *member's firm's independence* is *impaired*, provided that the *member* or *member's firm* does not perform procedures that require updating the date or dual dating the report.

.02 In order to consent to, or acknowledge the inclusion or incorporation by reference of, a previously issued report, the *member* or *member's firm* may perform procedures required by applicable professional standards when the *member's* or *member's firm's independence* is *impaired*. Such procedures include making inquiries of successor auditors, reading the subsequent *financial statements*, or other procedures that the *member* believes are necessary to assess the effect of subsequently discovered facts on the *financial statements* covered by the previously issued report. [Prior reference: paragraphs .200–.201 of ET section 191]

## 1.228 Engagement Contractual Terms

### 1.228.010 Indemnification of a Covered Member

.01 *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and a *covered member's independence* would not be *impaired* if the *covered member* includes in engagement letters a clause that provides that its *attest client* would release, indemnify, defend, and hold the *covered member* (and the *covered member's partners*, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from knowing misrepresentations by management. [Prior reference: paragraphs .188–.189 of ET section 191]

.02 Refer to the "Indemnification and Limitation of Liability Provisions" interpretation [1.400.060] of the "Acts Discreditable Rule" [1.400.001].

### 1.228.020 Indemnification of an Attest Client

.01 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* enters into an agreement providing, among other things, that the *covered member* indemnifies the *attest client* for damages, losses, or costs arising from lawsuits, claims, or settlements

that relate, directly or indirectly, to the *attest client's* acts. The *covered member's independence* would be *impaired* under these circumstances. [Prior reference: paragraphs .204–.205 of ET section 191]

### 1.228.030 *Alternative Dispute Resolution*

.01 A *covered member* may include in an engagement letter a provision to use alternative dispute resolution (ADR) techniques to resolve disputes relating to past services (in lieu of litigation). *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* because the *covered member* and *attest client* would not be in positions of material adverse interests due to threatened or actual litigation.

.02 The *covered member* should exercise professional judgment when rendering current services, regardless of the existence of the provision. [Prior reference: paragraphs .190–.191 of ET section 191]

.03 If ADR techniques are initiated to resolve a dispute with the *attest client*, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* when the ADR techniques are designed to facilitate negotiation, and the conduct of those negotiations does not place the *covered member* and the *attest client* in positions of material adverse interests. *Independence* would not be *impaired* under these circumstances. If, however, the ADR proceedings are sufficiently similar to litigation (as in the case of binding arbitration), an adverse interest *threat* may exist and place the *covered member* and the *attest client* in a position of material adverse interests. Under such circumstances, the *member* should apply the guidance under the "Actual or Threatened Litigation" interpretation [1.290.010] of the "Independence Rule." [Prior reference: paragraphs .192–.193 of ET section 191]

## 1.230 Fees

A nonauthoritative question and answer regarding *pro bono* and below cost fees is available in the Ethics FAQ at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).

### 1.230.010 *Unpaid Fees*

.01 The existence of unpaid fees to a *covered member* for *professional services* previously rendered to an *attest client* may create self-interest, undue influence, or advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001].

.02 *Threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a *covered member* has unpaid fees from an *attest client* for any previously rendered *professional service* provided more than one year prior to the date of the current-year report. Accordingly, *independence* would be *impaired*. Unpaid fees include fees that are unbilled or a note receivable arising from such fees.

.03 This interpretation does not apply to fees outstanding from an *attest client* in bankruptcy. [Prior reference: paragraphs .103–.104 of ET section 191]

.04 Refer to the "Fees and Other Types of Remuneration" topic [1.500] for additional guidance.

### **1.230.020 Fees and Other Types of Remuneration**

.01 See the "Fees and Other Types of Remuneration" topic [1.500] for guidance on contingent fees, commissions, and referral fees. [No prior reference: new content]

#### **Effective Date**

.02 Effective December 15, 2014.

## **1.240 Financial Interests**

### **1.240.010 Overview of Financial Interests**

.01 If a *covered member* had or was committed to acquire any *direct financial interest* in an *attest client* during the *period of the professional engagement*, the self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .02A(1) and .17 of ET section 101]

.02 If a *covered member* had or was committed to acquire any material *indirect financial interest* in an *attest client* during the *period of the professional engagement*, the self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .02A(1) and .17 of ET section 101]

.03 If a *partner* or professional employee of the *firm*, his or her *immediate family*, or any group of such persons acting together owned more than 5 percent of an *attest client's* outstanding equity securities or other ownership interests during the *period of the professional engagement*, the self-interest *threat* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02B of ET section 101]

.04 Refer to the "Joint Closely Held Investments" interpretation [1.265.020] for additional guidance.

### **1.240.020 Unsolicited Financial Interests**

.01 When a *covered member* becomes aware that he or she will receive, or has received, an unsolicited *financial interest* in an *attest client* during the *period of the professional engagement*, such as through a gift or an inheritance, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if both of the following *safeguards* are met:

- a. The *covered member* disposes of the *financial interest* as soon as practicable but no later than 30 days after the *covered member* has knowledge of and obtains the right to dispose of the *financial interest*.

- b. During the period in which the *covered member* does not have the right to dispose of the *financial interest*, the *covered member* does not participate on the *attest engagement team*, and the *direct financial interest* or *indirect financial interest* is not material to the *covered member*. [Prior reference: paragraph .17 of ET section 101]

### 1.240.030 Mutual Funds

.01 A *covered member* who owns shares in a mutual fund has a *direct financial interest* in the mutual fund. However, whether the underlying investments in the mutual fund are considered to be the *covered member's direct financial interests* or *indirect financial interests* depends on the proportion of the mutual fund's outstanding shares that the *covered member* owns and whether the mutual fund is diversified.

.02 If a *covered member* owns 5 percent or less of the outstanding shares of a diversified mutual fund, the underlying investments would be considered immaterial *indirect financial interests*. Accordingly, the self-interest *threat* would be at an *acceptable level*, and *independence* would not be *impaired*. To determine if the mutual fund is diversified, the *covered member* should consider referring to (a) the mutual fund's prospectus for disclosure regarding fund management's determination regarding diversification and (b) Section 5(b)(1) of the Investment Company Act of 1940.

.03 If a *covered member* owns more than 5 percent of a diversified mutual fund's outstanding shares, or if a *covered member* owns a *financial interest* in a nondiversified mutual fund, the *covered member* should evaluate the mutual fund's underlying investments to determine whether the *covered member* holds a material *indirect financial interest* in any of the underlying investments.

.04 The following example illustrates how to determine if the underlying investments are material to a *covered member's* net worth. If

- a nondiversified mutual fund owns shares in client company A,
- the mutual fund's net assets are \$10 million,
- the *covered member* owns 1 percent of the outstanding shares of the mutual fund, having a value of \$100,000, and
- the mutual fund has 10 percent of its assets invested in company A,

then the *covered member's indirect financial interest* in company A is \$10,000 (\$100,000 10%). The *covered member* would then compare the \$10,000 *indirect financial interest* with his or her net worth, including the net worth of his or her *immediate family*, to determine if the *indirect financial interest* in company A is material. [Prior reference: paragraph .17 of ET section 101]

### 1.240.040 Retirement, Savings, Compensation, or Similar Plans

.01 Depending upon the facts and circumstances, *financial interests* held in a retirement, savings, compensation, or similar plan are either *direct financial interests* or *indirect financial interests*.

.02 Investments held by a retirement, savings, compensation, or similar plan sponsored by a *firm* are *direct financial interests* of the *firm*.

.03 If a *covered member* or his or her *immediate family* self-directs the investments in a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan's investment decisions, the

*financial interests* held by the plan are *direct financial interests* of the *covered member*. For example,

- a. when a *covered member* or his or her *immediate family* member is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan's investment decisions (including through the selection of investment managers or pooled investment vehicles), the underlying investments are *direct financial interests* of the *covered member*.
- b. for self-directed or participant-directed plans (that is, the *covered member* or his or her *immediate family* member selects the underlying plan investments or selects from investment alternatives offered by the plan), the underlying investments are *direct financial interests* of the *covered member*.

**.04** When the *covered member* or his or her *immediate family* do not participate in a self-directed or participant-directed plan and have no authority to supervise or participate in the plan's investment decisions, the underlying investments would be considered to be *indirect financial interests* of the *covered member*.

**.05** *Financial interests* held by a defined benefit plan are not considered *financial interests* of the *covered member* unless the *covered member* or his or her *immediate family* member is a trustee of the plan or otherwise has the ability to supervise or participate in the plan's investment decisions.

**.06** Allocated shares held in an employee stock ownership plan (ESOP) are considered *beneficially owned* by the *covered member*. Until the *covered member* or his or her *immediate family* member has the right to dispose of the allocated shares of the ESOP, the beneficial ownership is considered an *indirect financial interest*. Once the participant has the right to dispose of the *financial interests*, the *financial interests* are *direct financial interests* of the *covered member*.

**.07** Rights to acquire equity interests, restricted stock awards, or other *share-based compensation arrangements* are considered the *direct financial interests* of the *covered member*, regardless of whether such *financial interests* are vested or exercisable.

**.08** See the "Plan Is an Attest Client or Is Sponsored by an Attest Client" interpretation [1.250.010] and the "Former Employment or Association With an Attest Client" interpretation [1.277.010] of the "Independence Rule" [1.200.001] and the interpretations of the "Family Relationships With Attest Clients" subtopic [1.270] under the "Independence Rule." [Prior reference: paragraph .17 of ET section 101]

### 1.240.050 Partnerships

**.01** When used in this interpretation, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*.

**.02** The ownership of a general or limited partnership interest is considered a *direct financial interest* in the partnership.

**.03** *General partner*. If the *covered member* is a general partner, the *financial interests* held by a partnership are a *covered member's direct financial*

*interests* because the *covered member* is in a position to control the partnership or supervise or participate in the partnership's investment decisions.

**.04 Limited partner.** If the *covered member* is a limited partner, the *financial interests* held by a limited partnership are a *covered member's indirect financial interests* as long as the *covered member* does not control the partnership or supervise or participate in the partnership's investment decisions. However, if the *covered member* has the ability to replace the general partner or has the authority to supervise or participate in the partnership's investment decisions, the partnership's *financial interests* would be the *covered member's direct financial interests*.

**.05** Refer to the "Client Affiliates" interpretation [1.224.010] [1.200.001] and the "Joint Closely Held Investments" interpretation [1.265.020] of the "Independence Rule" for additional guidance. [Prior reference: paragraph .17 of ET section 101]

### **1.240.060 Limited Liability Companies**

**.01** When used in this interpretation, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*.

**.02** Ownership of an interest in a limited liability company (LLC) is a *direct financial interest* in the LLC.

**.03** In an LLC, managing members control the LLC and have the authority to supervise or participate in the LLC's investment decisions. Accordingly, if a *covered member* is a manager of the LLC, the *financial interests* of the LLC are the *covered member's direct financial interests*. When a *covered member* is not a managing member of the LLC, the *covered member* should review the LLC's operating agreement to determine whether he or she can control the LLC or has the authority to supervise or participate in the LLC's investment decisions. In situations in which the *covered member* does not control the LLC and does not have the authority to supervise or participate in the LLC's investment decisions, the *financial interests* held by the LLC are the *covered member's indirect financial interests*. [Prior reference: paragraph .17 of ET section 101]

### **1.240.070 Section 529 Plans**

**.01** Section 529 plans are sponsored by states or higher education institutions and may be prepaid tuition plans or savings plans. An account owner establishes both types of plans for the benefit of a single beneficiary. The account owner may change the beneficiary at any time to another individual who is a relative of the previous beneficiary.

**.02 Prepaid tuition plan.** A *covered member* who is the account owner of a Section 529 prepaid tuition plan is considered to have a *direct financial interest* in the plan. The account owner does not have any *financial interests* in the plan's underlying investments because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the plan's investment performance or the cost of the education at the future date.

**.03 Savings plan.** A *covered member* who is the account owner of a Section 529 savings plan is considered to have a *direct financial interest* in both the plan and the plan's underlying investments because the account owner elects which sponsor's Section 529 savings plan to invest in, and prior to making the investment decision, the *covered member* has access to information about the

plan's investment options or funds. However, if the Section 529 savings plan does not hold *financial interests* in an *attest client* at the time of the investment but the plan subsequently invests in that *attest client*, the financial interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if the *covered member* applies both of the following *safeguards*:

- a. The *covered member* transfers the account to another sponsor's Section 529 savings plan.
- b. The *covered member* transfers the account to another account owner who is not a *covered member*.

When the transfer of the account will result in a penalty or tax that is significant to the account, the *covered member* may continue to own the account until the account can be transferred without significant penalty or tax, provided that the *covered member* does not participate on the *attest engagement team* and is not an *individual in a position to influence the attest engagement*.

**.04 Beneficiary of Section 529 account.** A *covered member* who is a beneficiary of a Section 529 account is not considered to have a *financial interest* in the plan or the plan's underlying investments because the *covered member* does not own the account or possess any of the underlying benefits of ownership. The beneficiary's only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

**.05 Government or governmental entity sponsors Section 529 plan.** Before becoming engaged to perform an *attest engagement* for a government or governmental entity that sponsors a Section 529 plan, *covered members* who are account owners of a Section 529 plan should consider the guidance in the "Entities Included in State and Local Government Financial Statements" interpretation [1.224.020]. [Prior reference: paragraph .17 of ET section 101]

## 1.245 Trusts and Estates

### 1.245.010 Trustee or Executor

**.01** The designation of a *covered member* to serve as a trustee of a trust or an executor or administrator of an estate that held, or was committed to acquire, any *direct financial interest* or any material *indirect financial interest* in an *attest client* during the *period of the professional engagement* does not in itself create a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001]. [Prior reference: paragraphs .021–.022 of ET section 191]

**.02** However, when the *covered member* serves as the trustee or executor during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if

- a. the *covered member* (individually or with others) has the authority to make investment decisions for the trust or estate,
- b. the trust or estate owned or was committed to acquire more than 10 percent of the *attest client's* outstanding equity securities or other ownership interests, or
- c. the value of the trust's or estate's holdings in the *attest client* exceeds 10 percent of the total assets of the trust or estate.



Accordingly, in these situations, *independence* would be *impaired*. [Prior reference: paragraph .02A(2) of ET section 101]

### **1.245.020 Trust Investments**

**.01** When used in this interpretation, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*.

**.02** When a *covered member* is a grantor of a trust, including a blind trust, the trust and its underlying investments are considered to be the *covered member's direct financial interest* if any of the following rights or responsibilities exist:

- a. The *covered member* has the ability to amend or revoke the trust.
- b. The *covered member* has authority to control the trust.
- c. The *covered member* has ability to supervise or participate in the trust's investment decisions.
- d. The underlying trust investments will ultimately revert to the *covered member* as the grantor of the trust.

However, the trust and the trust's underlying investments are not considered to be *financial interests* of a *covered member* if the *covered member* is the grantor of the trust and the *covered member* does not have any of the rights or responsibilities in items a–d.

**.03** When a *covered member* is only a beneficiary of a trust and does not have any of the rights or responsibilities noted in paragraph .02, the trust is considered to be the *direct financial interest* of the *covered member*, and the trust's underlying investments are considered to be *indirect financial interests* of the *covered member*. [Prior reference: paragraph .17 of ET section 101]

### **Effective Date**

**.04** This revised interpretation is effective December 15, 2014.

A nonauthoritative question and answer regarding the use of blind trusts is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).

## **1.250 Participation in Employee Benefit Plans**

### **1.250.010 Plan Is an Attest Client or Is Sponsored by an Attest Client**

**.01** When a *covered member* participates in an employee benefit plan that is an *attest client* or is sponsored by an *attest client*, during the *period of the professional engagement* or during the period covered by the *financial statements*, the self-interest *threat* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*. *Independence* with respect to the employee benefit plan and the sponsor would be *impaired* except in the following specific situations:

- a. *Governmental organization.* When a *covered member* is an employee of a governmental organization that sponsors, cosponsors, or participates with other governmental organizations in a public employee retirement plan (the plan) and the *covered member* is required by law, rule, or regulation to audit the plan, *threats to independence* would be at an *acceptable level* if all of the following *safeguards* are met:
- i. The *covered member* is required to participate in the plan as a condition of employment.
  - ii. The plan is offered to all employees in comparable employment positions.
  - iii. The *covered member* is not associated with the plan in any capacity prohibited by the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule."
  - iv. The *covered member* has no influence or control over the investment strategy, benefits, or other management activities associated with the plan.
- b. *Former employment or association with the attest client.* The requirements of paragraph .04 of the "Former Employment or Association With an Attest Client" interpretation [1.277.010] must be met. [Prior reference: paragraphs .214–.215 of ET section 191]

.02 When an *immediate family* member participates as a result of his or her employment, in an employee benefit plan that is an *attest client* or is sponsored by an *attest client*, the requirements of the "Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)" interpretation [1.270.030] of the "Independence Rule" [1.200.001] must be met. [Prior reference: paragraph .17 of ET section 101]

### **1.250.020 Former Partners and Professional Employees Participation in a Firm-Sponsored Plan**

.01 When *partners* and professional employees leave a *firm* and are subsequently employed by, or associated with, an *attest client* of the *firm* in a *key position*, the requirements of paragraph .02a–c of the "Subsequent Employment or Association With an Attest Client" interpretation [1.279.020] must be met to reduce the familiarity, self-interest, or management participation *threats* to an *acceptable level*. [Prior reference: paragraph .04 of ET section 101]

## **1.255 Depository, Brokerage, and Other Accounts**

### **1.255.010 Depository Accounts**

.01 If a *covered member* maintains checking, savings, certificates of deposit, money market, or other depository accounts (depository accounts) at a bank or similar depository institution that is an *attest client* during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. For specific guidance applicable to any other types of custodial accounts (for example, brokerage

accounts), see the "Brokerage and Other Accounts" interpretation [1.255.020] of the "Independence Rule."

**.02** When the *covered member* is a *firm*, the *threat* would be at an *acceptable level*, and *independence* would not be *impaired* if the *firm* concludes that the likelihood is remote that the bank or similar depository institution will experience financial difficulties.

**.03** When the *covered member* is an individual, the *threat* would be at an *acceptable level*, and *independence* would not be *impaired* if

- a. the balance in the depository account(s) is fully insured by the appropriate state or federal government deposit insurance agencies or by any other insurer, or
- b. any uninsured amounts, in the aggregate, were not material to the *covered member's* net worth, or
- c. if uninsured amounts were considered material, any uninsured amounts, in the aggregate, are reduced to an immaterial amount no later than 30 days from the date that the uninsured amount becomes material to the covered member's net worth.

**.04** Refer to the "Member of a Credit Union" interpretation [1.280.040] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraphs .140–.141 of ET section 191]

### **1.255.020 Brokerage and Other Accounts**

**.01** If an *attest client* in the financial services industry, such as an insurance company, an investment adviser, a broker-dealer, a bank, or similar depository institution, has custody of a *covered member's* assets other than depository accounts, including retirement plan assets, during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. For specific guidance applicable to depository accounts held at a bank or similar depository institution, see the "Depository Accounts" interpretation [1.255.010] of the "Independence Rule."

**.02** *Threats* would not be at an *acceptable level* and *independence* would be *impaired* unless the following safeguards are met

- a. The *attest client's* services were rendered under the *attest client's* normal terms, procedures, and requirements.
- b. Any *covered member's* assets subject to the risk of loss are immaterial to the *covered member's* net worth.

**.03** In determining if there is a risk of loss, the *covered member* should consider losses arising from the *attest client's* insolvency, bankruptcy, or acts of fraud or other illegal acts but should not consider potential losses arising from a market decline in the value of the assets.

**.04** When considering the materiality of assets subject to the risk of loss, the *covered member* should consider the following:

- a. Protection that state or federal regulators provide for the assets, such as state insurance funds
- b. Private insurance or other forms of protection that the financial services company obtains to protect its customers' assets, such as coverage by the Securities Investor Protection Corporation
- c. Protection from creditors, such as assets held in a pooled separate account or separate escrow accounts [Prior reference: paragraphs .081–.082 of ET section 191]

## 1.257 Insurance Products

### 1.257.010 Insurance Policies With No Investment Option

.01 An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered a *financial interest*.

.02 If during the *period of the professional engagement*, a *covered member* owns an insurance policy with no investment option issued by an *attest client*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would not be at an *acceptable level*, and could not be reduced to an *acceptable level* through the application of *safeguards*, if the *covered member* purchased the policy not under the normal terms, procedures, and requirements. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .17 of ET section 101]

### 1.257.020 Insurance Policies With Investment Options

.01 If during the *period of the professional engagement* the *covered member* owns an insurance policy with investment options issued by an *attest client*, but the *covered member* did not purchase the policy under the insurance company's normal terms, procedures, and requirements, *threats* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.02 When a *covered member* purchases an insurance policy, under the insurance company's normal terms, procedures, and requirements, which offers an investment option that allows the *covered member* to invest part of the policy's cash value in various investment products, the policy's underlying investments are considered to be *financial interests* of the *covered member*. Accordingly, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.03 If the *covered member* has the ability to select the policy's underlying investments or the authority to supervise or participate in the investment decisions and the *covered member* invests in an *attest client* during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired* because the investment would be considered a *direct financial interest*. For example, if the *covered member* invested the policy's cash value into a mutual fund that is an *attest client*, the investment in the mutual fund would be considered a *direct financial interest* and *independence* would be *impaired*. However, the mutual fund's underlying investments are considered to be *indirect financial interests*.

.04 Refer to the "Financial Interests" subtopic [1.240] and the "Joint Closely Held Investments" interpretation [1.265.020] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .17 of ET section 101]

### 1.257.030 Insurer Undergoes Demutualization

.01 If a mutual insurance company begins demutualization, a *covered member* who holds an insurance policy from the insurer should apply the

guidance in the "Unsolicited Financial Interests" interpretation [1.240.020] of the "Independence Rule" [1.200.001]. [Prior reference: paragraph .17 of ET section 101]

## 1.260 Loans, Leases, and Guarantees

### 1.260.010 Loans

.01 If a *covered member* has a *loan* to or from an *attest client*, any officer or director of the *attest client*, or any individual owning 10 percent or more of the *attest client's* outstanding equity securities or other ownership interests, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would not be at an *acceptable level* and *independence* would be *impaired* if the *loan* exists during the *period of the professional engagement*, except as provided for in the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule." [Prior reference: paragraph .02A(4) of ET section 101]

### 1.260.020 Loans and Leases With Lending Institutions

.01 The "Loans" interpretation [1.260.010] of the "Independence Rule" [1.200.001] provides that a self-interest *threat* would not be at an *acceptable level* and *independence* would be *impaired* if a *covered member* had a *loan* to or from an *attest client*, any officer or director of the *attest client*, or any individual owning 10 percent or more of the *attest client's* outstanding equity securities or other ownership interests, except as provided for in this interpretation.

.02 *Home mortgages, secured loans, and immaterial unsecured loans.* However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* or his or her *immediate family* has an unsecured *loan* that is not material to the *covered member's* net worth (that is, immaterial unsecured *loan*), a home mortgage, or a secured *loan* from a *lending institution attest client*, if all the following *safeguards* are met:

- a. The home mortgage, secured *loan*, or immaterial unsecured *loan* was obtained under the *lending institution's normal lending procedures, terms, and requirements*. In determining when the home mortgage, secured *loan*, or immaterial unsecured *loan* was obtained, the date a commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.
- b. The home mortgage, secured *loan*, or immaterial unsecured *loan* was obtained
  - i. from the *lending institution* prior to its becoming an *attest client*;
  - ii. from a *lending institution* for which *independence* was not required and was later sold to an *attest client*;
  - iii. after May 31, 2002, from a *lending institution attest client* by a borrower prior to his or her becoming a *covered member* with respect to that *attest client*; or
  - iv. prior to May 31, 2002 and the requirements of the loan transition provision in [www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf](http://www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf) are met.

- c. After becoming a *covered member*, any home mortgage, secured *loan*, or immaterial unsecured *loan* must be kept current regarding all terms at all times, and the terms may not change in any manner not provided for in the original agreement. Examples of changed terms are a new or extended maturity date, a new interest rate or formula, revised collateral, and revised or waived covenants.
- d. The estimated fair value of the collateral for a home mortgage or other secured *loan* must equal or exceed the outstanding balance during the term of the home mortgage or other secured *loan*. If the estimated fair value of the collateral is less than the outstanding balance of the home mortgage or other secured *loan*, the portion that exceeds the estimated fair value of the collateral may not be material to the *covered member's* net worth.

**.03** *Loans to partnerships and other similar entities.* For purposes of applying the loan provision in paragraph .02 when the *covered member* is a partner in a partnership, a *loan* to a limited partnership (or similar type of entity) or general partnership would be ascribed to each *covered member* who is a partner in the partnership on the basis of his or her legal liability as a limited or general partner if

- a. the *covered member's* interest in the limited partnership, either individually or combined with the interest of one or more *covered members*, exceeds 50 percent of the total limited partnership interest, or
- b. the *covered member*, either individually or together with one or more *covered members*, can *control* the general partnership.

Even if no amount of a partnership *loan* is ascribed to the *covered member(s)* previously identified, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if the partnership renegotiates a loan or obtains a new *loan* that is not a permitted *loan*, as described in paragraph .04 of this interpretation. Accordingly, *independence* would be *impaired*.

**.04** *Other loans and leases.* *Threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* obtains one of the following types of *loans* or leases under the *lending institution's normal lending procedures, terms, and requirements*, provided the *covered member* complies with the terms of the loan or lease agreement at all times (for example, keeping payments current):

- a. Automobile *loans* and leases collateralized by the automobile
- b. *Loans* fully collateralized by the cash surrender value of an insurance policy
- c. *Loans* fully collateralized by cash deposits at the same *lending institution* (for example, passbook *loans*)
- d. Aggregate outstanding balances from credit cards and overdraft reserve accounts that have a balance of \$10,000 or less after payment of the most recent monthly statement made by the due date or within any available grace period

**.05** *Members* should consider that certain state and federal agencies may proscribe more restrictive requirements over *lending institutions* that are subject to their oversight and that, in turn, impose more restrictive requirements

upon *members* that perform *attest engagements* for these *lending institutions*. For example, the Securities and Exchange Commission (SEC) proscribes more restrictive requirements over *members* providing attest services to *lending institutions* and broker-dealers within their purview. [Prior reference: paragraph .07 of ET section 101 and paragraphs .150–.151 of ET section 191]

**.06** *Covered members* may be subject to additional restrictions, as described in the "Depository Accounts" interpretation [1.255.010] and the "Member of a Credit Union" interpretation [1.280.040] of the "Independence Rule" [1.200.001].

### **1.260.030 Servicing of a Loan**

**.01** The self-interest *threat* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if a *lending institution* *attest client* services a *loan* originally extended to a *covered member* by another *lending institution*. [Prior reference: paragraphs .134–.135 of ET section 191]

### **1.260.040 Leases**

**.01** If a *covered member* enters into a leasing agreement with an *attest client* during the *period of the professional engagement*, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if all the following *safeguards* are met:

- a. The lease meets the criteria of an operating lease (as described in GAAP).
- b. The terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature.
- c. All amounts are paid in accordance with the lease terms or provisions.

This paragraph excludes leases addressed by paragraph .04 of the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule" [1.200.001].

**.02** *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if a *covered member* has a lease that meets the criteria of a capital lease (as described in GAAP). Accordingly, *independence* would be *impaired* because the lease would be considered to be a *loan* with an *attest client*. This paragraph excludes a lease that is in compliance with the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule." [Prior reference: paragraphs .182–.183 of ET section 191]

### **1.260.050 Association With an Entity That Has a Loan To or From an Attest Client**

**.01** If a *covered member* is an officer, a director, or a shareholder of an entity and the entity has a *loan* to or from an *attest client* during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if

the *covered member* has *control* over the entity. Accordingly, *independence* would be *impaired* because the lease would be considered to be a *loan* with an *attest client*. This paragraph excludes a lending relationship that is permitted under the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule."

**.02** If any *partner* or professional employee of the *firm* is an officer, a director, or a shareholder of an entity and the entity has a *loan* to or from an *attest client*, *threats* to the *partner's* or professional employee's objectivity may exist. If the *partner* or professional employee is able to exercise *significant influence* over the entity but is not a *covered member* who can *control* the entity (see paragraph .01), the *partner* or professional employee should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001].

**.03** When making the decision about whether to perform a *professional service* and in making disclosure to the appropriate parties, the *member* should consider the "Confidential Client Information Rule" [1.700.001]. [Prior reference: paragraphs .220–.221 of ET section 191]

## 1.265 Business Relationships

### 1.265.010 Cooperative Arrangements With Attest Clients

**.01** If a *member* or his or her *firm* has a cooperative arrangement with an *attest client*, self-interest, familiarity, and undue influence *threats* to the *member* or his or her *firm's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if, during the *period of the professional engagement*, the cooperative arrangement is material to the *firm* or *attest client*. Accordingly, *independence* would be *impaired*.

**.02** A cooperative arrangement exists when a *member* or the *member's firm* and an *attest client* jointly participate in a business activity. However, a cooperative arrangement would not exist when all of the following *safeguards* are met:

- a. The participation of the *firm* and *attest client* are governed by separate agreements, arrangements, or understandings that do not create rights or obligations between the *firm* and *attest client*.
- b. Neither the *firm* nor the *attest client* assumes responsibility for the other's activities or results.
- c. Neither party has the authority to act as the other's representative or agent.

**.03** Examples of cooperative arrangements include the following:

- a. Prime and subcontractor arrangements to provide services or products to a third party
- b. Joint ventures to develop or market products or services
- c. Arrangements to combine one or more of the *firm's* services or products with one or more of the *attest client's* services or products and market the package with references to both parties



- d. Arrangements under which the *firm* acts as a distributor or marketer of the *attest client's* products or services or the *attest client* acts as the distributor or marketer of the *firm's* products or services

.04 Refer to the "Contingent Fees Rule" [1.510.001] and the "Commissions and Referral Fees Rule" [1.520.001] for additional guidance. [Prior reference: paragraph .14 of ET section 101]

### **1.265.020 Joint Closely Held Investments**

.01 If a *covered member* has a *joint closely held investment*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* holds a material *joint closely held investment* during the *period of the professional engagement*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02A(3) of ET section 101]

.02 A *joint closely held investment* includes a joint interest in a vacation home shared by a *covered member* and an *attest client* (or one of the client's officers or directors, or any owner who has the ability to exercise significant influence over the *attest client*), if the *covered member* and *attest client* (or one of the client's officers or directors or any owner who has the ability to exercise significant influence over the *attest client*) control the investment and the vacation home is material to the *covered member*. Such is the case even if the vacation home is solely intended for the personal use of the owners. [Prior reference: paragraphs .184–.185 of ET section 191]

## **1.270 Family Relationships With Attest Clients**

### **1.270.010 Immediate Family Members**

.01 The *immediate family* of a *covered member* must comply with the "Independence Rule" [1.200.001] and its *interpretations*, except as permitted in the following interpretations:

- a. "Immediate Family Member Is Employed by the Attest Client" [1.270.020]
- b. "Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)" [1.270.030]
- c. "Immediate Family Member Participation in an Employee Benefit Plan With Financial Interests in an Attest Client" [1.270.040]
- d. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients" [1.270.050]
- e. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client" [1.270.060]

- f. "Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation" [1.270.070]
- g. "Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan" [1.270.080]

**.02** Notwithstanding any exceptions provided for in paragraph .01, the ownership interests of a *covered member's immediate family* may not exceed those specified in paragraph .03 of the "Overview of Financial Interests" interpretation [1.240.010] of the "Independence Rule" [1.200.001].

**.03** When materiality of a *financial interest* is identified as a factor affecting *independence* in the *interpretations* of the "Independence Rule" [1.200.001], interests of the *immediate family* member and the *covered member* should be combined to determine materiality to the *covered member*. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative white paper, *Independence Rules Modernization Project*, provides some discussion on changes made to the independence provisions that are applicable to close relatives. The white paper is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/IndependenceModernizationWhitePaper.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/IndependenceModernizationWhitePaper.doc).

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

### **1.270.020 Immediate Family Member Is Employed by the Attest Client**

**.01** When an individual in a *covered member's immediate family* is employed by an *attest client*, management participation, familiarity, and self-interest *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** If a *covered member's immediate family* is employed by an *attest client* but is not in a *key position*, *threats* would be at an *acceptable level* and *independence* would not be *impaired*.

**.03** If a *covered member's immediate family* is in a *key position* with an *attest client* during the period covered by the *financial statements* or during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

### **Grandfathered Employment Relationships**

**.04** For information about grandfathered employment relationships for immediate family members, refer to [www.aicpa.org/interestareas/professional-ethics/community/downloadabledocuments/transistion%20periods.pdf](http://www.aicpa.org/interestareas/professional-ethics/community/downloadabledocuments/transistion%20periods.pdf). [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative white paper, *Independence Rules Modernization Project*, provides some discussion on changes made to the independence provisions that are applicable to close relatives. The white paper is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/IndependenceModernizationWhitePaper.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/IndependenceModernizationWhitePaper.doc).

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

**1.270.030 Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)**

.01 If during the period covered by the *financial statements* or during the *period of the professional engagement*, an *immediate family member* of a *covered member* participates in an employee benefit plan (plan) that is an *attest client* or is sponsored by an *attest client* (other than an *attest client's share-based compensation arrangement* and nonqualified deferred compensation plan), *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family member* does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The plan is offered to all employees in comparable employment positions.
- c. The *immediate family member* does not serve in a position of governance (for example, board of trustees) for the plan.
- d. The *immediate family member* does not have the ability to supervise or participate in the plan's investment decisions or in the selection of the investment options made available to plan participants. [Prior reference: paragraph .02 of ET section 101]

.02 *Share-based compensation arrangements* and nonqualified deferred compensation plans are discussed in the following interpretations:

- a. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients" interpretation [1.270.050] of the "Independence Rule" [1.200.001]
- b. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client" interpretation [1.270.060] of the "Independence Rule"
- c. "Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation" interpretation [1.270.070] of the "Independence Rule"

- d. "Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan" interpretation [1.270.080] of the "Independence Rule"

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

### **1.270.040 Immediate Family Member Participation in an Employee Benefit Plan With Financial Interests in an Attest Client**

**.01** If during the *period of the professional engagement*, an *immediate family member* of a *covered member* is employed at a non-client or employed in a non-key position at an *attest client*, the *immediate family member* may hold a *direct financial interest* or *material indirect financial interest* in an *attest client* through participation in an employee benefit plan if *threats* are at an *acceptable level*. *Threats* would be at an *acceptable level*, and *independence* would not be *impaired*, if all of the following *safeguards* were met:

- a. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- b. Such investment is an unavoidable consequence of such participation. Unavoidable consequence means that the *immediate family member* has no other investment options available for selection, including money market or invested cash options, except for selecting an investment option in an *attest client*.
- c. In the event that a plan provides an option that permits the *immediate family member* to invest in a nonattest *client* or a non-client investment option that becomes available, the *immediate family member* is required to select the investment option in the non-client or nonattest *client* and dispose of *financial interests* in the *attest client* as soon as practicable but no later than 30 days after such option becomes available. When legal or other similar restrictions exist on an *immediate family member's* right to dispose of a *financial interest* at a particular time, the *immediate family member* need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family member* is not required to dispose of a *financial interest* in an *attest client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not fall within this exception. [Prior reference: paragraph .02 of ET section 101]

This paragraph excludes participation in *share-based compensation arrangements* and nonqualified deferred compensation arrangements (see paragraph .02).

**.02** *Share-based compensation arrangements* and nonqualified deferred compensation plans are discussed in the following interpretations:

- a. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned

Financial Interests in Attest Clients" interpretation [1.270.050] of the "Independence Rule" [1.200.001]

- b. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client" interpretation [1.270.060] of the "Independence Rule"
- c. "Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation" interpretation [1.270.070] of the "Independence Rule"
- d. "Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan" interpretation [1.270.080] of the "Independence Rule"

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

### **1.270.050 Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients**

**.01** If during the period of the professional engagement, an immediate family member of a covered member participates in a share-based compensation arrangement of an attest client, such as an ESOP, that results in the immediate family member holding a financial interest in an attest client that is beneficially owned, threats are at an acceptable level and independence would not be impaired if all of the following safeguards were met:

- a. The immediate family member does not serve in a key position for the attest client, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The covered member neither participates on the attest engagement team nor is an individual in a position to influence the attest engagement.
- c. The immediate family member does not serve as a trustee for the share-based compensation arrangement and does not have the ability to supervise or participate in the selection of any investment options made available to plan participants.
- d. When the financial interests that are beneficially owned are distributed or the immediate family member has the right to dispose of the financial interests, the immediate family member is required to do one of the following:
  - i. Dispose of the financial interests as soon as practicable but no later than 30 days after he or she has the right to dispose of the financial interests.
  - ii. Exercise his or her put option to require the employer to repurchase the financial interests as soon as permitted by the terms of the share-based compensation arrangement.

In addition, any repurchase obligation due to the *immediate family* member arising from exercise of the option that is outstanding for more than 30 days needs to be immaterial to the *covered member* during the payout period. When legal or other similar restrictions exist on an *immediate family* member's right to dispose of a *financial interest* at a particular time, the *immediate family* member need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family* member does not have to dispose of a *financial interest* in an *attest client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest does not qualify for this exception.

- e. Benefits payable from the *share-based compensation arrangement* to the *immediate family* member upon termination of employment, whether through retirement, death, disability, or voluntary or involuntary termination, are funded by investment options other than the employer's *financial interests*, and any unfunded benefits payable are immaterial to the *covered member* at all times during the payout period. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

### **1.270.060 Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client**

.01 If during the *period of the professional engagement* an *immediate family* member of a *covered member* participates in a *share-based compensation arrangement* resulting in a right to acquire shares in an *attest client*, such as an ESOP or restricted stock rights plan, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family* member does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- c. The *immediate family* member exercises or forfeits these rights once he or she is vested, and the closing market price of the underlying stock equals or exceeds the exercise price for 10 consecutive days (market period). The exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period. In addition, if the *immediate family* member exercises his or her right to acquire shares in the *attest client*, he

or she should dispose of the shares as soon as practicable but no later than 30 days after the exercise date. Also, note the following:

- i. When legal or other similar restrictions exist on an *immediate family* member's right to dispose of a *financial interest* at a particular time, the *immediate family* member need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family* member does not have to dispose of a *financial interest* in an *attest client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not qualify for this exception.
- ii. If the employer repurchases the shares, any employer repurchase obligation due to the *immediate family* member that is outstanding for more than 30 days needs to be immaterial to the *covered member* during the payout period.

**.02** Refer to paragraph .06 of the "Retirement, Savings, Compensation, or Similar Plans" interpretation [1.240.040] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

### **1.270.070 Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation**

**.01** If during the *period of the professional engagement* an *immediate family* member of a *covered member* participates in a *share-based compensation arrangement* based on the appreciation of an *attest client's* underlying shares, such as a stock appreciation plan or phantom stock plan, *threats* are at an *acceptable level* and *independence* would not be impaired if all of the following *safeguards* were met:

- a. The *immediate family* member does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The *share-based compensation arrangement* does not provide for the issuance of rights to acquire the employer's *financial interests*.
- c. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- d. The *immediate family* member exercises or forfeits these rights once he or she is vested, if the underlying price of the employer's shares equals or exceeds the exercise price for 10 consecutive days (market period). Exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period.

- e. Any resulting compensation payable to the *immediate family* member that is outstanding for more than 30 days is immaterial to the *covered member* during the payout period. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

### **1.270.080 Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan**

**.01** If during the *period of the professional engagement* an *immediate family* member of a *covered member* participates in a nonqualified deferred compensation plan of an *attest client* as a result of his or her employment, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family* member does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- c. The amount of the deferred compensation payable to the *immediate family* member is funded through life insurance, an annuity, a trust, or similar vehicle, and any unfunded portion is immaterial to the *covered member*.
- d. Any funding of the deferred compensation does not include *financial interests* in the *attest client*. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsImmediateFamilyMember6-1-10Final.doc).

### **1.270.100 Close Relatives**

**.01** When a *close relative* of a *covered member* is employed by an *attest client* or has *financial interests* in an *attest client*, management participation, familiarity, and self-interest *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level*



by the application of *safeguards*, and *independence* would be *impaired*, if an individual participating on the *attest engagement team* has a *close relative* who has either of the following:

- a. A *key position* with the *attest client* during the period covered by the *financial statements* or during the *period of the professional engagement*.
- b. A *financial interest* in the *attest client* during the *period of the professional engagement* that
  - i. the individual knows or has reason to believe was material to the *close relative* or
  - ii. enabled the *close relative* to exercise *significant influence* over the *attest client*.

**.03** *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and *independence* will be *impaired* if an *individual in a position to influence the attest engagement* or any *partner* or *partner equivalent* in the *office* in which the lead *attest engagement partner* or *partner equivalent* primarily practices in connection with the *attest engagement* has a *close relative* who has either of the following:

- a. A *key position* with the *attest client* during the period covered by the *financial statements* or during the *period of the professional engagement*.
- b. A *financial interest* in the *attest client* during the *period of the professional engagement* that
  - i. the individual, *partner*, or *partner equivalent* knows or has reason to believe was material to the *close relative* and
  - ii. enabled the *close relative* to exercise *significant influence* over the *attest client*.

### **Grandfathered Employment Relationships**

**.04** For information about grandfathered employment relationships for close relatives, refer to [www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf](http://www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf). [Prior reference: paragraph .02 of ET section 101]

### **Effective Date**

**.05** The addition of partner equivalents to paragraph .03 is effective for engagements covering periods beginning on or after December 15, 2014.

A nonauthoritative white paper, *Independence Rules Modernization Project*, provides some discussion about changes made to the independence provisions that are applicable to close relatives. The white paper is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/IndependenceModernizationWhitePaper.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/IndependenceModernizationWhitePaper.doc).

## 1.275 Current Employment or Association With an Attest Client

### 1.275.005 *Simultaneous Employment or Association With an Attest Client*

.01 In this interpretation, simultaneous employment or association with an *attest client* is serving as a director, an officer, an employee, a promoter, an underwriter, a voting trustee, a trustee for any pension or profit-sharing trust of the *attest client*, or in any capacity equivalent to that of a member of management of an *attest client* during the period covered by the *financial statements* or the *period of the professional engagement*.

.02 If a *partner* or professional employee of the *member's firm* is simultaneously employed or associated with an *attest client*, familiarity, management participation, advocacy, or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02C of ET section 101]

.03 However, *threats* will be at an *acceptable level* and *independence* will not be *impaired* if a *partner* or professional employee of a *firm* serves as an adjunct faculty member of an educational institution that is an *attest client* of the *firm*, provided that the *partner* or professional employee meets all of the following *safeguards*:

- a. Does not hold a *key position* at the educational institution
- b. Does not participate on the *attest engagement team*
- c. Is not an *individual in a position to influence the attest engagement*
- d. Is employed by the educational institution on a part-time and non-tenure basis
- e. Does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required
- f. Does not assume any management responsibilities or set policies for the educational institution

Upon termination of employment, the *partner* or professional employee should comply with the requirements of the "Former Employment or Association With an Attest Client" interpretation [1.277.010] of the "Independence Rule" [1.200.001]. [Prior reference: paragraph .21 of ET section 101]

.04 *Members* that are simultaneously employed or associated with an *attest client* should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

### **Effective Date**

.05 Paragraph .04 of this interpretation is effective December 15, 2014.

A nonauthoritative question and answer regarding independent contractors retained by the firm who are simultaneously employed or associated with an attest client is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).

**1.275.010 Honorary Director or Trustee of a Not-for-Profit Organization**

**.01** When a *partner* or professional employee of a *member's firm* is asked to lend the prestige of his or her name to a not-for-profit organization (the assumption is that the organization limits its activities to charitable, religious, or civic or other matters of a similar nature) by serving as an honorary director or trustee of the organization during the period covered by the *financial statements* or during the *period of the professional engagement*, familiarity, self-review, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The position is clearly honorary and the individual holds the position in name only.
- b. The individual cannot vote or otherwise participate in board or management responsibilities.
- c. If the individual is named in letterheads and externally circulated materials, the individual is identified as an honorary director or honorary trustee. [Prior reference: paragraph .06 of ET section 101]

**.02** *Members* that are simultaneously employed or associated with an *attest client* should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

**Effective Date**

**.03** Paragraph .02 of this interpretation is effective December 15, 2014.

**1.275.015 Member of Advisory Board**

**.01** If a *partner* or professional employee of a *member's firm* serves on an advisory board of an *attest client*, familiarity, self-review, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The responsibilities of the advisory board are in fact advisory in nature.
- b. The advisory board has no authority to make nor does it appear to make management decisions on behalf of the *attest client*.
- c. The advisory board and those having authority to make management decisions, including the board of directors or its equivalent, are distinct groups with minimal, if any, common membership. [Prior reference: paragraphs .144–.145 of ET section 191]

**.02** *Members* in such positions should consider their obligations as *members in business* under part 2 of the code. [No prior reference: new content]

**Effective Date**

**.03** Paragraph .02 of this interpretation is effective December 15, 2014.

### **1.275.020 Member of Governmental Advisory Committee**

.01 If a *partner* or professional employee of the *firm* serves on a citizens' advisory committee that is studying possible changes in the form of a county government that is an *attest client* of the *member's firm*, familiarity, self-review, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* with respect to the county.

.02 If a *partner* or professional employee of the *firm* serves on an advisory committee appointed to study the financial status of the state in which the county is located, *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*. Accordingly, *independence* would not be *impaired* with respect to the county. [Prior reference: paragraphs .039–.040 of ET section 191]

.03 *Members* in such positions should consider their obligations as *members in business* under part 2 of the code. [No prior reference: new content]

#### **Effective Date**

.04 Paragraph .03 of this interpretation is effective December 15, 2014.

### **1.275.025 Campaign Treasurer**

.01 If a *partner* or professional employee of a *member's firm* serves as the treasurer for a mayoral candidate's campaign organization, during the period covered by the *financial statements* or during the *period of the professional engagement* and the campaign organization is an *attest client*, the management participation *threat* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. The *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.02 If, instead, the candidate's political party or the municipality in which the candidate may become mayor is an *attest client*, the *threat* to the *member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*. Accordingly, *independence* would not be *impaired*.

.03 Refer to the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] for additional guidance. In addition, *members* in such positions should consider their obligations as *members in business* under part 2 of the code. [Prior reference: paragraphs .164–.165 of ET section 191]

### **1.275.030 Member of Federated Fund-Raising Organization**

.01 When a *partner* or professional employee of a *member's firm* serves as a director or an officer of a federated fund-raising organization, such as United Way (the organization), during the period covered by the *financial statements* or during the *period of the professional engagement*, and a charity that receives funds from the organization is an *attest client* of the *member's firm*, management participation or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the organization has managerial control over the charity, the *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.03 Even if the organization does not have managerial control over the charity, a conflict of interest could arise that may create a *threat* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001]. In such situations, the *member* should consult the "Conflicts of Interest" interpretation [1.110.010]. [Prior reference: paragraphs .027–.028 of ET section 191]

.04 In addition, *members* in such positions should consider their obligations as *members in business* under part 2 of the code. [No prior reference: new content]

### **Effective Date**

.05 Paragraph .04 of this interpretation is effective December 15, 2014.

## **1.275.035 Member of Organization that Receives Funds From Fund-Raising Organization**

.01 When a *partner* or professional employee of a *member's firm* serves on the board of directors of an organization during the period covered by the *financial statements* or during the *period of the professional engagement* and the organization receives funds from a fund-raising foundation that is an *attest client*, management participation or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the fund-raising foundation functions solely to raise funds for that organization, the *threat* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.03 However, if the directorship is clearly honorary, in accordance with the "Honorary Director or Trustee of a Not-for-Profit Organization" interpretation [1.275.010] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level*. Accordingly, *independence* would not be *impaired*. [Prior reference: paragraphs .128–.129 of ET section 191]

.04 *Members* in such positions should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

### **Effective Date**

.05 Paragraph .04 of this interpretation is effective December 15, 2014.

## **1.277 Former Employment or Association With an Attest Client**

### **1.277.010 Former Employment or Association With an Attest Client**

.01 This interpretation applies to *covered members* who were formerly employed by an entity or associated with an entity as an officer, a director, a promoter, an underwriter, a voting trustee, or a trustee for the entity's pension or profit sharing trust and subsequently became employed by a *firm* that provides attest service to that entity.

.02 When a *member* becomes a *partner* or professional employee of a *firm* that provides attest services to an entity where the *member* was formerly employed or otherwise associated, familiarity, self-interest, self-review, or

management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.03** If a *covered member* participates on the *client's attest engagement* or is an *individual in a position to influence the attest engagement* covering any period that includes the *covered member's* former employment or association with the *attest client*, *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

**.04** If a *member* fails to disassociate from the *attest client* before becoming a *covered member*, *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and *independence* would be *impaired* unless all of the following *safeguards* are met:

- a. The *covered member* ceases to participate in all employee health and welfare plans sponsored by the *attest client*, unless the *attest client* is legally required to allow the *member* to participate in the plan (for example, the Consolidated Omnibus Budget Reconciliation Act [COBRA]) and the *member* pays 100 percent of the *member's* portion of the cost of participation on a current basis.
- b. The *covered member* ceases to participate in all other employee benefit plans by liquidating or transferring, at the earliest date permitted under the plan, all vested benefits in the *attest client's* defined benefit plans, defined contribution plans, *share-based compensation arrangements*, deferred compensation plans, and other similar arrangements.

However, when a *covered member's* participation in one of these plans results from former employment or association with an *attest client*, *threats* would be at an *acceptable level* and *independence* would not be *impaired* provided the liquidation or transfer of any vested benefits is either not permitted under the terms of the plan or would result in a penalty significant to the benefits being imposed upon such liquidation or transfer and the *covered member*

- i. does not participate on the *attest engagement team* or
- ii. is not an *individual in a position to influence the attest engagement*.

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

- c. The *covered member* disposes of any *direct financial interest* or material *indirect financial interests* in the *attest client*.
- d. The *covered member* collects or repays any *loans* to or from the *attest client*, except for *loans* specifically permitted or grandfathered by the *interpretations* of the "Loans, Leases, and Guarantees" subtopic [1.260] under the "Independence Rule."
- e. *Covered members* should evaluate whether other relationships with the *attest client* create *threats* that require the *member* to apply *safeguards* to reduce those *threats* to an *acceptable level*. [Prior reference: paragraph .02 of ET section 101]

## 1.279 Considering or Subsequent Employment or Association With an Attest Client

### 1.279.010 Considering Employment or Association With an Attest Client

**.01** This interpretation applies to a member of the *attest engagement team* or an *individual in a position to influence the attest engagement* (individual) who intends to seek or discuss potential employment or association with an *attest client* or is in receipt of a specific offer of employment from an *attest client*.

**.02** The undue influence and self-interest *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The individual promptly reports such consideration or offer to an appropriate person in the *firm*.
- b. The individual immediately ceases participation in the engagement and does not provide any services to the *attest client* until the employment offer is rejected or employment is no longer sought.
- c. If a *covered member* becomes aware that an individual is considering employment or association with an *attest client*, the *covered member* should notify an appropriate person in the *firm*.
- d. The appropriate person in the *firm* should consider whether, based on the nature of the engagement and the individual involved, the *firm* should perform additional procedures to provide reasonable assurance that any work that the individual performed for the *attest client* was performed in compliance with the "Integrity and Objectivity Rule" [1.100.001].

**.03** If the individual accepts an offer of employment or otherwise becomes associated with the *attest client* in a *key position*, see the "Subsequent Employment or Association With an Attest Client" interpretation [1.279.020] of the "Independence Rule" [1.200.001] for additional requirements. [Prior reference: paragraph .04 of ET section 101]

### 1.279.020 Subsequent Employment or Association With an Attest Client

**.01** This interpretation applies to *partners* and professional employees who leave their *firms* and are subsequently employed by, or associated with, one of the *firm's attest clients* in a *key position*.

**.02** The familiarity, self-interest, undue influence, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and *independence* would be *impaired* unless all of the *safeguards* in items a–e of the following list are met:

#### *Individual Safeguards*

- a. Amounts due to the former *partner* or professional employee for his or her previous interest in the *firm* and unfunded, vested retirement benefits cannot be material to the *firm*, and the underlying formula used to calculate the payments remain fixed during the payout period. The *firm* may adjust the retirement benefits for inflation and pay interest on amounts due.
- b. The former *partner* or professional employee is not in a position to influence the *firm's* operations or financial policies.

- c. The former *partner* or professional employee does not participate or appear to participate in the *firm's* business and is not otherwise associated with the *firm*, regardless of whether he or she is compensated for such participation or association, once employment or association with the *attest client* begins. For example, the individual would appear to participate in, or be associated with, the *firm* if
  - i. the individual provides consultation to the *firm*;
  - ii. the *firm* provides the individual with an *office* and related amenities, such as administrative and technology services;
  - iii. the individual's name is included in the *firm's office* directory; or
  - iv. the individual is identified as a member of the *firm* in membership lists of business, professional, or civic organizations, unless the *member* is clearly designated as retired.

*Ongoing Attest Engagement Team Safeguards*

- d. The ongoing *attest engagement team* should consider whether to modify the engagement procedures to adjust for the risk that the former *partner's* or professional employee's prior knowledge of the audit plan could reduce audit effectiveness. In addition, if the individual will have significant interaction with the *attest engagement team*, an appropriate individual in the *firm* should evaluate whether the existing *attest engagement team* members have sufficient experience and stature to deal effectively with the individual in conducting the engagement.
- e. If the former *partner* or professional employee joins the *attest client* in a *key position* within one year of disassociating from the *firm* and has significant interaction with the *attest engagement team*, an appropriate professional in the *firm* should review the subsequent *attest engagement* to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the individual's representations and work. The professional applying this *safeguard* should have appropriate stature, expertise, and objectivity. In performing this review, the professional should consider relevant factors, such as the following:
  - i. The position that the individual assumed at the *attest client*.
  - ii. The position that the individual held at the *firm*.
  - iii. The nature of the services that the individual provided to the *attest client*. The professional should take appropriate actions, as deemed necessary, based on the results of this review.

**.03** The procedures performed in applying items *d–e* of paragraph .02 of this interpretation will depend on several factors, including the following:

- a. Whether the individual served on the engagement team
- b. The positions that the individual held at the *firm* and has accepted at the *attest client*
- c. The length of time that has elapsed since the individual left the *firm*
- d. The circumstances of the individual's departure



.04 An inadvertent and isolated failure to apply items *d–e* in paragraph .02 of this interpretation would not *impair independence* provided that the relevant parties perform the required procedures promptly upon discovery of the failure to do so and all other provisions of this interpretation are met. [Prior reference: paragraph .04 of ET section 101]

## 1.280 Memberships

### 1.280.010 Member of a Social Club

.01 If a *covered member* belongs to a social club (for example, a country club, tennis club) that is an *attest client* and is required to acquire a pro rata share of the club's equity or debt securities, then management participation, self-review, and self-interest *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would be at an *acceptable level* if the club membership is essentially a social matter, because such equity or debt ownership would not be considered to be a *direct financial interest*. Accordingly, *independence* would not be *impaired*.

.02 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a *partner* or professional employee is simultaneously employed or associated with the *attest client's* social club as described in the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule." Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .033–.034 of ET section 191]

### 1.280.020 Member of a Trade Association

.01 If a *covered member* belongs to a trade association that is an *attest client*, management participation or self-review *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a *partner* or professional employee is simultaneously employed or associated with the trade association as described in the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule." Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .003–.004 of ET section 191]

### 1.280.030 Member of Common Interest Realty Association

.01 If a *covered member* belongs to a common interest realty association (CIRA) because the *covered member* owns or leases real estate, then management participation, self-interest, self-review, or advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. Examples of CIRAs include cooperatives, condominium associations, planned unit developments, homeowners associations, and timeshare developments.

.02 *Threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The CIRA performs functions similar to local governments, such as public safety, road maintenance, and utilities.
- b. The *covered member's* annual assessment is not material to either the *covered member* or the CIRA's operating budgeted assessments.

- c. The liquidation of the CIRA or the sale of common assets would not result in a distribution to the *covered member*.
- d. The CIRA's creditors would not have recourse to the *covered member's* assets if the CIRA became insolvent.

**.03** *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and cannot be reduced to an *acceptable level* by the application of *safeguards* if a *partner* or professional employee is simultaneously employed or associated with the CIRA as described in the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule." Accordingly, *independence* would be *impaired*.

**.04** A *member* who has a personal or professional relationship with a real estate developer or management company that is associated with the CIRA should consider the "Conflicts of Interest" interpretation [1.110.010] under the "Integrity and Objectivity Rule" [1.100.001]. [Prior reference: paragraphs .061–.062 of ET section 191]

### **1.280.040 Member of a Credit Union**

**.01** When a *covered member* is a member of a credit union that is an *attest client*, the self-interest *threat* would be at an *acceptable level*, and *independence* would not be *impaired*, if the *covered member* individually qualifies to join the credit union other than by virtue of the *professional services* provided to the *client*. However, if during the *period of the professional engagement* the *member's* qualification to join the credit union is a result of the *professional services* provided to the *client*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

**.02** *Covered members* may be subject to additional restrictions, as described in the "Depository Accounts" interpretation [1.255.010] and the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule" [1.200.001]. In addition, *partners* and professional employees may be subject to additional restrictions, as described in paragraph .03 of the "Overview of Financial Interests" interpretation [1.240.010] of the "Independence Rule." [Prior reference: paragraphs .150–.151 of ET section 191]

## **1.285 Gifts and Entertainment**

### **1.285.010 Offering or Accepting Gifts or Entertainment**

**.01** For purposes of this interpretation, the *attest client* also includes an individual in a *key position* with the *attest client* and individuals owning 10 percent or more of the *attest client's* outstanding equity securities or other ownership interests.

**.02** Accepting a gift from an attest client during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *member's firm*, a member of the *attest engagement team*, or an *individual in a position to influence the attest engagement* accepts a gift from an attest client and the value is not clearly insignificant to the recipient, the *threat* to the *member's* compliance with the "Independence Rule" would not be at an *acceptable level*

and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

**.03** Accepting entertainment from an attest client during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *covered member* accepts entertainment from an attest client that is not reasonable in the circumstances, the *threats* to the *member's* compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

**.04** Offering gifts or entertainment to an attest client during the *period of the professional engagement* may create a familiarity *threat* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *covered member* offers a gift or entertainment to an attest client that is not reasonable in the circumstances, the *threat* to the *member's* compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

**.05** The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Examples of relevant facts and circumstances include the following:

- a. The nature of the gift or entertainment
- b. The occasion giving rise to the gift or entertainment
- c. The cost or value of the gift or entertainment
- d. The nature, frequency, and value of other gifts and entertainment offered or accepted
- e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f. Whether other attest clients also participated in the entertainment
- g. The individuals from the attest client's and *member's firm* who participated in the entertainment

**.06** Refer to the "Offering or Accepting Gifts or Entertainment" interpretation [1.120.010] of the "Integrity and Objectivity Rule" [1.100.001] for additional guidance. [Prior reference: paragraphs .228–.229 of ET section 191]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts\\_Basis\\_Document.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts_Basis_Document.pdf).

A nonauthoritative question and answer regarding campaign contributions made to the campaign of an individual that is associated with an attest client in a key position or holds a financial interest in an attest client that is material or enables the individual to exercise significant influence over the attest client is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).

## 1.290 Actual or Threatened Litigation

### 1.290.010 Actual or Threatened Litigation

.01 The relationship between an *attest client's* management and a *covered member* must be characterized by complete candor and full disclosure regarding all aspects of the *attest client's* business operations. In addition, the *covered member* must not be biased so that the *covered member* can exercise professional judgment and objectivity in evaluating management's financial reporting decisions.

.02 Litigation or the expressed intention to commence litigation between a *covered member* and an *attest client* or its management and, in some cases, other parties during the *period of the professional engagement* may create self-interest or adverse interest *threats* to the *member's* compliance with the "Independence Rule" [1.200.001]. Accordingly, *covered members* should evaluate all such circumstances in accordance with this interpretation.

.03 Litigation or the expressed intention to commence litigation between a *covered member* and an *attest client* or its management and, in some cases, other parties requires the *covered member* to assess the materiality of the litigation to the *covered member*, the *covered member's firm*, and the *attest client*. The *covered member's* assessment should include an evaluation of the nature of the matter(s) underlying the litigation and all other relevant factors.

### **Litigation Between the Attest Client and Member**

.04 When an *attest client's* present management commences, or expresses an intention to commence, legal action against a *covered member*, the *covered member* and the *attest client's* management may be placed in adversarial positions in which self-interest may affect the *covered member's* objectivity and management's willingness to make complete disclosures.

.05 Accordingly, *independence* may be *impaired* whenever the *covered member* and the *covered member's attest client* or its management are in threatened or actual positions of material adverse interests due to threatened or actual litigation.

.06 Situations involving threatened or actual litigation are complex and diverse, making it difficult to identify precise points at which *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*. There are situations regarding litigation between *covered members* and *attest clients* in which *threats* to the *covered member's* compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by *safeguards* and *independence* would be *impaired*. Examples of these situations are:

- a. An *attest client's* present management commences litigation alleging deficiencies in audit work performed for the *attest client* or expresses its intention to commence such litigation, and the *covered member* concludes that it is probable that such a claim will be filed.
- b. A *covered member* commences litigation against an *attest client's* present management alleging management fraud or deceit.

.07 If threatened or actual litigation is unrelated to the performance of a *client's attest engagement* and is for an amount that is not material to the *covered member's firm* or the *attest client*, *threats* to the *covered member's*

compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*, and *independence* would not be *impaired*. Such claims may arise, for example, out of immaterial disputes regarding billings for services, results of tax or management services advice, or similar matters.

### **Litigation by Security Holders**

**.08** A *covered member* may also become involved in litigation (primary litigation) in which the *covered member* and the *attest client* or its management are defendants. For example, one or more stockholders may bring a stockholders' derivative action or class-action lawsuit against the *attest client* or its management, the *attest client's* officers, directors, or underwriters, and *covered members*.

**.09** Such primary litigation by itself would not *threaten* the *covered member's* compliance with the "Independence Rule" [1.200.001]. However, if other circumstances exist that may create *threats*, the *covered member* should apply the "Conceptual Framework for Independence" interpretation [1.210.010] to evaluate whether the *threats* are at an *acceptable level*. For example, *threats* will exist if cross-claims are filed against the *covered member* alleging that the *covered member* is responsible for any deficiencies in work performed for the *attest client* or if the *covered member*, as a defense, alleges that the *attest client's* management engaged in fraud or deceit.

**.10** The following are examples of situations in which *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by *safeguards*, thereby *impairing independence*:

- a. The *attest client* or its management or directors have filed cross-claims to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations), and there is a significant risk that the cross-claim will result in a settlement or judgment in an amount that is material to the *covered member's firm* or the *attest client*.
- b. The *attest client's* underwriter and the *attest client* or its present management assert cross-claims against the *covered member*.

**.11** If only the underwriter or officers or directors of other *clients* of the *covered member* file cross-claims against the *covered member*, *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* unless other circumstances create *threats* to compliance with the "Independence Rule."

### **Other Third-Party Litigation**

**.12** A *lending institution* or other creditor, security holder, or insurance company that alleges reliance on the *attest client's financial statements* as a basis for having extended credit or insurance coverage to an *attest client* may commence third-party litigation against the *covered member* to recover their loss. An example is an insurance company commencing litigation either as a result of receiving an assignment of a claim or under subrogation rights against the *covered member* in the *attest client's* name to recover losses that the insurer reimbursed to the *attest client*. If the *attest client* is only the nominal plaintiff, *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* unless other circumstances exist, such as when the *covered member* alleges, as a defense, that present

management engaged in fraud or deceit. The *attest client* is a nominal plaintiff when the insurance company or lender sues in the name of the *attest client* as a result of obtaining subrogation rights or an assignment from the *attest client* and the *attest client* does not have a beneficial interest in the claim.

**.13** If the real party in interest in the litigation (for example, the insurance company) is also the *covered member's attest client* (the plaintiff client), *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist if the litigation carries a significant risk of a settlement or judgment in an amount that would be material to the *covered member's firm* or the plaintiff client.

### **Termination of Impairment**

**.14** *Threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be eliminated or reduced to an *acceptable level* when the parties reach a final resolution of the matter(s) at issue and the matter(s) no longer affects the relationship between the *covered member* and the *attest client*, as described in paragraph .01 of this interpretation. The *covered member* should determine whether the conditions of such resolution have effectively eliminated such *threats* or reduced them to an *acceptable level*. [Prior reference: paragraph .08 of ET section 101]

## **1.295 Nonattest Services**

### **1.295.010 Scope and Applicability of Nonattest Services**

**.01** When a *member* performs nonattest services for an *attest client*, self-review, management participation, or advocacy *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. When significant *independence threats* exist during the *period of the professional engagement* or the period covered by the *financial statements* (except as provided for in paragraph .03), *independence* will be *impaired* unless the *threats* are reduced to an *acceptable level* and any requirements included in the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" have been met.

**.02** For purposes of the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" [1.200.001], the term *member* includes the *member's firm*.

**.03** *Period of engagement*. A *member's independence* would not be *impaired* if the *member* performed nonattest services that would have otherwise *impaired independence* during the period covered by the *financial statements* if all of the following conditions exist:

- a. The nonattest services were provided prior to *period of the professional engagement*.
- b. The nonattest services related to periods prior to the period covered by the *financial statements*.
- c. The *financial statements* for the period to which the nonattest services relate were audited by another *firm* (or in the case of a review engagement, reviewed or audited by another *firm*).

Nonauthoritative questions and answers regarding the period of the professional engagement are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

**.04** *Activities related to attest services.* Performing attest services often involves communications between the member and *client* management regarding

- a. the *client's* selection and application of accounting standards or policies and *financial statement* disclosure requirements;
- b. the appropriateness of the *client's* methods used in determining accounting and financial reporting;
- c. adjusting journal entries that the member has prepared or proposed for *client* management consideration; and
- d. the form or content of the *financial statements*.

These communications are considered a normal part of the *attest engagement* and are not considered nonattest services subject to the "General Requirements for Performing Nonattest Services" [1.295.040] and "Documentation Requirements When Providing Nonattest Services" [1.295.050] interpretations.

**.05** However, the member should exercise judgment in determining whether his or her involvement has become so extensive that it would constitute performing a separate service which would be subject to the "General Requirements for Performing Nonattest Services" interpretation [1.295.040].

**.06** For example, activities such as *financial statement* preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the *attest engagement* and, therefore, constitute a nonattest service. Such activities would not *impair independence* if the requirements of the *interpretations* of the "Nonattest Services" subtopic [1.295] are met.

Nonauthoritative questions and answers regarding routine activities are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

**.07** *Engagements subject to independence rules of certain regulatory or standard-setting bodies.* *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a member is not in compliance with the *independence* regulations of authoritative regulatory bodies that are more restrictive than the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" (examples of such authoritative bodies are the SEC, the Government Accountability Office [GAO], the Department of Labor [DOL], the Public Company Accounting Oversight Board [PCAOB], and state boards of accountancy) when a member performs nonattest services for an *attest client* and is required to be independent of the *attest client* under the regulations of the applicable regulatory body. Independence would be *impaired* under these circumstances. [Prior reference: paragraph .05 of ET section 101]

**Effective Date**

.08 Paragraph .06 of this interpretation is effective for engagements covering periods beginning on or after December 15, 2014.

**1.295.020 Cumulative Effect on Independence When Providing Multiple Nonattest Services**

.01 The *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" [1.200.001] include various examples of nonattest services that individually would not *impair independence* because the *safeguards* in the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] reduce the self-review and management participation *threats* to an *acceptable level*. However, performing multiple nonattest services can increase the significance of these *threats* as well as other *threats* to *independence*.

.02 Before agreeing to perform nonattest services, the member should evaluate whether the performance of multiple nonattest services by the *member* or *member's firm* in the aggregate creates a significant *threat* to the member's *independence* that cannot be reduced to an *acceptable level* by the application of the *safeguards* in the "General Requirements for Performing Nonattest Services" interpretation [1.295.040].

.03 In situations in which a member determines that *threats* are not at an *acceptable level*, *safeguards* in addition to those in the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] should be applied to eliminate the *threats* or reduce them to an *acceptable level*. If no *safeguards* exist that will eliminate or reduce the *threats* to an *acceptable level*, *independence* would be *impaired*.

.04 For purposes of this interpretation, the member is not required to consider the possible *threats* to *independence* created due to the provision of nonattest services by other *network firms* within the *firm's network*. [Prior reference: paragraph .05 of ET section 101]

**Effective Date**

.05 This interpretation is effective for engagements covering periods beginning on or after December 15, 2014.

**1.295.030 Management Responsibilities**

.01 If a member were to assume a management responsibility for an *attest client*, the management participation *threat* would be so significant that no *safeguards* could reduce the *threat* to an *acceptable level* and *independence* would be *impaired*. It is not possible to specify every activity that is a management responsibility. However, management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

.02 Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered management responsibilities and, as such, *impair independence* if performed for an *attest client*, include

- a. setting policy or strategic direction for the *attest client*.
- b. directing or accepting responsibility for actions of the *attest client's* employees except to the extent permitted when using



- internal auditors to provide assistance for services performed under auditing or attestation standards.
- c. authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of an *attest client* or having the authority to do so.
  - d. preparing *source documents*, in electronic or other form, that evidence the occurrence of a transaction.
  - e. having custody of an *attest client's* assets.
  - f. deciding which recommendations of the member or other third parties to implement or prioritize.
  - g. reporting to *those charged with governance* on behalf of management.
  - h. serving as an *attest client's* stock transfer or escrow agent, registrar, general counsel or equivalent.
  - i. accepting responsibility for the management of an *attest client's* project.
  - j. accepting responsibility for the preparation and fair presentation of the *attest client's financial statements* in accordance with the applicable financial reporting framework.
  - k. accepting responsibility for designing, implementing, or maintaining internal control.
  - l. performing ongoing evaluations of the *attest client's* internal control as part of its monitoring activities.

[Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding management responsibilities and controllership services are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

### **1.295.040 General Requirements for Performing Nonattest Services**

.01 When a member performs a nonattest service for an *attest client*, *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist. Unless an *interpretation* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" states otherwise, *threats* would be at an *acceptable level*, and *independence* would not be *impaired*, when all the following *safeguards* are met:

- a. The member determines that the *attest client* and its management agree to
  - i. assume all management responsibilities as described in the "Management Responsibilities" interpretation [1.295.030].
  - ii. oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

- iii. evaluate the adequacy and results of the services performed.
  - iv. accept responsibility for the results of the services.
- b. The member does not assume management responsibilities (See the "Management Responsibilities" interpretation [1.295.030] of the "Independence Rule") when providing nonattest services and the member is satisfied that the *attest client* and its management will
- i. be able to meet all of the criteria delineated in item *a*;
  - ii. make an informed judgment on the results of the member's nonattest services; and
  - iii. accept responsibility for making the significant judgments and decisions that are the proper responsibility of management.

If the *attest client* is unable or unwilling to assume these responsibilities (for example, the *attest client* cannot oversee the nonattest services provided or is unwilling to carry out such responsibilities due to lack of time or desire), the member's performance of nonattest services would *impair independence*.

- c. Before performing nonattest services the member establishes and documents in writing his or her understanding with the *attest client* (board of directors, audit committee, or management, as appropriate in the circumstances) regarding
- i. objectives of the engagement,
  - ii. services to be performed,
  - iii. *attest client's* acceptance of its responsibilities,
  - iv. member's responsibilities, and
  - v. any limitations of the engagement.

**.02** The *safeguards* in paragraph .01 and the "Documentation Requirements When Providing Nonattest Services" interpretation [1.295.050] of the "Independence Rule" [1.200.001] do not apply to certain routine activities performed by the member, such as providing advice and responding to the *attest client's* questions as part of the *client*-member relationship. However, in providing such services, the member must not assume management responsibilities, as described in the "Management Responsibilities" interpretation [1.295.030] of the "Independence Rule." [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding suitable skill, knowledge, and experience are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

### **1.295.050 Documentation Requirements When Providing Nonattest Services**

**.01** Before performing nonattest services, the member should document in writing the member's understanding established with the *attest client*, as described in paragraph .01c of the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001].

**.02** Failure to prepare the required documentation does not *impair independence* provided that the member did establish the understanding with the *attest client*. However, failure to prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001].

**.03** The documentation requirement does not apply to nonattest services performed prior to the *period of the professional engagement* for an *attest client*. However, for nonattest services provided during the period covered by the *financial statements*, the member should document in writing that the requirements of the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] were met prior to the *period of the professional engagement*, including the requirement to establish an understanding with the *attest client*. [Prior reference: paragraph .05 of ET section 101]

Sample language for how to document your understanding with the attest client is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

### 1.295.105 Advisory Services

**.01** Self-review or management participation *threats* to compliance with the "Independence Rule" [1.200.001] may exist when a member performs advisory services for an *attest client*.

**.02** If the member's services are only advisory in nature and the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. provide advice, research materials, and recommendations to assist management in performing its functions and making decisions.
- b. attend board meetings as a nonvoting advisor.
- c. interpret *financial statements*, forecasts, or other analyses.
- d. provide management with advice regarding its potential plans, strategies, or relationships.

**.03** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a member assumes any management responsibilities, as described in the "Management Responsibilities" interpretation [1.295.030]. Accordingly, *independence* is *impaired*. [Prior reference: paragraph .05 of ET section 101 and paragraphs .015–.016 of ET section 191]

### 1.295.110 Appraisal, Valuation, and Actuarial Services

**.01** Self-review or management participation *threats* to compliance with the "Independence Rule" [1.200.001] may exist when a member performs appraisal, valuation, or actuarial service for an *attest client*.

**.02** *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the member performs an appraisal, a valuation, or an actuarial service for an *attest client* when (a) the services involve a significant degree of subjectivity and (b) the results of the service, individually or when

combined with other valuation, appraisal, or actuarial services, are material to the *attest client's financial statements*. Accordingly, *independence* would be *impaired* under these circumstances.

**.03** When performing appraisal, valuation, and actuarial services for an *attest client* that are permitted under this interpretation, all requirements of the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001] should be met, including that all significant assumptions and matters of judgment are determined or approved by the *attest client*, and the *attest client* is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

### **Valuations Involving a Significant Degree of Subjectivity**

**.04** Examples of valuations that generally involve a significant degree of subjectivity include, ESOPs, business combinations, or appraisals of assets or liabilities. Accordingly, if these services produce results that are material to the *attest client's financial statements*, *independence* would be *impaired*.

### **Actuarial Valuations of Pension or Postemployment Benefit Liabilities**

**.05** An actuarial valuation of an *attest client's* pension or postemployment benefit liabilities generally does not involve a significant degree of subjectivity because reasonably consistent results are produced when the same assumptions and information are used in performing the valuation. Therefore, *threats* would be at an *acceptable level* and *independence* would not be *impaired*.

### **Appraisal, Valuations, and Actuarial Services for Nonfinancial Statement Purposes**

**.06** *Threats* would be at an *acceptable level* if a member provided appraisal, valuation, or actuarial services solely for nonfinancial statement purposes. Some examples are appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. Accordingly, *independence* would not be *impaired*. [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding appraisal, valuation, and actuarial services are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

### **1.295.115 Benefit Plan Administration**

**.01** When a member provides benefit plan administration services to an *attest client*, self-review and management participation *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist.

**.02** Notwithstanding the conclusions reached in paragraph .03 of this interpretation, a member should comply with the more restrictive independence provisions of the Employee Retirement Income Security Act (ERISA) of 1974 and DOL regulations when performing audits of employee benefit plans subject to those regulations.

**.03** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule"

[1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, the member may

- a. communicate summary plan data to a plan trustee.
- b. advise management regarding the application and impact of provisions in a plan document.
- c. process certain transactions that have been initiated by plan participations or approved by the plan administrators using the member's electronic media, such as an interactive voice response system or Internet connection or other media. Such transactions may include processing investment or benefit elections, changes in contributions to the plan, data entry, participant confirmations, and distributions and *loans*.
- d. prepare account valuations for plan participants using data collected through the member's electronic or other media.
- e. prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other media.

**.04** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if, for example, a member

- a. makes policy decisions on behalf of management.
- b. interprets the provisions in a plan document for a plan participant on behalf of management without first obtaining management's concurrence.
- c. makes disbursements on behalf of the plan.
- d. has custody of the plan's assets.
- e. serves in a fiduciary capacity, as defined by ERISA. [Prior reference: paragraph .05 of ET section 101]

### **1.295.120 Bookkeeping, Payroll, and Other Disbursements**

**.01** When a member provides bookkeeping, payroll, and other disbursement services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. record transactions to an *attest client's* general ledger when management has determined or approved the account classifications for the transaction.
- b. post *client*-coded transactions to an *attest client's* general ledger.
- c. prepare *financial statements* based on information in the *attest client's* trial balance.
- d. post *client*-approved journal or other entries to an *attest client's* trial balance.
- e. propose standard, adjusting, or correcting journal entries or other changes affecting the *financial statements* to the *attest client*. Prior to the member posting these journal entries or changes,

the member should be satisfied that management has reviewed the entries and understands the nature of the proposed entries and the effect the entries will have on the *attest client's financial statements*.

- f. generate unsigned checks using *source documents* or other records provided and approved by the *attest client*.
- g. process an *attest client's* payroll using payroll time records that the *attest client* has provided and approved.
- h. transmit *client*-approved payroll or other disbursement information to a bank or similar entity subsequent to the *attest client's* review and authorization for the member to make the transmission. Prior to such transmission, the *attest client* is responsible for making the arrangements with the bank or similar entity to limit the corresponding individual payments regarding the amount and payee. In addition, once transmitted, the *attest client* must authorize the bank or similar entity to process the payroll information.
- i. prepare a reconciliation (for example, bank and accounts receivable) that identifies reconciling items for the *client's* evaluation.

**.03** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. determines or changes journal entries, any account coding or classification of transactions, or any other accounting records without first obtaining the *attest client's* approval.
- b. authorizes or approves transactions.
- c. prepares *source documents*.
- d. makes changes to *source documents* without the *attest client's* approval.
- e. accepts responsibility to authorize payment of *attest client* funds, electronically or otherwise, except for electronic payroll tax payments when the member complies with the requirements of the "Tax Services" interpretation [1.295.160] of the "Independence Rule."
- f. accepts responsibility to sign or cosign an *attest client's* checks, even if only in emergency situations.
- g. maintains an *attest client's* bank account or otherwise has custody of an *attest client's* funds or makes credit or banking decisions for the *attest client*.
- h. approves vendor invoices for payment. [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers about bookkeeping services are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

### 1.295.125 Business Risk Consulting

**.01** When a member provides business risk consulting services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. assist management in its assessment of the *attest client's* business risk control processes.
- b. recommend improvements to an *attest client's* business risk control processes and assists in the implementation of these improvements.

**.03** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. makes or approves business risk decisions.
- b. presents business risk considerations to the board or others on behalf of management. [Prior reference: paragraph .05 of ET section 101]

### 1.295.130 Corporate Finance Consulting

**.01** When a member provides corporate finance consulting services to an *attest client*, self-review, management participation, and advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. assist management in developing its corporate strategies.
- b. assist management in identifying possible sources of capital that meet the *attest client's* specifications or criteria.
- c. introduce management to possible sources of capital that meet the *attest client's* specifications or criteria.
- d. assist management in analyzing the effects of proposed transactions with potential buyers, sellers, or capital sources.
- e. advise an *attest client* during its negotiations with potential buyers, sellers, or capital sources.
- f. assist the *attest client* in drafting its offering document or memorandum.
- g. participate with management in its transaction negotiations in an advisory capacity.
- h. be named as a financial adviser in an *attest client's* private placement memoranda or offering documents.

**.03** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to

an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest client* to the terms of a transaction.
- b. consummates a transaction on behalf of the *attest client*.
- c. acts as a promoter, an underwriter, a broker-dealer, or a guarantor of an *attest client's* securities or as a distributor of private placement memoranda or offering documents.
- d. maintains custody of an *attest client's* securities. [Prior reference: paragraph .05 of ET section 101]

### **1.295.135 Executive or Employee Recruiting**

**.01** When a member provides executive or employee recruiting services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. recommend a position description or candidate specifications.
- b. solicit and screen candidates based on *client*-approved criteria, such as required education, skills, or experience.
- c. recommend qualified candidates to the *attest client* for their consideration based on *client*-approved criteria.
- d. participate in employee hiring or compensation discussions in an advisory capacity.

**.03** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest client* to employee compensation or benefit arrangements.
- b. hires or terminates the *attest client's* employees. [Prior reference: paragraph .05 of ET section 101]

### **1.295.140 Forensic Accounting**

**.01** *Forensic accounting services*. For purposes of this interpretation, forensic accounting services are nonattest services that involve the application of (a) special skills in accounting, auditing, finance, quantitative methods or certain areas of the law, and research and (b) investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings. Forensic accounting services consist of investigative services and litigation services.

**.02** *Attest client*. For purposes of this interpretation, the term *attest client* refers to an underlying party to the litigation for whom the member is providing services, not the law firm that engages the member on behalf of the law firm's client. If the law firm that engages the member on behalf of the member's *attest client* is also an *attest client* of the member, the member should consider the applicability of the "Cooperative Arrangements With Attest Clients" interpretation [1.265.010] of the "Independence Rule" [1.200.001].

**.03** *Investigative services*. For purposes of this interpretation, investigative services include all forensic services that do not involve actual or threatened



litigation, such as performing analyses or investigations that may require the same skills used in litigation services. When a member provides investigative services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. However, if the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* will be at an *acceptable level* and *independence* will not be *impaired*.

**.04 Litigation services.** For purposes of this interpretation, litigation services recognize the role of the member as an expert or a consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of expert witness services, litigation consulting services, or other litigation services:

- a. *Expert witness services.* For purposes of this interpretation, expert witness services are those litigation services in which a member is engaged to render an opinion before a trier of fact about the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events:
  - i. Expert witness services create the appearance that a member is advocating or promoting an *attest client's* position. Therefore, the advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, if a member is engaged conditionally or unconditionally to provide expert witness services or expert testimony for an *attest client*, *independence* would be *impaired*, except as discussed in the following item ii.
  - ii. *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and *independence* would not be *impaired*, if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more *attest clients* of the *firm*, provided that at the outset of the engagement
    1. the member's *attest clients* constitute less than 20 percent of the members of the group, voting interests of the group, and the claim;
    2. no *attest client* within the group is designated as the lead plaintiff or defendant of the group; and
    3. no *attest client* has the sole decision-making power to select or approve the selection of the expert witness.
  - iii. *Fact witness testimony.* Acting as a fact witness (also referred to as a "percipient witness" or "sensory witness") would not be considered a nonattest service. Fact witness testimony is based on the member's direct knowledge of the matters, facts, or events in dispute obtained through the member's performance of prior *professional services* for the *attest client*. As a fact witness, the member's role is to provide factual testimony to the trier of fact. While testifying as a fact witness, the trier of fact or counsel may question a member about the member's opinions pertaining to matters within the member's area of expertise.

Answering such questions would not *impair* the member's *independence*.

- iv. In determining whether the member's services are considered expert witness services or fact witness testimony, members should refer to Rules 701–703 of Article VII, "Opinions and Expert Testimony," of the *Federal Rules of Evidence* and also refer to other applicable laws, regulations, and rules.
  - v. When providing expert witness services or fact witness testimony, members are required to comply with the "Integrity and Objectivity Rule" [1.100.001].
- b. *Litigation consulting services.* For purposes of this interpretation, litigation consulting services are those litigation services in which a member provides advice about the facts, issues, or strategy pertaining to a matter. The consultant does not testify as an expert witness before a trier of fact:
- i. When a member provides litigation consulting services, advocacy and management participation *threats* to the *covered member's* compliance with the "Independence Rule" may exist. If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For purposes of complying with paragraph .01b of the "General Requirements for Performing Nonattest Services" interpretation of the "Independence Rule," the *attest client* may designate its attorney to oversee the litigation consulting services.
  - ii. However, if the member providing litigation consulting services subsequently agrees to serve as an expert witness, *threats* to the member's compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.
- c. *Other litigation services.* The advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a member serves as a trier of fact, a special master, a court-appointed expert, or an arbitrator (including serving on an arbitration panel) in a matter involving an *attest client*. These services create the appearance that the member is not independent; accordingly, *independence* would be *impaired*.
- d. However, if the member applies the "General Requirements for Performing Nonattest Services" interpretation of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired* when a member serves as a mediator or any similar role in a matter involving an *attest client*, provided that the member is not making any decisions on behalf of the parties but, rather, is acting as a facilitator by assisting the parties in reaching their own agreement. When providing such services, the member should consider the requirements of the "Conflicts of

Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule." [Prior reference: paragraph .05 of ET section 101]

.05 See [www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf](http://www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf) for information about transition provision for engagements commenced prior to February 28, 2007.

.06 When providing any type of forensic accounting service, members are required to comply with the "Integrity and Objectivity Rule" [1.100.001].

### **1.295.145 Information Systems Design, Implementation, or Integration**

.01 When a member provides information systems design, implementation, or integration services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. install or integrate an *attest client's* financial information system that the member did not design or develop (for example, an off-the-shelf accounting package).
- b. assist in setting up the *attest client's* chart of accounts and *financial statement* format with respect to the *attest client's* financial information system.
- c. design, develop, install, or integrate an *attest client's* information system that is unrelated to the *attest client's financial statements* or accounting records.
- d. provide training and instruction to an *attest client's* employees on an information and control system.
- e. perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings consistent with management's request.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. designs or develops an *attest client's* financial information system.
- b. makes other than insignificant modifications to source code underlying an *attest client's* existing financial information system.
- c. supervises *attest client* personnel in the daily operation of an *attest client's* information system.
- d. operates an *attest client's* network. [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding information systems design, implementation, and integration services are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

### 1.295.150 Internal Audit

.01 For purposes of this interpretation, internal audit services involve assisting the *attest client* in the performance of its internal audit activities, sometimes referred to as "internal audit outsourcing." When a member provides internal audit services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 The *attest client's* management is responsible for directing the internal audit function, including the management thereof. Such responsibilities include, but are not limited to, designing, implementing and maintaining internal control. *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, cannot be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if the *attest client* outsources the internal audit function to the member, whereby the member, in effect, manages the *attest client's* internal audit activities.

.03 However, except for the outsourcing services discussed in paragraph .02, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if the member assists the *attest client* in performing financial and operational internal audit activities, provided that, in addition to the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," the member is satisfied that management

- a. designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for the internal audit function.
- b. determines the scope, risk, and frequency of internal audit activities, including those the member will perform in providing the services.
- c. evaluates the findings and results arising from the internal audit activities, including those the member will perform in providing the services.
- d. evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures.

.04 For example, if the member applies the *safeguards* in paragraph .03, the member may assess whether performance is in compliance with management's policies and procedures, identify opportunities for improvement, and recommend improvement or further action for management consideration and decision making.

.05 The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. The member should also be satisfied that *those charged with governance* are informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide *those charged with governance* a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

.06 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, in addition to those activities listed in the "Management Responsibilities" interpretation [1.295.030] of the "Independence Rule," a member

- a. performs ongoing evaluations (see paragraph .10 that follows) or control activities (for example, reviewing *loan* originations as part of the *attest client's* approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed or accounted for, or both, and performs routine activities in connection with the *attest client's* operating or production processes that are equivalent to those of an ongoing compliance or quality control function.
- b. performs separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the *attest client's* business process.
- c. has *attest client* management rely on the member's work as the primary basis for the *attest client's* assertions on the design or operating effectiveness of internal controls.
- d. determines which, if any, recommendations for improving the internal control system should be implemented.
- e. reports to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function.
- f. approves or is responsible for the overall internal audit work plan, including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures.
- g. is connected with the *attest client* as an employee or in any capacity equivalent to a member of management (for example, being listed as an employee in the *attest client's* directories or other *attest client* publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the *attest client's* internal audit function, or using the *attest client's* letterhead or internal correspondence forms in communications).

**.07** *Monitoring activities.* Designing, implementing, or maintaining the *attest client's* monitoring activities are management responsibilities. Accordingly, *independence* would be *impaired* if a member accepts responsibility for performing such activities. Monitoring activities are procedures performed to assess whether components of internal control are present and functioning. Monitoring can be done through ongoing evaluations, separate evaluations, or some combination of the two. Ongoing evaluations are generally defined, routine operations built in to the *attest client's* business processes and performed on a real-time basis. Ongoing evaluations, including managerial activities and everyday supervision of employees, monitor the presence and functioning of the components of internal control in the ordinary course of managing the business. A member who performs such activities for an *attest client* would be considered to be accepting responsibility for maintaining the *attest client's* internal control. Accordingly, the management participation *threat* created by a member performing ongoing evaluations is so significant that no *safeguards* could reduce the *threat* to an *acceptable level*, and thus *independence* would be *impaired*.

**.08** Separate evaluations are conducted periodically and generally not ingrained within the business but can be useful in taking a fresh look at whether internal controls are present and functioning. Such evaluations include observations, inquiries, reviews, and other examinations, as appropriate, to ascertain whether controls are designed, implemented, and conducted. The scope and frequency of separate evaluations is a matter of judgment and vary depending on

assessment of risks, effectiveness of ongoing evaluations, and other considerations. Because separate evaluations are not built into the *attest client's* business process, separate evaluations generally do not create a significant management participation *threat to independence*.

**.09** Members should refer to the Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) *Internal Control—Integrated Framework*, for additional guidance on monitoring activities and distinguishing between ongoing and separate evaluations.

**.10** Members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation *threat to independence*, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall *financial statements* of the *client*, as well as the frequency of the internal audit services. If the *threat to independence* is considered significant, the member should apply *safeguards* to eliminate or reduce the *threat* to an *acceptable level*. If no *safeguards* could reduce the *threat* to an *acceptable level*, then *independence* would be *impaired*.

**.11** *Attest-related services*. Services considered extensions of the member's audit scope applied in the audit of the *attest client's financial statements*, such as confirming accounts receivable and analyzing fluctuations in account balances, are not considered internal audit services and would be subject to this interpretation even if the extent of such testing exceeds that required by generally accepted auditing standards (GAAS). In addition, engagements performed under the attestation standards would not be considered internal audit services and, therefore, would not *impair independence*.

**.12** When a member performs internal audit services that would not *impair independence* under this interpretation and is subsequently engaged to perform an attestation engagement to report on management's assertion regarding the effectiveness of its internal control, *independence* would not be considered *impaired*, provided the member is satisfied that *attest client* management does not rely on the member's work as the primary basis for its assertion. [Prior reference: paragraph .05 of ET section 101]

### **1.295.155 Investment Advisory or Management**

**.01** When a member provides investment advisory or management services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

**.02** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. recommend the *attest client's* allocation of funds among various investments or asset classes based upon the *attest client's* desired rate of return, risk tolerance, or other parameters.
- b. perform recordkeeping and reporting of the *attest client's* portfolio balances, including providing the *attest client* with a comparative analysis of the *attest client's* investments to third-party benchmarks.
- c. evaluate the manner in which an *attest client's* portfolio is being managed by investment account managers, including assessing whether the managers are

- i. following the guidelines of the *attest client's* investment policy statement.
  - ii. meeting the *attest client's* investment objectives.
  - iii. conforming to the *attest client's* stated investment parameters or risk tolerance.
- d. transmit an *attest client's* investment selection, with the *attest client's* consent, to the *attest client's* broker-dealer or equivalent, provided that the *attest client* has authorized the broker-dealer or equivalent to execute the transaction.

**.03** However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. makes investment decisions on behalf of management or otherwise has discretionary authority over an *attest client's* investments.
- b. executes a transaction to buy or sell an *attest client's* investments.
- c. has custody of an *attest client's* assets, such as taking temporary possession of securities purchased by an *attest client*. [Prior reference: paragraph .05 of ET section 101]

### 1.295.160 Tax Services

**.01** For purposes of this interpretation, tax services include preparation of a tax return, transmittal of a tax return, and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, having a power of attorney limited strictly to tax matters; and authorized representation of *attest clients* in administrative proceedings before a taxing authority.

**.02** For purposes of this interpretation, a tax return includes all tax filings, including informational tax forms (such as estimated tax vouchers), extension forms, and Forms 990, 5500, 1099, and W-2, filed with a taxing authority or other regulatory agency.

**.03** *Preparation and transmittal.* When a member prepares a tax return and transmits the tax return and related tax payment to a taxing authority in paper or electronic form, self-review and management participation *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist. If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the member does not have custody or control over the *attest client's* funds or assets and the individual designated by the *attest client* to oversee the tax services

- a. reviews and approves the tax return and related tax payment.
- b. if required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

The following are not considered having custody or control over an *attest client's* funds: making electronic tax payments authorized by an *attest client* pursuant to a taxing authority's prescribed criteria (as discussed in paragraph .04), affixing the *attest client's* depository account information on a tax return, or remitting an *attest client's* check made payable to the taxing authority.

**.04** If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule"

[1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* when a member signs and files a tax return on behalf of management, provided that the member has the legal authority to do so and

- a. the taxing authority has prescribed procedures in place for an *attest client* to permit a member to sign and file a tax return on behalf of the *attest client* (for example, Forms 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in Form 8879, or
- b. an individual in management who is authorized to sign and file the *attest client's* tax return provides the member with a signed statement that clearly identifies the return being filed and represents that such individual
  - i. is authorized to sign and file the tax return.
  - ii. has reviewed the tax return, including accompanying schedules and statements, and it is true, correct, and complete to the best of the individual's knowledge and belief.
  - iii. authorizes the *member* or another named individual in the *member's firm* to sign and file the tax return on the *attest client* behalf.

**.05** *Authorized representation in administrative proceedings.* If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* if a member acts as the *attest client's* authorized representative in administrative proceedings before a taxing authority, provided that the member obtains the *attest client's* agreement prior to committing the *attest client* to a specific resolution with the taxing authority. [Prior reference: paragraph .05 of ET section 101]

**.06** *Power of attorney.* When a member has an *attest client's* power of attorney, the self-review, management participation, and advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the member's use of the power of attorney is limited strictly to tax matters and the member does not bind the *attest client* to any agreement with a taxing authority or other regulatory agency. [No prior reference: new content]

**.07** *Representation in court.* *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* through the application of *safeguards*, and *independence* would be *impaired* if a member represents an *attest client* in court to resolve a tax dispute. For purposes of this interpretation, court encompasses a tax, district, or federal court of claims and the equivalent state, local, or foreign forums. [Prior reference: paragraph .05 of ET section 101]

**.08** For information about transition provision for engagements commenced prior to February 28, 2007, see [www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf](http://www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf).

### **Effective Date**

**.09** Paragraph .06 of this interpretation is effective December 15, 2014.



A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsNonAttestServices.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsNonAttestServices.doc).

In addition, nonauthoritative questions and answers regarding performance tax services are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.doc).

## **1.297 Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements**

### ***1.297.010 Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements***

**.01** The "Independence Rule" [1.200.001] and its *interpretations* apply to all *attest engagements*. However, when performing engagements to issue reports in accordance with Statements on Standards for Attestation Engagements (SSAEs), when *independence* is required or when the *member's* compilation report does not disclose a lack of *independence*, the *covered member* needs to be independent with respect to the responsible party(ies), as defined in the SSAEs.

**.02** If the individual or entity that engages the *covered member* is not the responsible party, the *covered member* need not be independent of that individual or entity. However, the *covered member* should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001], with regard to any relationships that may exist with the individual or entity that engages the *covered member* to perform these services.

**.03** In addition, application of the "Independence Rule" [1.200.001] is further modified as set forth in the "Agreed-Upon Procedures Engagements in Accordance With SSAEs" interpretation [1.297.020] and the "Engagements, Other Than AUPs, Performed in Accordance With SSAEs" interpretation [1.297.030] of the "Independence Rule." [Prior reference: paragraph .13 of ET section 101]

### ***1.297.020 Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs***

**.01** For purposes of this interpretation, subject matter is as defined in the SSAEs.

**.02** When performing agreed-upon procedures (AUP) engagements in accordance with the SSAEs, the application of the "Independence Rule" [1.200.001] is modified, as described in the "Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation [1.297.010] of the "Independence Rule" and this interpretation.

**.03** When providing nonattest services that would otherwise *impair independence* under the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the nonattest services do not relate to the specific subject matter of the SSAE engagement. *Threats* would be at an *acceptable level* and *independence* would also not be *impaired* if the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" were not applied when providing the nonattest services, provided that the nonattest services do not relate to the specific subject matter of the AUP engagement.

**.04** In addition, when performing an AUP engagement under the SSAEs, *threats* would be at an *acceptable level* and *independence* would not be *impaired*, if the following *covered members* and their *immediate families* are independent of the responsible party(ies):

- a. Individuals participating on the AUP engagement team
- b. Individuals who directly supervise or manage the AUP engagement *partner* or *partner equivalent*
- c. Individuals who consult with the *attest engagement team* regarding technical or industry-related issues specific to the AUP engagement

**.05** Furthermore, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if the *firm* had a material financial relationship with the responsible party(ies) that was covered by any of the following interpretations of the "Independence Rule":

- a. Paragraph .02 of "Overview of Financial Interests" [1.240.010]
- b. "Trustee or Executor" [1.245.010]
- c. "Joint Closely Held Investments" [1.265.020]
- d. "Loans" [1.260.010] [Prior reference: paragraph .13 of ET section 101]

### **Effective Date**

**.06** The addition of *partner equivalents* to paragraph .04 is effective for engagements covering periods beginning on or after December 15, 2014.

### **1.297.030 Engagements, Other Than AUPs, Performed in Accordance With SSAEs**

**.01** For purposes of this interpretation, subject matter is as defined in the SSAEs.

**.02** When performing an engagement, other than an AUP, in accordance with the SSAEs, the application of the "Independence Rule" [1.200.001] is modified, as described in the "Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation [1.297.010] of the "Independence Rule" and this interpretation.

**.03** When providing nonattest services that would otherwise *impair independence* under the *interpretations* of the "Nonattest Services" subtopic [1.295],

*threats* would be at an *acceptable level* and *independence* would not be *impaired* if the following safeguards are met:

- a. Nonattest services do not relate to the specific subject matter of the SSAE engagement.
- b. The "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001] are met when providing the nonattest service. [Prior reference: paragraph .13 of ET section 101]

## 1.300 General Standards

### 1.300.001 General Standards Rule

**.01** A *member* shall comply with the following standards and with any *interpretations* thereof by bodies designated by *Council*:

- a. Professional Competence. Undertake only those *professional services* that the *member* or the *member's firm* can reasonably expect to be completed with professional competence.
- b. Due Professional Care. Exercise due professional care in the performance of *professional services*.
- c. Planning and Supervision. Adequately plan and supervise the performance of *professional services*.
- d. Sufficient Relevant Data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any *professional services* performed.

(See appendix A, "*Council* Resolution Designating Bodies to Promulgate Technical Standards.") [Prior reference: paragraph .01 of ET section 201]

### Interpretations Under the General Standards Rule

#### 1.300.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

**.01** In the absence of an *interpretation* of the "General Standards Rule" [1.300.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

**.02** A *member* would be considered in violation of the "General Standards Rule" [1.300.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

**.03** A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

### **Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

### **1.300.010 Competence**

.01 Competence, in this context, means that the *member* or *member's* staff possess the appropriate technical qualifications to perform *professional services* and that the *member*, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession's standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of *professional services*.

.02 A *member's* agreement to perform *professional services* implies that the *member* has the necessary competence to complete those services according to professional standards and to apply the *member's* knowledge and skill with reasonable care and diligence. However, the *member* does not assume a responsibility for infallibility of knowledge or judgment.

.03 The *member* may have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing *professional services* involves performing additional research or consulting with others to gain sufficient competence.

.04 If a *member* is unable to gain sufficient competence, the *member* should suggest, in fairness to the *client* and public, the engagement of a competent person to perform the needed *professional service*, either independently or as an associate. [Prior reference: paragraph .02 of ET section 201]

### **1.300.020 Supervision of a Specialist on Consulting Engagements**

.01 A *member* who employs a specialist to perform consulting services for the *member's clients* must be qualified to supervise and evaluate the work of that specialist. Although the *member* is not required to be able to perform each of the specialist's tasks, the *member* should be able to define the tasks and evaluate the end product. [Prior reference: paragraphs .017–.018 of ET section 291]

### **1.300.030 Submission of Financial Statements**

.01 When a *member* prepares or submits *financial statements* as a stockholder, a partner, a director, an officer, or an employee of an entity using the *firm's* letterhead or similar identification, the *member* should comply with the "Compliance With Standards Rule" [1.310.001], including any requirements to disclose a lack of *independence* in the *member's* report.

.02 Refer to the "Use of a CPA Credential" interpretation [2.400.100] of the "Acts Discreditable Rule" [2.400.001] and the "Submission of Financial Statements" interpretation [2.300.030] of the "General Standards Rule" [2.300.001] for additional guidance. [Prior reference: paragraphs .019–.020 of ET section 291]

## 1.300.040 Use of a Third-Party Service Provider

**.01** A *member* who uses a *third-party service provider* to assist the *member* in providing *professional services* such as bookkeeping, tax preparation, or consulting or attest services, including related clerical or data entry functions, is required to comply with the "General Standards Rule" [1.300.001] and the "Compliance With Standards Rule" [1.310.001]. To accomplish this,

- a. before using a *third-party service provider*, the *member* should ensure that the *third-party service provider* has the required professional qualifications, technical skills, and other resources. Factors that can be helpful in evaluating a prospective *third-party service provider* include business, financial, and personal references from banks, other CPAs, and other customers of the *third-party service provider*; the *third-party service provider's* professional reputation and recognition in the community; published materials (articles and books that he or she has authored); and the *member's* personal evaluation of the *third-party service provider*.
- b. the *member* must adequately plan and supervise the *third-party service provider's professional services* so that the *member* ensures that the services are performed with competence and due professional care. The *member* must also obtain sufficient relevant data to support the work product and comply with all technical standards applicable to the *professional services*.

**.02** The *member's* responsibility for planning and supervising the *third-party service provider's* work does not extend beyond the requirements of applicable professional standards, which may vary depending upon the nature of the *member's* engagement.

**.03** Refer to the "Use of a Third-Party Service Provider" interpretation [1.150.040] of the "Integrity and Objectivity Rule" [1.100.001] and the "Disclosing Information to a Third-Party Service Provider" interpretation [1.700.040] of the "Confidential Client Information Rule" [1.700.001] for additional guidance. [Prior references: paragraphs .015--.016 and .023--.024 of ET section 291]

A nonauthoritative basis-for-conclusion document summarizing considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsOutsourcing.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsOutsourcing.pdf).

## 1.310 Compliance With Standards

### 1.310.001 Compliance With Standards Rule

**.01** A *member* who performs auditing, review, compilation, management consulting, tax, or other *professional services* shall comply with standards promulgated by bodies designated by *Council*.

**.02** See Appendix A "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 202]

## Interpretations Under the Compliance with Standards Rule

### 1.310.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Compliance With Standards Rule" [1.310.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Compliance With Standards Rule" [1.310.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

#### **Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

## 1.320 Accounting Principles

### 1.320.001 Accounting Principles Rule

.01 A *member* shall not (1) express an opinion or state affirmatively that the *financial statements* or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by *Council* to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the *member* can demonstrate that due to unusual circumstances the *financial statements* or data would otherwise have been misleading, the *member* can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

.02 See appendix A "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 203]

## Interpretations Under the Accounting Standards Rule

### 1.320.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Accounting Principles Rule" [1.320.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Accounting Principles Rule" [1.320.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

### **Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

## **1.320.010 Responsibility for Affirming That Financial Statements Are in Conformity With the Applicable Financial Reporting Framework**

.01 A *member* shall not state affirmatively that an entity's *financial statements* or other financial data are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by *Council* to establish such principles. *Members* who affirm that *financial statements* or other financial data are presented in conformity with GAAP should comply with the "Accounting Principles Rule" [1.320.001]. A *member's* representation in a letter or other communication that an entity's *financial statements* are in conformity with GAAP may be considered an affirmative statement within the meaning of this rule with respect to the *member* who signed the letter or other communication (for example, the *member* signed a report to a regulatory authority). [Prior reference: paragraph .05 of ET section 203]

## **1.320.020 Status of Financial Accounting Standards Board, Governmental Accounting Standards Board, Federal Accounting Standards Advisory Board, and International Accounting Standards Board Interpretations**

.01 The "Accounting Principles Rule" [1.320.001] authorizes *Council* to designate bodies to establish accounting principles. *Council* has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB *Accounting Standards Codification*<sup>®</sup> (ASC) constitutes accounting principles as contemplated in the rule. *Council* designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities, pursuant to the "Accounting Principles Rule." *Council* designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities, pursuant to the "Accounting Principles Rule." *Council* designated the International Accounting Standards Board (IASB) as an accounting body for purposes of establishing international financial accounting and reporting principles.

.02 Reference to GAAP in the "Accounting Principles Rule" [1.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in paragraph .01 and in appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards."

.03 The Professional Ethics Division will look to the codification or statements and any *interpretations* thereof issued by FASB, GASB, FASAB, or IASB in determining whether a *member* has departed from an accounting principle established by a designated accounting standard-setter in FASB ASC, a Statement of Governmental Accounting Standards, a Statement of Federal Accounting Standards, or International Financial Reporting Standards (IFRS). [Prior reference: paragraph .03 of ET section 203]

### 1.320.030 Departures From Generally Accepted Accounting Principles

.01 It is difficult to anticipate all the circumstances in which accounting principles may be applied. However, there is a strong presumption that adherence to GAAP would, in nearly all instances, result in *financial statements* that are not misleading. The "Accounting Principles Rule" [1.320.001] recognizes that, upon occasion, there may be unusual circumstances when the literal application of GAAP would have the effect of rendering *financial statements* misleading. In such cases, the proper accounting treatment to apply is that which will not render the *financial statements* misleading.

.02 The question of what constitutes unusual circumstances, as referred to in the "Accounting Principles Rule" [1.320.001], is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle within GAAP would be regarded generally by reasonable persons as producing misleading *financial statements*.

.03 Examples of circumstances that may justify a departure from GAAP include new legislation or evolution of a new form of business transaction. Examples of circumstances that do not justify departures from GAAP include an unusual degree of materiality or conflicting industry practices. [Prior reference: paragraph .02 of ET section 203]

.04 If the statements or data contain such departures, see the "Accounting Principles Rule" [1.320.001] for further guidance.

### 1.320.040 Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other Than GAAP

.01 Reference to GAAP in the "Accounting Principles Rule" [1.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in appendix A. The bodies designed by *Council* to promulgate accounting principles are

- a. FASAB,
- b. FASB,
- c. GASB, and
- d. IASB.

.02 *Financial statements* prepared pursuant to other accounting principles would be considered financial reporting frameworks other than GAAP within the context of the "Accounting Principles Rule" [1.320.001].

.03 However, the "Accounting Principles Rule" [1.320.001] does not preclude a *member* from preparing or reporting on *client financial statements* that



have been prepared pursuant to financial reporting frameworks other than GAAP, such as

- a. financial reporting frameworks generally accepted in another country, including jurisdictional variations of IFRS such that the *client's financial statements* do not meet the requirements for full compliance with IFRS, as promulgated by the IASB;
- b. financial reporting frameworks prescribed by an agreement or a contract; or
- c. other special purpose frameworks, including statutory financial reporting provisions required by law or a U.S. or foreign governmental regulatory body to whose jurisdiction the entity is subject.

**.04** In such circumstances, however, the *client's financial statements* and *member's* reports thereon should not purport that the *financial statements* are in accordance with GAAP, and the *financial statements* or reports on those *financial statements*, or both, should clarify the financial reporting framework(s) used. [Prior reference: paragraph .06 of ET section 203]

## 1.400 Acts Discreditable

### 1.400.001 Acts Discreditable Rule

**.01** A *member* shall not commit an act discreditable to the profession. [Prior reference: paragraph .01 of ET section 501]

### Interpretations Under the Acts Discreditable Rule

#### 1.400.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

**.01** In the absence of an *interpretation* of the "Acts Discreditable Rule" [1.400.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

**.02** A *member* would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

**.03** A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

#### **Effective Date**

**.04** Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

### **1.400.010 Discrimination and Harassment in Employment Practices**

.01 A *member* would be presumed to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [1.400.001] if a final determination, no longer subject to appeal, is made by a court or an administrative agency of competent jurisdiction that a *member* has violated any antidiscrimination laws of the United States, a state, or a municipality, including those related to sexual and other forms of harassment. [Prior reference: paragraph .03 of ET section 501]

### **1.400.020 Solicitation or Disclosure of CPA Examination Questions and Answers**

.01 A *member* who solicits or knowingly discloses the Uniform CPA Examination question(s) or answer(s), or both, without the AICPA's written authorization shall be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference: paragraph .07 of ET section 501]

### **1.400.030 Failure to File a Tax Return or Pay a Tax Liability**

.01 A *member* who fails to comply with applicable federal, state, or local laws or regulations regarding (a) the timely filing of the *member's* personal tax returns or tax returns of the *member's firm* that the *member* has the authority to timely file or (b) the timely remittance of all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference: paragraph .08 of ET section 501]

### **1.400.040 Negligence in the Preparation of Financial Statements or Records**

.01 A *member* shall be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member*, by virtue of his or her negligence, does any of the following:

- a. Makes, or permits or directs another to make, materially false and misleading entries in the *financial statements* or records of an entity.
- b. Fails to correct an entity's *financial statements* that are materially false and misleading when the *member* has the authority to record an entry.
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .05 of ET section 501]

### **1.400.050 Governmental Bodies, Commissions, or Other Regulatory Agencies**

.01 Many governmental bodies, commissions, or other regulatory agencies have established requirements, such as audit standards, guides, rules, and regulations, that *members* are required to follow in the preparation of *financial statements* or related information or in performing attest or similar services for entities subject to their jurisdiction. For example, the SEC; the Federal

Communications Commission; state insurance commissions; and other regulatory agencies, such as the PCAOB, have established such requirements.

**.02** If a *member* prepares *financial statements* or related information for purposes of reporting to such bodies, commissions, or regulatory agencies, the *member* should follow the requirements of such organizations, in addition to the applicable financial reporting framework.

**.03** If a *member* agrees to perform an attest or a similar service for the purpose of reporting to such bodies, commissions, or regulatory agencies, the *member* should follow such requirements, in addition to the applicable financial reporting framework.

**.04** A *member's* material departure from such requirements would be considered a violation of the "Acts Discreditable Rule" [1.400.001] unless the *member* discloses in the *financial statements* or his or her report, as applicable, that such requirements were not followed and the applicable reasons. [Prior reference: paragraph .06 of ET section 501]

### 1.400.055 Governmental Audits

**.01** Engagements for audits of government grants, government units, or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules, and regulations, in addition to GAAS.

**.02** If a *member* accepts such an engagement and undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules, and regulations, the *member* is obligated to follow such requirements, in addition to GAAS.

**.03** Failure to do so is a violation of the "Acts Discreditable Rule" [1.400.001] unless the *member* discloses in his or her report that such requirements were not followed and the applicable reasons for not following the requirements. [Prior reference: paragraph .04 of ET section 501]

### 1.400.060 Indemnification and Limitation of Liability Provisions

**.01** Certain governmental bodies, commissions, or other regulatory agencies (collectively, regulators) have established requirements through laws, regulations, or published interpretations that

- a. prohibit entities subject to their regulation (regulated entity) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators or
- b. provide that the existence of such provisions disqualifies a *member* from rendering such services to these entities.

For example, federal banking regulators, state insurance commissions, and the SEC have established such requirements.

**.02** If a *member* enters into or directs or knowingly permits another individual to enter into a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the *member* should not include or knowingly permit or direct another individual to include an indemnification or limitation of liability provision that would cause the regulated entity or a *member* to be in violation of such requirements or disqualify a *member* from providing such services to the regulated entity. A *member* who enters into or directs or knowingly permits another individual to enter into

such an agreement for the performance of audit or other attest services would be considered in violation of the "Acts Discreditable Rule" [1.400.001].

**.03** Refer to the "Indemnification of a Covered Member" [1.228.010] and "Indemnification of an Attest Client" [1.228.020] interpretations of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .09 of ET section 501]

### **1.400.070 Confidential Information Obtained From Employment or Volunteer Activities**

**.01** A *member* should maintain the confidentiality of his or her employer's or *firm's* (employer) confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer's vendors, customers, or lenders (for example, any confidential information pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the *member* is working in a volunteer capacity).

**.02** For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the *member* may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

**.03** A *member* should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or *close relative or immediate family member*. The *member* should also take reasonable steps to ensure that staff under his or her control or others within the *employing organization* and persons from whom advice and assistance are obtained are aware of the confidential nature of the information.

**.04** When a *member* changes employment, a *member* should not use confidential employer information acquired as a result of a prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain the confidentiality of an employer's confidential information continues even after the end of the relationship between a *member* and the employer. However, the *member* is entitled to use experience and expertise gained through prior employment relationships.

**.05** A *member* would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the *member* may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

**.06** The following are examples of situations in which *members* are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the employer.
- b. Disclosure is required by law, for example, to
  - i. comply with a validly issued and enforceable subpoena or summons or
  - ii. inform the appropriate public authorities of violations of law that have been discovered.
- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to

- i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;
  - ii. protect the *member's* professional interests in legal proceedings;
  - iii. comply with professional standards and other ethics requirements; or
  - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the employer's confidential complaint hotline or *those charged with governance*.
- d. Disclosure is permitted on behalf of the employer to
- i. obtain financing with lenders;
  - ii. communicate with vendors, *clients*, and customers; or
  - iii. communicate with the employer's external accountant, attorneys, regulators, and other business professionals.

**.07** In deciding whether to disclose confidential employer information, relevant factors to consider include the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable. When the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, the *member* should use professional judgment in determining the type of disclosure to be made, if any.
- b. Whether the parties to whom the communication may be addressed are appropriate recipients.

**.08** A *member* may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information.

**.09** Refer to the "Subordination of Judgment" interpretation [1.130.020] of the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Information" topic [1.700] for additional guidance. [Prior reference: paragraph .10 of ET section 501]

## **1.400.090 False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services**

**.01** A *member* would be in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* promotes or markets the *member's* abilities to provide *professional services* or makes claims about the *member's* experience or qualifications in a manner that is false, misleading, or deceptive.

**.02** Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body.

**.03** Refer to the "False, Misleading, or Deceptive Acts in Advertising or Solicitations" interpretation [1.600.010] of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] for additional guidance. [No prior reference: new content]

**Effective Date**

.04 Effective December 15, 2014.

**1.400.100 Use of the CPA Credential**

.01 A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference .12 section 501]

**1.400.200 Records Requests****Terminology**

.01 The following terms are defined here solely for use with this interpretation:

- a. A client includes current and former *clients*.
- b. A member means the *member* or the *member's firm*.
- c. Client-provided records are accounting or other records, including hardcopy and electronic reproductions of such records, belonging to the client that were provided to the member by, or on behalf of, the client.
- d. Member-prepared records are accounting or other records that the member was not specifically engaged to prepare and that are not in the client's books and records or are otherwise not available to the client, thus rendering the client's financial information incomplete. Examples include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries) and supporting schedules and documents that the member proposed or prepared as part of an engagement (for example, an audit).
- e. Member's work products are deliverables set forth in the terms of the engagement, such as tax returns.
- f. Working papers are all other items prepared solely for purposes of the engagement and include items prepared by the
  - i. member, such as audit programs, analytical review schedules, and statistical sampling results and analyses.
  - ii. client at the request of the member and reflecting testing or other work done by the member.

**Interpretation**

.02 Members must comply with the rules and regulations of authoritative regulatory bodies, such as the member's state board(s) of accountancy, when the member performs services for a client and is subject to the rules and regulations of such regulatory body. For example, a member's state board(s) of accountancy may not permit a member to withhold certain records, even though fees are due to the member for the work performed. Failure to comply with the more

restrictive provisions of the applicable regulatory body's rules and regulations concerning the return of certain records would constitute a violation of this interpretation.

**.03** The member should return client-provided records in the member's custody or control to the client at the client's request.

**.04** Unless a member and the client have agreed to the contrary, when a client makes a request for member-prepared records or a member's work products that are in the member's custody or control and that have not previously been provided to the client, the member should respond to the client's request as follows:

- a. The member should provide member-prepared records relating to a completed and issued work product to the client, except that such records may be withheld if fees are due to the member for that specific work product.
- b. Member's work products should be provided to the client, except that such work products may be withheld
  - i. if fees are due to the member for the specific work product;
  - ii. if the work product is incomplete;
  - iii. if for purposes of complying with professional standards (for example, withholding an audit report due to outstanding audit issues); or
  - iv. if threatened or outstanding litigation exists concerning the engagement or member's work.

**.05** Once a member has complied with these requirements, he or she is under no ethical obligation to

- a. comply with any subsequent requests to again provide records or copies of records described in paragraphs .03–.04. However, if subsequent to complying with a request, a client experiences a loss of records due to a natural disaster or an act of war, the member should comply with an additional request to provide such records.
- b. retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed. [Prior reference: paragraph .02 of ET section 501]

**.06** A member who has provided records to an individual designated or held out as the client's representative, such as the general partner, majority shareholder, or spouse, is not obligated to provide such records to other individuals associated with the client. [Prior reference: paragraphs .377–.378 of ET section 591]

**.07** Working papers are the member's property, and the member is not required to provide such information to the client. However, state and federal statutes and regulations and contractual agreements may impose additional requirements on the member.

**.08** In fulfilling a request for client-provided records, member-prepared records, or a member's work products, the member may

- a. charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records and require that the client pay the fee before the member provides the records to the client.

- b. provide the requested records in any format usable by the client. However, the member is not required to convert records that are not in electronic format to electronic format. If the client requests records in a specific format and the records are available in such format within the member's custody and control, the client's request should be honored. In addition, the member is not required to provide the client with formulas, unless the formulas support the client's underlying accounting or other records or the member was engaged to provide such formulas as part of a completed work product.
- c. make and retain copies of any records that the member returned or provided to the client.

**.09** A member who is required to return or provide records to the client should comply with the client's request as soon as practicable but, absent extenuating circumstances, no later than 45 days after the request is made.

**.10** The fact that the statutes of the state in which the member practices grant the member a lien on certain records in his or her custody or control does not relieve the member of his or her obligation to comply with this interpretation. [Prior reference: paragraph .02 of ET section 501]

**.11** A member would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the member does not comply with the requirements of this interpretation.

### **1.400.210 Removing Client Files or Proprietary Information From a Firm**

**.01** A *member* whose employment relationship is terminated would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* takes or retains (a) originals or copies (in any format) from the *firm's client* files or (b) proprietary information without the *firm's* permission, unless the *member* has a contractual arrangement with the *firm* allowing such action. [Prior reference: paragraphs .381–.382 of ET section 591]

**.02** A *firm's* ownership agreement would govern ownership of *client* files and proprietary information; accordingly, this interpretation would not apply to owners of *firms*. [No prior reference: new content]

#### **Effective Date**

**.03** Paragraph .02 of this interpretation is effective December 15, 2014.

### **1.400.240 Use of Confidential Information From Nonclient Sources**

**.01** If a *member* discloses confidential information obtained from a prospective *client* or nonclient without consent, the *member* would be in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference: paragraphs .027–.028 of ET section 391 and new content]

#### **Effective Date**

**.02** This interpretation is effective December 15, 2014.



## 1.500 Fees and Other Types of Remuneration

### 1.500.008 Unpaid Fees

.01 Refer to the "Fees" topic [1.230] of the "Independence Rule" [1.200.001] for guidance. [No prior reference: new content]

#### **Effective Date**

.02 Effective December 15, 2014.

### 1.510 Contingent Fees

#### 1.510.001 *Contingent Fees Rule*

.01 A *member in public practice* shall not

- a. Perform for a contingent fee any *professional services* for, or receive such a fee from a *client* for whom the *member* or the *member's firm* performs,
  - i. an audit or review of a *financial statement*; or
  - ii. a compilation of a *financial statement* when the *member* expects, or reasonably might expect, that a third party will use the *financial statement* and the *member's* compilation report does not disclose a lack of *independence*; or
  - iii. an examination of prospective financial information; or
- b. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any *client*.

.02 The prohibition in a. above applies during the period in which the *member* or *member's firm* is engaged to perform any of the services listed above and the period covered by any historical *financial statements* involved in any such listed services.

.03 Except as stated in the next sentence, a contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. Solely for purposes of this rule, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

.04 A *member's* fees may vary depending, for example, on the complexity of services rendered. [Prior reference: paragraph .01 of ET section 302]

#### **Interpretations Under the Contingent Fees Rule**

#### 1.510.005 *Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts*

.01 In the absence of an *interpretation* of the "Contingent Fees Rule" [1.510.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

**.02** A *member* would be considered in violation of the "Contingent Fees Rule" [1.510.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

**.03** A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

### **Effective Date**

**.04** Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

### **1.510.010 Tax Matters**

**.01** This interpretation defines certain terms used in the "Contingent Fees Rule" [1.510.001] and provides examples of the application of the rule in tax matters. When practicing before the IRS or before other taxing authorities, *members* should also comply with other applicable and more restrictive requirements.

### **Contingent Fee Language**

**.02** Preparation of an original or amended tax return or claim for tax refund includes giving advice on events that have occurred at the time that the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, an entry, or another portion of a return or claim for refund

**.03** A fee is considered determined based on the findings of governmental agencies and, therefore, is not a contingent fee if the *member* can demonstrate a reasonable expectation, at the time of a fee arrangement, that a government agency will provide substantive consideration of the subject matter with respect to the *member's client*. Such an expectation is not reasonable if the *member* prepares a *client's* original tax returns as outlined in paragraph .02 above.

### **Examples of When a Contingent Fee Is Permitted**

**.04** The following are examples of circumstances in which a contingent fee is permitted under the "Contingent Fees Rule" [1.510.001]:

- a. Representing a *client* in connection with a revenue agent's examination of the *client's* federal or state income tax return
- b. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is the subject of a test case involving a different taxpayer or with respect to which the taxing authority is developing a position
- c. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Taxation or state taxing authority
- d. Requesting a refund of either overpayments of interest or penalties charged to a *client's* account or tax deposits that a federal or state taxing authority improperly accounted for in circumstances

in which the taxing authority has established procedures for the substantive review of such refund requests

- e. Requesting, by means of a protest or similar document, the state or local taxing authority's consideration of a reduction in a property's assessed value under an established taxing authority's review process for hearing all taxpayer arguments relating to assessed value
- f. Representing a *client* in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute

### **Example of When a Contingent Fee Is Not Permitted**

.05 A contingent fee is not permitted if a *member* prepared a *client's* amended federal or state income tax return claiming a refund of taxes because a valid deduction was inadvertently omitted from the originally filed return. [Prior reference: paragraph .02 of ET section 302]

### **1.510.020 Receipt of Contingent Fee**

.01 A contingent fee is considered to be received when the *member* has completed the related services and the fee is determined. [Prior reference: paragraphs .033–.034 of ET section 391]

### **1.510.030 Services Performed by a Member's Spouse For a Contingent Fee**

.01 A *member's* spouse may provide services for a contingent fee to a *client* for whom the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule" [1.510.001] without causing the *member* to be in violation of the "Contingent Fees Rule" if

- a. the activities of the *member's* spouse are separate from the *member's* practice and
- b. the *member* is not significantly involved in the spouse's activities.

.02 In all such situations, the *members* should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] to determine the appropriate action. [Prior reference: paragraphs .037–.038 of ET section 391]

### **1.510.040 Contingent Fee Arrangements With an Investment Advisory Services Nonattest Client That Is Related to a Client**

.01 A *member* or *member's firm* may provide investment advisory services for a contingent fee to

- a. owners, officers, or employees of a *client* for whom the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule" [1.510.001].
- b. a nonattest *client* employee benefit plan that is sponsored by a *client* for whom the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule."

.02 The *member* should also consider the "Conflicts of Interest" interpretation [1.110.010] and the "Confidential Client Information Rule" [1.700.001] to determine the appropriate action(s). [Prior reference: paragraphs .049–.050 of ET section 391]

### **1.510.050 Investment Advisory Services**

**.01** A *member* or *member's firm* may provide investment advisory services for a fee based on a percentage of the investment portfolio to a *client* for whom the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule" [1.510.001] without violating that rule if all of the following *safeguards* are met:

- a. The fee is determined based on a specified percentage of the *client's* investment portfolio.
- b. The dollar amount of the portfolio on which the fee is based is determined at the beginning of each quarter (or longer period of time as may be agreed upon) and is adjusted only for the *client's* additions or withdrawals during the period.
- c. The fee arrangement is not renewed with the *client* more frequently than on a quarterly basis. [Prior reference: paragraphs .047–.048 of ET section 391]

**.02** When performing such services, the *member* should also consider the "Independence Rule" [1.200.001], especially the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule."

## **1.520 Commissions and Referral Fees**

### **1.520.001 Commissions and Referral Fees Rule**

**.01** *Prohibited commissions.* A *member* in *public practice* shall not for a commission recommend or refer to a *client* any product or service, or for a commission recommend or refer any product or service to be supplied by a *client*, or receive a commission, when the *member* or *member's firm* also performs for that *client*

- a. an audit or review of a *financial statement*; or
- b. a compilation of a *financial statement* when the *member* expects, or reasonably might expect, that a third party will use the *financial statement* and the *member's* compilation report does not disclose a lack of *independence*; or
- c. an examination of prospective financial information.

**.02** This prohibition applies during the period in which the *member* is engaged to perform any of the services listed above and the period covered by any historical *financial statements* involved in such listed services.

**.03** *Disclosure of permitted commissions.* A *member* in *public practice* who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall disclose that fact to any person or entity to whom the *member* recommends or refers a product or service to which the commission relates.

**.04** *Referral fees.* Any *member* who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a *client* shall disclose such acceptance or payment to the *client*. [Prior reference: paragraph .01 of ET section 503]

A nonauthoritative question and answer regarding disclosure of a commission is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf).

## ***Interpretations Under the Commission and Referral Fees Rule***

### ***1.520.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts***

**.01** In the absence of an *interpretation* of the "Commissions and Referral Fees Rule" [1.520.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

**.02** A *member* would be considered in violation of the "Commissions and Referral Fees Rule" [1.520.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

**.03** A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

### ***Effective Date***

**.04** Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

### ***1.520.020 Receipt of Commission***

**.01** A commission is considered to be received when the performance of the related services is complete and the fee has been determined. For example, if in one year a *member* sells a life insurance policy to a *client*, and the *member's* commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year that the policy is sold. [Prior reference: paragraphs .367–.368 of ET section 591]

### ***1.520.030 Services Performed by a Member's Spouse For a Commission***

**.01** A *member's* spouse may receive a commission for referring products or services to or from a *client* for whom the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001] without causing the *member* to be in violation of the "Commissions and Referral Fees Rule" if both

- a. the activities of the *member's* spouse are separate from the *member's* practice and
- b. the *member* is not significantly involved in the spouse's activities.

**.02** In such situations, *members* should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] to determine the appropriate action. [Prior reference: paragraphs .373–.374 of ET section 591]

### ***1.520.040 Referral of Products of Others***

**.01** Paragraph .04 of the "Application of the AICPA Code" [0.200.020] section of the preface provides that a *member* shall not permit others to perform

acts on the *member's* behalf that, if carried out by the *member*, would place the *member* in violation of the rules. Therefore, the *member* would be held responsible for the actions of third parties, such as distributors or agents, that act on the *member's* behalf.

**.02** For example, if the *member* or *member's firm* performs for a *client* a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001], the *member* may not recommend or refer to that *client* any product or services for a commission that will be paid through a distributor or an agent or receive a commission for the recommendation or referral. This prohibition applies during the period in which the *member* is engaged to perform any of the services listed in paragraph .01 of the rule and during the period covered by any historical *financial statements* in such services.

**.03** In addition, if a *member* receives a commission for referring a third party's product or service to a *client* for whom the *member* does not perform a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001] through a distributor or an agent and receives a commission from the third party, the *member* should disclose the commission to the *client*, as discussed in paragraph .03 of the "Commissions and Referral Fees Rule." However, any subsequent performance of a service listed in paragraph .01 of that rule during a period in which the commission was received would be considered to violate the rule. [Prior reference: paragraphs .375–.376 of ET section 591]

### **1.520.050 Commission Arrangements With an Investment Advisory Services Nonattest Client That Is Related to a Client**

**.01** A *member* or *member's firm* may receive a commission for referring a nonclient or nonattest *client's* products or services to the following:

- a. Owners, officers, or employees of a *client* for whom the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001]
- b. A nonattest *client* employee benefit plan that is sponsored by a *client* for whom the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule"

**.02** In such instances, the *member* should disclose the commission arrangement to the *client's* owners, officers, or employees or the employee benefit plan. The *member's* failure to disclose the commission would be in violation of the "Commissions and Referral Fees Rule" [1.520.001].

**.03** When making the disclosure, *members* should also consider the applicability of the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] and the *member's* professional responsibilities under the "Confidential Client Information Rule" [1.700.001] to determine the appropriate action(s). [Prior reference: paragraphs .383–.384 of ET section 591]

### **1.520.060 Sale of Products to Clients**

**.01** If a *member* purchases a product, taking title to the product and assuming all the associated risks of ownership, any profit the *member* receives on reselling it to a *client* would not constitute a commission. [Prior reference: paragraphs .369–.370 of ET section 591]

### **1.520.070 Billing for a Subcontractor's Services**

.01 If, in providing *professional services* to a *client*, a *member* subcontracts the services of another person or entity, any mark-up of the cost of the subcontracted services would not constitute a commission.

.02 Refer to the following for additional guidance:

- "Use of a Third-Party Service Provider" interpretation [1.150.040] of the "Integrity and Objectivity Rule" [1.100.001]
- "Fees" subtopic [1.230] under the "Independence Rule" [1.200.001]
- "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001]
- "Disclosing Information to a Third-Party Service Provider" interpretation [1.700.040] of the "Confidential Client Information Rule" [1.700.001] [Prior reference: paragraphs .371–.372 of ET section 591]

#### **Effective Date**

.03 The revisions to this interpretation are effective December 15, 2014.

## **1.600 Advertising and Other Forms of Solicitation**

### **1.600.001 Advertising and Other Forms of Solicitation Rule**

.01 A *member* in *public practice* shall not seek to obtain *clients* by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited. [Prior reference: paragraph .01 of ET section 502]

#### **Interpretations Under the Advertising and Other Forms of Solicitation Rule**

### **1.600.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts**

.01 In the absence of an *interpretation* of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

**Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

**1.600.010 False, Misleading, or Deceptive Acts in Advertising or Solicitations**

.01 A *member* would be in violation of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] if the *member's* promotional efforts are false, misleading, or deceptive. If a *member* is asked to perform *professional services* for a *client* or customer of a third party, the *member* should determine that the third party's promotional efforts comply with the "Advertising and Other Forms of Solicitation Rule." Such action is required because the *member* will receive the benefits of such efforts by third parties, and *members* must not do through others what they are prohibited from doing themselves. [Prior reference: paragraph .06 of ET section 502]

.02 Promotional efforts would be considered false, misleading, or deceptive if they

- a. create false or unjustified expectations of favorable results.
- b. imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
- c. contain a representation that the *member* will perform specific *professional services* in current or future periods for a stated fee, estimated fee, or fee range when it was likely at the time of the representation that such fees would be substantially increased and the *member* failed to advise the prospective *client* of that likelihood.
- d. contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived. [Prior reference: paragraph .03 of ET section 502]

**1.600.030 Use of AICPA-Awarded Designation**

.01 A *member* who holds an AICPA-awarded designation, such as the Personal Financial Specialist (PFS) designation, may use the designation after the *member's* name.

.02 A *member's firm* may use an AICPA-awarded designation, such as the PFS designation, on *firm* letterhead and in marketing materials if all the *firm's* partners hold the AICPA-awarded designation. [Prior reference: paragraphs .365–.366 of ET section 591]

**Effective Date**

.03 The revisions to this interpretation are effective December 15, 2014.

**1.600.100 Use of the CPA Credential**

.01 A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner



that is false, misleading, or deceptive and in violation of the "Advertising and Other Forms of Solicitation Rule" [1.600.001]. [Prior reference .07 section 502.]

## 1.700 Confidential Information

### 1.700.001 Confidential Client Information Rule

**.01** A *member* in *public practice* shall not disclose any *confidential client information* without the specific consent of the *client*.

**.02** This rule shall not be construed (1) to relieve a *member* of his or her professional obligations of the "Compliance With Standards Rule" [1.310.001] or the "Accounting Principles Rule" [1.320.001], (2) to affect in any way the *member's* obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a *member's* compliance with applicable laws and government regulations, (3) to prohibit review of a *member's* professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a *member* from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the *Institute* or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy. *Members* of any of the bodies identified in (4) above and *members* involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any *member's confidential client information* that comes to their attention in carrying out those activities. This prohibition shall not restrict *members'* exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above. [Prior reference: paragraph .01 of ET section 301]

### Interpretations Under the Confidential Client Information Rule

#### 1.700.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

**.01** In the absence of an *interpretation* of the "Confidential Client Information Rule" [1.700.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

**.02** A *member* would be considered in violation of the "Confidential Client Information Rule" [1.700.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

**.03** A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

#### **Effective Date**

**.04** Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

### 1.700.010 Client Competitors

.01 When a *member* provides *professional services* to *clients* that are competitors, *threats* to compliance with the "Confidential Client Information Rule" [1.700.001] may exist because the *member* may have access to *confidential client information*, such as sales, purchases, and gross profit percentages of the respective competitors.

.02 To reduce the *threat* of disclosing *confidential client information* to a competitor, the *member* should emphasize to all relevant parties, including employees of the *firm* and affected *clients*, that the "Confidential Client Information Rule" [1.700.001] prohibits *members* from revealing to others any *confidential client information* obtained in their professional capacity. [Prior reference: paragraphs .011–.012 of ET section 391]

### 1.700.020 Disclosing Information From Previous Engagements

.01 When a *member* evaluates whether to accept a new *client* engagement, the *member* should consider whether knowledge and experience that the *member* or *member's firm* will share while providing the *professional services* to the prospective *client* would be *confidential client information*. If such information would be *confidential client information*, and the circumstances are such that the prospective *client* would be able to identify the *client* or *clients* that are the source of the information, the engagement should not be accepted unless the *member* obtains the original *client's* specific consent to disclose the information. [Prior reference: paragraphs .029–.030 of ET section 391]

.02 When a *member* withdraws from an engagement due to, for example, discovery of irregularities in a *client's* tax return, if contacted by the successor, the *member* should suggest that the successor ask the *client* to permit the *member* to discuss all matters freely with the successor. The successor is then on notice of some conflict.

.03 The "Confidential Client Information Rule" [1.700.001] is not intended to help an unscrupulous *client* cover up illegal acts or otherwise hide information by changing CPAs. Due to the possibility of legal implications in such matters, the *member* should seek legal advice on the *member's* status and obligations in the matter. [Prior reference: paragraphs .005–.006 of ET section 391]

### 1.700.030 Disclosing Information to Persons or Entities Associated With Clients

.01 When a *member* is engaged to prepare a married couple's joint tax return, both spouses are considered to be the *member's client*, even if the *member* was engaged by one spouse and deals exclusively with that spouse.

.02 Accordingly, if the married couple is undergoing a divorce and one spouse directs the *member* to withhold joint tax information from the other spouse, the *member* may provide the information to both spouses, in compliance with the "Confidential Client Information Rule" [1.700.001], because both are the *member's client*. The *member* should consider reviewing

- a. the legal implications of such disclosure with an attorney and
- b. responsibilities under any tax performance standards, such as Section 10.29 of IRS Circular 230. [Prior reference: paragraphs .031–.032 of ET section 391]

.03 If a *member* provides *professional services* to a company's executives at the request of the company, the *member's* disclosure of *confidential client*

*information* to the company without the consent of the applicable executives would be a violation of the "Confidential Client Information Rule" [1.700.001], even if the company is not otherwise a *client*. [Prior reference: paragraphs .041–.042 of ET section 391]

### **1.700.040 Disclosing Information to a Third-Party Service Provider**

**.01** When a *member* uses a *third-party service provider* to assist the *member* in providing *professional services, threats* to compliance with the "Confidential Client Information Rule" [1.700.001] may exist.

**.02** *Clients* may not expect the *member* to use a *third-party service provider* to assist the *member* in providing the *professional services*. Therefore, before disclosing *confidential client information* to a *third-party service provider*, the *member* should do one of the following:

- a. Enter into a contractual agreement with the *third-party service provider* to maintain the confidentiality of the information and provide reasonable assurance that the *third-party service provider* has appropriate procedures in place to prevent the unauthorized release of confidential information to others. The nature and extent of procedures necessary to obtain reasonable assurance depends on the facts and circumstances, including the extent of publicly available information on the *third-party service provider's* controls and procedures to *safeguard confidential client information*.
- b. Obtain specific consent from the *client* before disclosing *confidential client information* to the *third-party service provider*.

**.03** Refer to the "Use of a Third-Party Service Provider" interpretation [1.150.040] of the "Integrity and Objectivity Rule" [1.100.001] and the "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001] for additional guidance. [Prior reference: paragraphs .001–.002 of ET section 391]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsOutsourcing.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsOutsourcing.pdf).

In addition, nonauthoritative sample client disclosure language that could be used to fulfill the requirement discussed in this interpretation is also available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Sample\\_Disclosure\\_Notification.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Sample_Disclosure_Notification.pdf).

### **1.700.050 Disclosing Client Information in Connection With a Review of the Member's Practice**

**.01** For purposes of the "Confidential Client Information Rule" [1.700.001], a review of a *member's* professional practice includes a review performed in conjunction with a prospective purchase, sale, or merger of all or part of a *member's* practice. Such reviews may *threaten* a *member's* compliance with the "Confidential Client Information Rule." To reduce the *threat* to an *acceptable level*,

a *member* must take appropriate precautions (for example, through a written confidentiality agreement with the prospective purchaser) to help ensure that the prospective purchaser does not disclose any *confidential client information* obtained in the course of the review.

**.02** *Members* who perform such reviews shall not use to their advantage or disclose any *confidential client information* that comes to their attention during the review. [Prior reference: paragraph .04 of ET section 301]

### 1.700.060 Disclosure of Client Information to Third Parties

**.01** When a *member* receives a request from a third party (for example, a trade association, member of academia, or surveying or benchmarking organization) to disclose *client* information or intends to use such information for the *member's* own purposes (for example, publication of benchmarking data or studies) in a manner that may result in the *client's* information being disclosed to others without the *client* being specifically identified, *threats* to compliance with the "Confidential Client Information Rule" [1.700.001] may exist.

**.02** If the information is considered to be *confidential client information*, the *member* would be in violation of the "Confidential Client Information Rule" [1.700.001] if the *member* discloses or uses the information unless the *member* has the *client's* specific consent, preferably in writing, for the disclosure or use of such information. The consent should specify the nature of the information that may be disclosed, the type of third party to whom it may be disclosed, and its intended use.

**.03** If the information is not considered to be *confidential client information*, the disclosure or use of the information is not subject to the "Confidential Client Information Rule" [1.700.001]. However, the *member* should be cautious in the disclosure or use of the information so as not to disclose *client* information that may go beyond what is available to the public or that the *client* has agreed may be disclosed.

**.04** A *member* is not prohibited from marketing his or her services or advising a third party, such as a current or prospective *client*, of information based on his or her expertise or knowledge obtained from prior experiences with *clients* (for example, the nature of services provided to other *clients* or common practices within a *client's* industry). However, if the information may be identifiable to one or more *clients*, specific consent, preferably in writing, is required from such *client(s)*. Prior to disclosing *confidential client information* to a third party, the *member* should consider whether a contractual agreement with the third party to maintain the confidentiality or limit the use of the information is necessary.

**.05** In addition, the *member* should consider whether federal, state, or local statutes, rules, or regulations concerning the confidentiality of *client* information may be more restrictive than the requirements in this interpretation.

**.06** Refer to the "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001] for additional guidance. [Prior reference: paragraphs .003–.004 of ET section 391]

A nonauthoritative table providing examples of client information that is available to the public, client information not available to the public, and other information in the member's possession is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Categories-of-Information.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Categories-of-Information.pdf).

### 1.700.070 Disclosing Client Information During Litigation

.01 The "Confidential Client Information Rule" [1.700.001] is not intended to prohibit a *member* from disclosing information necessary to initiate, pursue, or defend the *member* in an actual or a threatened lawsuit or alternative dispute resolution proceeding. Accordingly, releasing *confidential client information* to the *member's* liability insurance carrier solely to assist in the defense against an actual or a potential claim against the *member* would not violate the "Confidential Client Information Rule." [Prior reference: paragraphs .039-.040 and .045-.046 of ET section 391]

### 1.700.080 Disclosing Client Information in Director Positions

.01 When a *member* serves as a director of an organization, such as a bank or an insurance company, the *member's* fiduciary responsibilities to the organization may create *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Client Information Rule" [1.700.001]. For example, the *member's* fiduciary duty to the organization may conflict with the *member's* obligations pursuant to the "Confidential Client Information Rule" (for example, failure to disclose information may constitute a breach of the director's fiduciary responsibilities) when the *member's clients* are customers of the organization.

.02 A *member's* general knowledge and experience may be very helpful to an organization in formulating a policy and making business decisions. Nevertheless, if the *member's clients* are likely to engage in significant transactions with the organization, it would be more appropriate for the *member* to serve as a consultant to the board. Under such an arrangement, the *member* could limit activities to those that do not *threaten* the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Client Information Rule" [1.700.001]. If, however, the *member* serves as a board member of the organization, the *member* should evaluate the significance of any *threats* and apply *safeguards*, when necessary, to eliminate or reduce the *threats* to an *acceptable level*.

.03 See the "Director Positions" interpretation [1.110.020] of the "Integrity and Objectivity Rule" [1.000.001]. [Prior reference: paragraphs .035-.036 of ET section 391]

#### **Effective Date**

.04 The revisions to this interpretation are effective December 15, 2014.

### 1.700.090 Disclosing Client Names

.01 The *member's* disclosure of a *client's* name would not violate the "Confidential Client Information Rule" [1.700.001] if disclosure of the *client's* name does not constitute the release of *confidential client information*. For example, if a *member's* practice is limited to bankruptcy matters, disclosure of the *client's* name could suggest that the *client* may be experiencing financial difficulties, which may be *confidential client information*. [Prior reference: paragraphs .013-.014 of ET section 391]

### 1.700.100 Disclosing Confidential Client Information as a Result of a Subpoena or Summons

.01 The *member's* disclosure of *confidential client information* in compliance with a validly issued and enforceable subpoena or summons would not violate the "Confidential Client Information Rule" [1.700.001].

.02 When complying with such subpoena or summons, the *member* is not required to notify the *client* that its records have been subpoenaed or that a summons related to the *client's* records has been issued. The *member* may also wish to consult with legal counsel to determine the validity and enforceability of the subpoena or summons and the specific *client* information required to be provided. The *member* may also wish to consult with his or her state board of accountancy. [No prior reference: New content from informal policy position]

### **Effective Date**

.03 Effective December 15, 2014.

## **1.800 Form of Organization and Name**

### **1.800.001 Form of Organization and Name Rule**

.01 A *member* may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of *Council*.

.02 A *member* shall not practice public accounting under a *firm* name that is misleading.

.03 Names of one or more past owners may be included in the *firm* name of a successor organization.

.04 A *firm* may not designate itself as "Members of the American Institute of Certified Public Accountants" unless all its CPA owners are *members* of the AICPA.

.05 See appendix B, "Council Resolution Concerning Form of Organization and Name." [Prior reference: paragraph .01 of ET section 505]

## **Interpretations Under the Form of Organization and Name Rule**

### **1.800.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts**

.01 In the absence of an *interpretation* of the "Form of Organization and Name Rule" [1.800.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Form of Organization and Name Rule" [1.800.001] if the *member* cannot demonstrate the application of *safeguards* that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

### **Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

## **1.810 Form of Organization and Related Practice Issues**

### **1.810.010 Ownership of a Separate Business**

.01 A *member* may own an interest in a separate business that performs for *clients* accounting, tax, personal financial planning, or litigation support services or other services for which standards are promulgated by bodies designated by *Council*.

.02 If the *member*, either individually or collectively with the *member's firm* or others in the *firm*, *controls* the separate business, then the separate business, its owners (including the *member*), and its professional employees must comply with the code. For example, if one or more *members* individually or collectively *control* the separate business, the *member(s)* and others associated with the separate business are subject to the "Commissions and Referral Fees Rule" [1.520.001] and its *interpretations*. With respect to an *attest client*, the "Independence Rule" [1.200.001] and its *interpretations* would apply to the activities of the separate business, its owners, and its professional employees.

.03 When the *member*, individually or collectively with the *member's firm* or others in the *firm*, does not *control* the separate business, the provisions of the code would apply to the *member's* actions but not to the separate business, its other (nonmember) owners, and its professional employees. For example, the separate business could enter into a contingent fee arrangement with the *member's attest client* or accept commissions for the referral of products or services to the *member's attest client*. [Prior reference: paragraph .03 of ET section 505]

.04 When the owners of the separate business are non-CPAs, to prevent any misunderstanding or misrepresentation, the CPA *member* should advise *clients* and other interested parties that the CPA *member* is an owner in two separate businesses: one made up of non-CPAs (except for the CPA *member*) and another that is a CPA *firm*. [Prior reference: paragraphs .275–.276 of ET section 591]

.05 See the "Network and Network Firms" interpretation [1.220.010] of the "Independence Rule" [1.200.001] and the definitions of *networks* and *network firms* for guidance applicable to these entities.

### **1.810.020 Partner Designation**

.01 Only *members* of a *firm* who are legally *partners* should use the designation *partner*. *Members* who are not parties to the *firm's* partnership agreement should not hold themselves out in any manner that might lead *clients* or the public to believe that they are *partners*. For example, using the designation "nonproprietary partner" to describe a high-ranking professional employee would be misleading and in violation of the "Form of Organization and Name Rule" [1.800.001] even if the professional employee was a *partner* in one of the predecessor *firms* that merged into the *firm*. [Prior reference: paragraphs .273–.274 of ET section 591]

**1.810.030 A Member's Responsibility for Nonmember Practitioners**

.01 A *member* who becomes an employee of a *firm* made up of one or more nonmember practitioners must still comply with the code. If the *member* becomes an owner in the *firm*, the *member* will be responsible for *firm's* professional employees, including the nonmember practitioners.

.02 Similarly, if a *member* forms a partnership with a nonmember, the *member* is ethically responsible for all the activities of the partnership. If the nonmember *partner* violates the code, the *member* would be held accountable for that *partner's* actions.

.03 See paragraph .04 of the "Application of the AICPA Code" [0.200.020] section of the preface and appendix B. [Prior reference: paragraphs .005–.006 and .281–.282 of ET section 591]

**1.810.040 Attest Engagement Performed With a Former Partner**

.01 Unless there are laws, rules or regulations that are applicable to the *member* that conclude otherwise, two former *partners* may continue to jointly perform an *attest engagement* even if one of them is not a CPA. However, to be clear that a partnership no longer exists and to assure the *attest client* and others that both individuals performed the *attest engagement*, they should present their report on plain paper (that is, paper with no letterhead) that is signed in the following manner:

John Doe, Certified Public Accountant  
Richard Roe, Accountant

[Prior reference: paragraphs .271–.272 of ET section 591]

**Effective Date**

.02 The revisions to this interpretation are effective December 15, 2014.

**1.810.050 Alternative Practice Structures**

.01 The "Form of Organization and Name Rule" [1.800.001] states, "A *member* may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of *Council*." The *Council* resolution (appendix B) requires, among other things, that CPAs own a majority of the *financial interests* in a *firm* engaged to provide attest services (as defined therein) to the public. This interpretation explains the application of this rule to an alternative practice structure (APS) in which (a) the majority of the *financial interests* in the attest *firm* is owned by CPAs and (b) all or substantially all of the revenues are paid to another entity in return for services and the lease of employees, equipment, and *office* space.

.02 To protect the public interest, the overriding focus of the resolution is that CPAs remain responsible, financially and otherwise, for a *firm's* attest work. In addition to the provisions of the resolution, other requirements of the code and bylaws ensure responsibility for

- a. compliance with all aspects of applicable law or regulation,
- b. enrollment in an AICPA-approved practice monitoring program,
- c. compliance with the "Independence Rule" [1.200.001], and
- d. compliance with applicable standards promulgated by *Council*-designated bodies ("Compliance With Standards Rule" [1.310.001]) and all other provisions of the code, including "Structure and Application of the AICPA Code" [0.200].



.03 Given all the previously mentioned *safeguards* that protect the public interest, if the CPAs who own the attest *firm* remain financially responsible, under applicable law or regulation, for the *firm's* attest work, the *member* is considered to be in compliance with the financial interests provision of the resolution. [Prior reference: paragraph .04 of ET section 505]

## 1.820 Firm Name

### 1.820.010 Use of a Retired Partner's Name

.01 The "Form of Organization and Name Rule" [1.800.001] permits the use of the name(s) of former *partner(s)* in a *firm's* name. For example, if two *firms* merge, the newly formed *firm* may use in its *firm* name the name of retired or other *partners* in either or both of the merged *firms* without violating the "Form of Organization and Name Rule." [Prior reference: paragraphs .289-.290 of ET section 591]

### 1.820.020 A Practice With Non-CPA Partners

.01 Unless there are laws, rules, or regulations that are applicable to the *member* that conclude otherwise, a CPA *member* who is in a partnership with non-CPAs may sign reports in the *firm's* name and also affix the designation, "Certified Public Accountant," to the *member's* signature if it is clear that the partnership itself is not being held out as entirely comprising CPAs. [Prior reference: paragraphs .379-.380 of ET section 591]

### 1.820.030 Misleading Firm Names

.01 The "Form of Organization and Name Rule" [1.800.001] prohibits a *member* from practicing public accounting under a *firm* name that is misleading. If the *firm* name contains any representation that would be likely to cause a reasonable person to misunderstand, or be confused about, what the legal form of the *firm* is or who the owners or members of the *firm* are, the *firm* name would be misleading and the *member* would be in violation of the "Form of Organization and Name Rule." For example, the *member* should not refer to a type of organization or an abbreviation thereof that does not accurately reflect the form under which the *firm* is organized.

.02 In addition, the *member* should consider the rules and regulations of his or her state board(s) of accountancy concerning misleading *firm* names that may be more restrictive than the requirements in this interpretation. [Prior reference: paragraph .05 of ET section 505]

### 1.820.040 Use of a Common Brand Name in Firm Name

.01 *Firms* within a *network* sometimes share the use of a common brand or share common initials as part of the *firm* name. The sharing of a common brand name or common initials of a *network* as part of the *member's firm* name would not be considered misleading, provided the *firm* is a *network firm*.

.02 The sharing of a common brand name or common initials of a *network* as the entire name of the *member's firm* would not be considered misleading, if the *firm* is a *network firm* and shares one or more of the following characteristics with other *firms* in the *network*:

- a. Common *control* among the firms through ownership, management, or other means

- b. Profits or costs, excluding costs of operating the *network*; costs of developing audit methodologies, manuals, and training courses; and other costs that are immaterial to the *firm*
- c. Common business strategy that involves ongoing collaboration amongst the *firms* whereby the *firms* are responsible for implementing the *network's* strategy and are held accountable for performance pursuant to that strategy
- d. Significant part of professional resources
- e. Common quality control policies and procedures that *firms* are required to implement and that are monitored by the *network*

**.03** Refer to the "Network and Network Firms" interpretation [1.220.010] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .06 of ET section 505]

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## ET Part 2

***Members in Business***

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## 2.000 Introduction

**.01** Part 2 of the Code of Professional Conduct (the code) applies to *members in business*. Accordingly, when the term *member* is used in part 2 of the code, the requirements apply only to *members in business*. When a *member in business* is also a *member in public practice* (for example, a *member* has a part-time tax practice), the *member* should also consult part 1 of the code, which applies to *members in public practice*. [No prior reference: new content]

### **Effective Date**

**.02** Effective December 15, 2014.

## 2.000.010 Conceptual Framework for Members in Business

### **Introduction**

**.01** *Members* may encounter various relationships or circumstances that create *threats* to the *member's* compliance with the rules. The rules and *interpretations* seek to address many situations; however, they cannot address all relationships or circumstances that may arise. Thus, in the absence of an *interpretation* that addresses a particular relationship or circumstance, a *member* should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a *threat* to the *member's* compliance with the rules that is not at an *acceptable level*. When making that evaluation, the *member* should apply the conceptual framework approach as outlined in this interpretation.

**.02** The code specifies that in some circumstances, no *safeguards* can reduce a *threat* to an *acceptable level*. For example, the code specifies that a *member* may not subordinate the *member's* professional judgment to others without violating the "Integrity and Objectivity Rule" [2.100.001]. A *member* may not use the conceptual framework to overcome this or any other prohibition or requirement in the code.

### **Definitions Used in Applying the Conceptual Framework**

**.03 Acceptable level.** A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's* compliance with the rules is not compromised.

**.04 Safeguards.** Actions or other measures that may eliminate a *threat* or reduce a *threat* to an *acceptable level*.

**.05 Threat(s).** Relationships or circumstances that could compromise a *member's* compliance with the rules.

### **Conceptual Framework Approach**

**.06** Under the conceptual framework approach, *members* should identify *threats* to compliance with the rules and evaluate the significance of those *threats*. *Members* should evaluate identified *threats* both individually and in the aggregate because *threats* can have a cumulative effect on a *member's* compliance with the rules. *Members* should perform three main steps in applying the conceptual framework approach:

- a. *Identify threats.* The relationships or circumstances that a *member* encounters in various engagements and work assignments or

positions will often create different *threats* to complying with the rules. When a *member* encounters a relationship or circumstance that is not specifically addressed by a rule or an *interpretation*, under this approach, the *member* should determine whether the relationship or circumstance creates one or more *threats*, such as those identified in paragraphs .09–.14 that follow. The existence of a *threat* does not mean that the *member* is in violation of the rules; however, the *member* should evaluate the significance of the *threat*.

- b. *Evaluate the significance of a threat.* In evaluating the significance of an identified *threat*, the *member* should determine whether a *threat* is at an *acceptable level*. A *threat* is at an *acceptable level* when a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* would not compromise the *member's* compliance with the rules. *Members* should consider both qualitative and quantitative factors when evaluating the significance of a *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*. If the *member* evaluates the *threat* and concludes that a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* does not compromise a *member's* compliance with the rules, the *threat* is at an *acceptable level* and the *member* is not required to evaluate the *threat* any further under this conceptual framework approach.
- c. *Identify and apply safeguards.* If, in evaluating the significance of an identified *threat*, the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. The *member* should apply judgment in determining the nature of the *safeguards* to be applied because the effectiveness of *safeguards* will vary depending on the circumstances. When identifying appropriate *safeguards* to apply, one *safeguard* may eliminate or reduce multiple *threats*. In some cases, the *member* should apply multiple *safeguards* to eliminate or reduce one *threat* to an *acceptable level*. In other cases, an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* will be unable to implement effective *safeguards*. Under such circumstances, providing the specific *professional services* would compromise the *member's* compliance with the rules, and the *member* should determine whether to decline or discontinue the *professional services* or resign from the *employing organization*.

## Threats

.07 Many *threats* fall into one or more of the following six broad categories: adverse interest, advocacy, familiarity, self-interest, self-review, and undue influence.

.08 Examples of *threats* associated with a specific relationship or circumstance are identified in the *interpretations* of the code. Paragraphs .09–.14 of this section define and provide examples, which are not all inclusive, of each of these *threat* categories.

.09 *Adverse interest threat.* The *threat* that a *member* will not act with objectivity because the *member's* interests are opposed to the interests of

the *employing organization*. Examples of adverse interest *threats* include the following:

- a. A *member* has charged, or expressed an intention to charge, the *employing organization* with violations of law.
- b. A *member* or the *member's immediate family* or *close relative* has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the *employing organization*.
- c. A *member* has sued or expressed an intention to sue the *employing organization* or its officers, directors, or employees.

**.10** *Advocacy threat*. The *threat* that a *member* will promote an *employing organization's* interests or position to the point that his or her objectivity is compromised. Examples of *advocacy threats* include the following:

- a. Obtaining favorable financing or additional capital is dependent upon the information that the *member* includes in, or excludes from, a prospectus, an offering, a business plan, a financing application, or a regulatory filing.
- b. The *member* gives or fails to give information that the *member* knows will unduly influence the conclusions reached by an external service provider or other third party.

**.11** *Familiarity threat*. The *threat* that, due to a long or close relationship with a person or an *employing organization*, a *member* will become too sympathetic to their interests or too accepting of the person's work or *employing organization's* product or service. Examples of *familiarity threats* include the following:

- a. A *member* uses an *immediate family's* or a *close relative's* company as a supplier to the *employing organization*.
- b. A *member* may accept an individual's work product with little or no review because the individual has been producing an acceptable work product for an extended period of time.
- c. A *member's immediate family* or *close relative* is employed as a *member's* subordinate.
- d. A *member* regularly accepts gifts or entertainment from a vendor or customer of the *employing organization*.

**.12** *Self-interest threat*. The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, the *employing organization* or persons associated with the *employing organization*. Examples of *self-interest threats* include the following:

- a. A *member's immediate family* or *close relative* has a *financial interest* in the *employing organization*.
- b. A *member* holds a *financial interest* (for example, shares or share options) in the *employing organization*, and the value of that *financial interest* is directly affected by the *member's* decisions.
- c. A *member* is eligible for a profit or other performance-related bonus, and the value of that bonus is directly affected by the *member's* decisions.

**.13** *Self-review threat*. The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the *member*, or an individual in the *employing organization* and that the *member* will rely on that service in forming a judgment as part of another service. Examples of *self-review threats* include the following:

- a. When performing an internal audit procedure, an internal auditor accepts work that he or she previously performed in a different position.
- b. The *member* accepts the work previously performed by the *member*, alone or with others, that will be the basis for providing another *professional service*.

**.14** *Undue influence threat.* The *threat* that a *member* will subordinate his or her judgment to that of an individual associated with the *employing organization* or any relevant third party due to that individual's position, reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

- a. A *member* is pressured to become associated with misleading information.
- b. A *member* is pressured to deviate from a company policy.
- c. A *member* is pressured to change a conclusion regarding an accounting or a tax position.
- d. A *member* is pressured to hire an unqualified individual.

### **Safeguards**

**.15** *Safeguards* may partially or completely eliminate a *threat* or diminish the potential influence of a *threat*. The nature and extent of the *safeguards* applied will depend on many factors. To be effective, *safeguards* should eliminate the *threat* or reduce it to an *acceptable level*.

**.16** *Safeguards* that may eliminate a *threat* or reduce it to an *acceptable level* fall into two broad categories:

- a. *Safeguards* created by the profession, legislation, or regulation
- b. *Safeguards* implemented by the *employing organization*

**.17** The effectiveness of a *safeguard* depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of *threats*
- c. Whether the *safeguard* is suitably designed to meet its objectives
- d. The party(ies) who will be subject to the *safeguard*
- e. How the *safeguard* is applied
- f. The consistency with which the *safeguard* is applied
- g. Who applies the *safeguard*
- h. How the *safeguard* interacts with a *safeguard* from another category
- i. Whether the *employing organization* is a *public interest entity*

**.18** Examples of *safeguards* within each category are presented in the following paragraphs. Because these are only examples and are not intended to be all inclusive, it is possible that *threats* may be sufficiently mitigated through the application of other *safeguards* not specifically identified herein.

**.19** The following are examples of *safeguards* created by the profession, legislation, or regulation:

- a. Education and training requirements on ethics and professional responsibilities



- b. Continuing education requirements on ethics
- c. Professional standards and the threat of discipline
- d. Legislation establishing prohibitions and requirements for entities and employees
- e. Competency and experience requirements for professional licensure
- f. Professional resources, such as hotlines, for consultation on ethical issues

**.20** Examples of *safeguards* implemented by the *employing organization* are as follows:

- a. A tone at the top emphasizing a commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies
- b. Policies and procedures addressing ethical conduct and compliance with laws, rules, and regulations
- c. Audit committee charter, including independent audit committee members
- d. Internal policies and procedures requiring disclosure of identified interests or relationships among the *employing organization*, its directors or officers, and vendors, suppliers, or customers
- e. Internal policies and procedures related to purchasing controls
- f. Internal policies and procedures related to customer acceptance or credit limits
- g. Dissemination of corporate ethical compliance policies and procedures, including whistle-blower hotlines, the reporting structure, dispute resolution, or other similar policies, to promote compliance with laws, rules, regulations, and other professional requirements
- h. Human resource policies and procedures *safeguarding* against discrimination or harassment, such as those concerning a worker's religion, sexual orientation, gender, or disability
- i. Human resource policies and procedures stressing the hiring and retention of technically competent employees
- j. Policies and procedures for implementing and monitoring ethical policies
- k. Assigning sufficient staff with the necessary competencies to projects and other tasks
- l. Policies segregating personal assets from company assets
- m. Staff training on applicable laws, rules, and regulations
- n. Regular monitoring of internal policies and procedures
- o. A reporting structure whereby the internal auditor does not report to the financial reporting group
- p. Policies and procedures that do not allow an internal auditor to monitor areas where the internal auditor has operational or functional responsibilities
- q. Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity
- r. Use of third-party resources for consultation as needed on significant matters of professional judgment [No prior reference: new content]

**Effective Date**

.21 Effective December 15, 2015. Early implementation is allowed provided the member has implemented the revised code.

**2.000.020 Ethical Conflicts**

.01 An ethical conflict arises when a *member* encounters one or both of the following:

- a. Obstacles to following an appropriate course of action due to internal or external pressures
- b. Conflicts in applying relevant professional and legal standards.

For example, a *member* suspects a fraud may have occurred, but reporting the suspected fraud would violate the *member's* responsibility to maintain the confidentiality of his or her employer's confidential information.

.02 Once an ethical conflict is encountered, a *member* may be required to take steps to best achieve compliance with the rules and law. In weighing alternative courses of action, the *member* should consider factors such as the following:

- a. Relevant facts and circumstances, including applicable rules, laws, or regulations
- b. Ethical issues involved
- c. Established internal procedures

.03 The *member* should also be prepared to justify any departures that the *member* believes were appropriate in applying the relevant rules and law. If the *member* was unable to resolve the conflict in a way that permitted compliance with the applicable rules and law, the *member* may have to address the consequences of any violations.

.04 Before pursuing a course of action, the *member* should consider consulting with appropriate persons within the organization that employs the *member*.

.05 If a *member* decides not to consult with appropriate persons within the organization that employs the *member*, and the conflict remains unresolved after pursuing the selected course of action, the *member* should consider either consulting with other individuals for help in reaching a resolution or obtaining advice from an appropriate professional body or legal counsel. The *member* also should consider documenting the substance of the issue, the parties with whom the issue was discussed, details of any discussions held, and any decisions made concerning the issue.

.06 If the ethical conflict remains unresolved, the *member* will in all likelihood be in violation of one or more rules if he or she remains associated with the matter creating the conflict. Accordingly, the *member* should consider his or her continuing relationship with the specific assignment or employer. [No prior reference: new content]

**Effective Date**

.07 Effective December 15, 2014.

## 2.100 Integrity and Objectivity

### 2.100.001 Integrity and Objectivity Rule

.01 In the performance of any *professional service*, a *member* shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others. [Prior reference: paragraph .01 of ET section 102]

### Interpretations Under the Integrity and Objectivity Rule

#### 2.100.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Integrity and Objectivity Rule" [2.100.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010].

.02 A *member* would be considered in violation of the "Integrity and Objectivity Rule" [2.100.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

#### ***Effective Date***

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

## 2.110 Conflicts of Interest

### 2.110.010 Conflicts of Interest for Members in Business

.01 A *member* may be faced with a conflict of interest when undertaking a *professional service*. In determining whether a *professional service*, relationship, or matter would result in a conflict of interest, a *member* should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

.02 A conflict of interest creates adverse interest and self-interest *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001]. For example, *threats* may be created when

- a. a *member* undertakes a *professional service* related to a particular matter involving two or more parties whose interests with respect to that matter are in conflict, or

- b. the interests of a *member* with respect to a particular matter and the interests of a party for whom the *member* undertakes a *professional service* related to that matter are in conflict.

**.03** A party may include an *employing organization*, a vendor, a customer, a lender, a shareholder, or other party.

**.04** The following are examples of situations in which conflicts of interest may arise:

- a. Serving in a management or governance position for two *employing organizations* and acquiring confidential information from one *employing organization* that could be used by the *member* to the advantage or disadvantage of the other *employing organization*
- b. Undertaking a *professional service* for each of two parties in a partnership employing the *member* to assist in dissolving their partnership
- c. Preparing financial information for certain *members* of management of the *employing organization* who are seeking to undertake a management buy-out
- d. Being responsible for selecting a vendor for the *member's employing organization* when the *member* or his or her *immediate family member* could benefit financially from the transaction
- e. Serving in a governance capacity or influencing an *employing organization* that is approving certain investments for the company in which one of those specific investments will increase the value of the personal investment portfolio of the *member* or his or her *immediate family member*

### **Identification of a Conflict of Interest**

**.05** In identifying whether a conflict of interest exists or may be created, a *member* should take reasonable steps to determine

- a. the nature of the relevant interests and relationships between the parties involved and
- b. the nature of the services and its implication for relevant parties.

**.06** The nature of the relevant interests and relationships and the services may change over time. The *member* should remain alert to such changes for the purposes of identifying circumstances that might create a conflict of interest.

### **Evaluation of a Conflict of Interest**

**.07** When an actual conflict of interest has been identified, the *member* should evaluate the significance of the *threat* created by the conflict of interest to determine if the *threat* is at an *acceptable level*. *Members* should consider both qualitative and quantitative factors when evaluating the significance of the *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*.

**.08** In evaluating the significance of an identified *threat*, *members* should consider the following:

- a. The significance of relevant interests or relationships.
- b. The significance of the *threats* created by undertaking the *professional service* or services. In general, the more direct the connection between the *member* and the matter on which the parties'

interests are in conflict, the more significant the *threat* to compliance with the rule will be.

**.09** If the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. Examples of *safeguards* include the following:

- a. Restructuring or segregating certain responsibilities and duties
- b. Obtaining appropriate oversight
- c. Withdrawing from the decision making process related to the matter giving rise to the conflict of interest
- d. Consulting with third parties, such as a professional body, legal counsel, or another professional accountant

**.10** In cases where an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* is unable to implement effective *safeguards*, the *member* should (a) decline to perform or discontinue the *professional services* that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the *threat* or reduce it to an *acceptable level*.

### ***Disclosure of a Conflict of Interest and Consent***

**.11** When a conflict of interest exists, the *member* should disclose the nature of the conflict to the relevant parties, including to the appropriate levels within the *employing organization* and obtain their consent to undertake the *professional service*. The *member* should disclose the conflict of interest and obtain consent even if the *member* concludes that *threats* are at an *acceptable level*.

**.12** The *member* is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the *safeguards* applied to eliminate or reduce the *threats* to an *acceptable level*, and the consent obtained.

**.13** When addressing a conflict of interest, a *member* is encouraged to seek guidance from within the *employing organization* or from others, such as a professional body, legal counsel, or another professional accountant. When making disclosures and seeking guidance of third parties, the *member* should remain alert to the requirements of the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070] of the "Acts Discreditable Rule" [2.400.001]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of employer information may be more restrictive than the requirements contained in the Code of Professional Conduct.

**.14** A *member* may encounter other *threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001]. This may occur, for example, when preparing or reporting financial information as a result of undue pressure from others within the *employing organization* or financial, business or personal relationships that *close relatives* or *immediate family* members of the *member* have with the *employing organization*. Guidance on managing such *threats* is covered by the "Knowing Misrepresentations in the Preparation of Financial Statements or Records" interpretation [2.130.010] and the "Subordination of Judgment" interpretation [2.130.020] under the "Integrity and Objectivity Rule."

[See Revision History Table.]

## 2.120 Gifts and Entertainment

### 2.120.010 Offering or Accepting Gifts or Entertainment

**.01** For purposes of this interpretation, a customer or vendor of the *member's* employer includes a representative of the customer or vendor.

**.02** When a *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member's* employer, self-interest, familiarity, or undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001] may exist.

**.03** *Threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and the *member* would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

- a. The *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member's* employer that violate applicable laws, rules, or regulations or the policies of the *member's* employer or the customer or vendor.
- b. The *member* knows of the violation or demonstrates recklessness in not knowing.

**.04** A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* when gifts or entertainment are reasonable in the circumstances. The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:

- a. The nature of the gift or entertainment
- b. The occasion giving rise to the gift or entertainment
- c. The cost or value of the gift or entertainment
- d. The nature, frequency, and value of other gifts and entertainment offered or accepted
- e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f. Whether other customers or vendors also participated in the entertainment
- g. The individuals from the customer or vendor and a *member's* employer who participated in the entertainment

**.05** *Threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member's* employer that is not reasonable in the circumstances. The *member* would be considered to lack objectivity in violation of the "Integrity and Objectivity Rule," under these circumstances. [Prior reference: paragraphs .226–.227 of ET section 191]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts\\_Basis\\_Document.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts_Basis_Document.pdf).

## 2.130 Preparing and Reporting Information

### 2.130.010 *Knowing Misrepresentations in the Preparation of Financial Statements or Records*

**.01** *Threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and the *member* would be considered to have knowingly misrepresented facts in violation of the "Integrity and Objectivity Rule," if the *member*

- a. makes, or permits or directs another to make, materially false and misleading entries in an entity's *financial statements* or records;
- b. fails to correct an entity's *financial statements* or records that are materially false and misleading when the *member* has the authority to record the entries; or
- c. signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .02 of ET section 102]

### 2.130.020 *Subordination of Judgment*

**.01** The "Integrity and Objectivity Rule" [2.100.001] prohibits a *member* from knowingly misrepresenting facts or subordinating his or her judgment when performing *professional services* for an employer or on a volunteer basis. This interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the *member's* organization.

**.02** Self-interest, familiarity, and undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001] may exist when a *member* and his or her supervisor or any other person within the *member's* organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.

**.03** A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* if the *member* concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If *threats* are not at an *acceptable level*, the *member* should apply the *safeguards* in paragraphs .05–.07 to eliminate or reduce the threat(s) to an *acceptable level* so that the *member* does not subordinate his or her judgment.

**.04** In evaluating the significance of any identified *threats*, the *member* should determine, after appropriate research or consultation, whether the result of the position taken by the supervisor or other person

- a. fails to comply with professional standards, when applicable;

- b. creates a material misrepresentation of fact; or
- c. may violate applicable laws or regulations.

**.05** If the *member* concludes that *threats* are at an *acceptable level*, the *member* should discuss his or her conclusions with the person taking the position. No further action would be needed under this interpretation.

**.06** If the *member* concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then *threats* would not be at an *acceptable level*. In such circumstances, the *member* should discuss his or her concerns with the supervisor.

**.07** If the difference of opinion is not resolved after discussing the concerns with the supervisor, the *member* should discuss his or her concerns with the appropriate higher level(s) of management within the *member's* organization (for example, the supervisor's immediate superior, senior management, and those charged with governance).

**.08** If after discussing the concerns with the supervisor and appropriate higher level(s) of management within the *member's* organization, the *member* concludes that appropriate action was not taken, then the *member* should consider, in no specific order, the following *safeguards* to ensure that *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001] are eliminated or reduced to an *acceptable level*:

- a. Determine whether the organization's internal policies and procedures have any additional requirements for reporting differences of opinion.
- b. Determine whether he or she is responsible for communicating to third parties, such as regulatory authorities or the organization's (former organization's) external accountant. In considering such communications, the *member* should be cognizant of his or her obligations under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070] of the "Acts Discreditable Rule" [2.400.001] and the "Obligation of a Member to His or Her Employer's External Accountant" interpretation [2.130.030] of the "Integrity and Objectivity Rule" [2.100.001].
- c. Consult with his or her legal counsel regarding his or her responsibilities.
- d. Document his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

**.09** If the *member* concludes that no *safeguards* can eliminate or reduce the *threats* to an *acceptable level* or if the *member* concludes that appropriate action was not taken, then he or she should consider the continuing relationship with the *member's* organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

**.10** Nothing in this interpretation precludes a *member* from resigning from the organization at any time. However, resignation may not relieve the



*member* of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

.11 A *member* should use professional judgment and apply similar *safeguards*, as appropriate, to other situations involving a difference of opinion as described in this interpretation so that the *member* does not subordinate his or her judgment. [Prior reference: paragraph .05 of ET section 102]

### **2.130.030 *Obligation of a Member to His or Her Employer's External Accountant***

.01 The "Integrity and Objectivity Rule" [2.100.001] requires a *member* to maintain objectivity and integrity in the performance of a *professional service*. When dealing with an employer's external accountant, a *member* must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which the employer's external accountant requests written representation. [Prior reference: paragraph .04 of ET section 102]

## **2.160 Educational Services**

### **2.160.010 *Educational Services***

.01 *Members* who perform educational services, such as teaching full or part time at a university, teaching a continuing professional education course, or engaging in research and scholarship, are performing *professional services* and, therefore, are subject to the "Integrity and Objectivity Rule" [2.100.001]. [Prior reference: paragraph .06 of ET section 102]

## **2.300 General Standards**

### **2.300.001 General Standards Rule**

.01 A *member* shall comply with the following standards and with any *interpretations* thereof by bodies designated by *Council*.

- a. *Professional Competence*. Undertake only those *professional services* that the *member* or the *member's firm* can reasonably expect to be completed with professional competence.
- b. *Due Professional Care*. Exercise due professional care in the performance of *professional services*.
- c. *Planning and Supervision*. Adequately plan and supervise the performance of *professional services*.
- d. *Sufficient Relevant Data*. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any *professional services* performed.

.02 See appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 201]

## Interpretations Under the General Standards Rule

### 2.300.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "General Standards Rule" [2.300.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010].

.02 A *member* would be considered in violation of the "General Standards Rule" [2.300.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

#### **Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

### 2.300.010 Competence

.01 Competence, in this context, means that the *member* or *member's* staff possesses the appropriate technical qualifications to perform *professional services* and, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession's standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of *professional services*.

.02 A *member's* agreement to perform *professional services* implies that the *member* has the necessary competence to complete those services according to professional standards and to apply the *member's* knowledge and skill with reasonable care and diligence. However, the *member* does not assume a responsibility for infallibility of knowledge or judgment.

.03 The *member* may have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing professional services involves performing additional research or consulting with others to gain sufficient competence.

.04 If a *member* is unable to gain sufficient competence, the *member* should suggest the involvement of a competent person to perform the needed *professional service*, either independently or as an associate. [Prior reference: paragraph .02 of ET section 201]

### 2.300.030 Submission of Financial Statements

.01 When a *member* is a stockholder, a *partner*, a director, an officer, or an employee of an entity and, in this capacity, prepares or submits the entity's *financial statements* to third parties, the *member* should clearly communicate, preferably in writing, the *member's* relationship to the entity and should not

imply that the *member* is independent of the entity. In addition, if the communication states affirmatively that the *financial statements* are presented in conformity with the applicable financial reporting framework, the *member* should comply with the "Accounting Principles Rule" [2.320.001].

.02 Refer to the "Use of CPA Credential" interpretation [2.400.100] of the "Acts Discreditable Rule" [2.400.001] for additional guidance. [Prior reference: paragraphs .019–.020 of ET section 291]

## 2.310 Compliance With Standards

### 2.310.001 Compliance With Standards Rule

.01 A *member* who performs auditing, review, compilation, management consulting, tax, or other *professional services* shall comply with standards promulgated by bodies designated by *Council*.

.02 See appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 202]

## Interpretations Under the Compliance with Standards Rule

### 2.310.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Compliance With Standards Rule" [2.310.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010]

.02 A *member* would be considered in violation of the "Compliance With Standards Rule" [2.310.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

### Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

## 2.320 Accounting Principles

### 2.320.001 Accounting Principles Rule

.01 A *member* shall not (1) express an opinion or state affirmatively that the *financial statements* or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such

statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by *Council* to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the *member* can demonstrate that due to unusual circumstances the *financial statements* or data would otherwise have been misleading, the *member* can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

.02 See appendix A, "*Council* Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 203]

## Interpretations Under the Accounting Principles Rule

### 2.320.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Accounting Principles Rule" [2.320.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010].

.02 A *member* would be considered in violation of the "Accounting Principles Rule" [2.320.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

#### **Effective Date**

.04 Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

### 2.320.010 Responsibility for Affirming That Financial Statements Are in Conformity With the Applicable Financial Reporting Framework

.01 A *member* shall not state affirmatively that an entity's *financial statements* or other financial data are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by *Council* to establish such principles. *Members* who affirm that *financial statements* or other financial data are presented in conformity with GAAP should comply with the "Accounting Principles Rule" [2.320.001]. A *member's* representation in a letter or other communication that an entity's *financial statements* are in conformity with GAAP may be considered an affirmative statement within the meaning of this rule with respect to the *member* who signed the letter or other communication (for example, the *member* signed a report to

a regulatory authority, a creditor, or an auditor). [Prior reference: paragraph .05 ET section 203]

### **2.320.020 Status of Financial Accounting Standards Board, Governmental Accounting Standards Board, Federal Accounting Standards Advisory Board, and International Accounting Standards Board Interpretations**

.01 The "Accounting Principles Rule" [2.320.001] authorizes *Council* to designate bodies to establish accounting principles. *Council* has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB *Accounting Standards Codification*<sup>®</sup> (ASC) constitutes accounting principles as contemplated in the rule. *Council* designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities, pursuant to the "Accounting Principles Rule." *Council* designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities, pursuant to the "Accounting Principles Rule." *Council* designated the International Accounting Standards Board (IASB) as an accounting body for purposes of establishing international financial accounting and reporting principles.

.02 Reference to GAAP in the "Accounting Principles Rule" [2.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in paragraph .01 and in appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards."

.03 The Professional Ethics Division will look to the codification or statements and any interpretations thereof issued by FASB, GASB, FASAB, or IASB in determining whether a *member* has departed from an accounting principle established by a designated accounting standard-setter in FASB ASC, a Statement of Governmental Accounting Standards, a Statement of Federal Accounting Standards, or International Financial Reporting Standards (IFRS). [Prior reference: paragraph .03 of ET section 203]

### **2.320.030 Departures From Generally Accepted Accounting Principles**

.01 It is difficult to anticipate all the circumstances in which accounting principles may be applied. However, there is a strong presumption that adherence to GAAP would, in nearly all instances, result in *financial statements* that are not misleading. The "Accounting Principles Rule" [2.320.001] recognizes that, upon occasion, there may be unusual circumstances when the literal application of GAAP would have the effect of rendering *financial statements* misleading. In such cases, the proper accounting treatment to apply is that which will not render the *financial statements* misleading.

.02 The question of what constitutes unusual circumstances, as referred to in the "Accounting Principles Rule" [2.320.001], is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle within GAAP would be regarded generally by reasonable persons as producing misleading *financial statements*.

**.03** Examples of circumstances that may justify a departure from GAAP include new legislation or evolution of a new form of business transaction. Examples of circumstances that would not justify departures from GAAP include an unusual degree of materiality or conflicting industry practices. [Prior reference: paragraph .02 of ET section 203]

**.04** If the statements or data contain such departures, see the "Accounting Principles Rule" [2.320.001] for further guidance.

## **2.320.040 Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other Than GAAP**

**.01** Reference to GAAP in the "Accounting Principles Rule" [2.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in appendix A. The bodies designed by *Council* to promulgate accounting principles are

- a. FASAB,
- b. FASB,
- c. GASB, and
- d. IASB.

**.02** *Financial statements* prepared pursuant to other accounting principles would be considered financial reporting frameworks other than GAAP within the context of the "Accounting Principles Rule" [2.320.001].

**.03** However, the "Accounting Principles Rule" [2.320.001] does not preclude a *member* from preparing or reporting on *financial statements* that have been prepared pursuant to financial reporting frameworks other than GAAP, such as

- a. financial reporting frameworks generally accepted in another country, including jurisdictional variations of IFRS such that the entity's *financial statements* do not meet the requirements for full compliance with IFRS, as promulgated by the IASB;
- b. financial reporting frameworks prescribed by an agreement or a contract; or
- c. other special purpose frameworks, including statutory financial reporting provisions required by law or a U.S. or foreign governmental regulatory body to whose jurisdiction the entity is subject.

**.04** In such circumstances, however, the *financial statements* or *member's* reports thereon should not purport that the *financial statements* are in accordance with GAAP and the *financial statements* or reports on those *financial statements*, or both, should clarify the financial reporting framework(s) used. [Prior reference: paragraph .06 of ET section 203]

## **2.400 Acts Discreditable**

### **2.400.001 Acts Discreditable Rule**

**.01** A *member* shall not commit an act discreditable to the profession. [Prior reference: paragraph .01 of ET section 501]

## Interpretations Under the Acts Discreditable Rule

### 2.400.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

**.01** In the absence of an *interpretation* of the "Acts Discreditable Rule" [2.400.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010].

**.02** A *member* would be considered in violation of the "Acts Discreditable Rule" [2.400.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

**.03** A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to follow an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional standards or legal standards, or both. [No prior reference: new content]

#### **Effective Date**

**.04** Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed. Paragraph .03 is effective December 15, 2014.

### 2.400.010 Discrimination and Harassment in Employment Practices

**.01** A *member* would be presumed to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [2.400.001] if a final determination, no longer subject to appeal, is made by a court or an administrative agency of competent jurisdiction that a *member* has violated any antidiscrimination laws of the United States, state, or municipality, including those related to sexual and other forms of harassment. [Prior reference: paragraph .03 of ET section 501]

### 2.400.020 Solicitation or Disclosure of CPA Examination Questions and Answers

**.01** A *member* who solicits or knowingly discloses the Uniform CPA Examination question(s) or answer(s), or both, without the AICPA's written authorization shall be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .07 of ET section 501]

### 2.400.030 Failure to File a Tax Return or Pay a Tax Liability

**.01** A *member* who fails to comply with applicable federal, state, or local laws or regulations regarding (a) the timely filing of the *member's* personal tax returns or tax returns for the *member's* employer that the *member* has the authority to timely file or (b) the timely remittance of all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .08 of ET section 501]

## 2.400.040 Negligence in the Preparation of Financial Statements or Records

.01 A *member* shall be considered in violation of the "Acts Discreditable Rule" [2.400.001] if the *member*, by virtue of his or her negligence, does any of the following:

- a. Makes, or permits or directs another to make, materially false and misleading entries in the *financial statements* or records of an entity.
- b. Fails to correct an entity's *financial statements* that are materially false and misleading when the *member* has the authority to record an entry.
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .05 of ET section 501]

## 2.400.050 Governmental Bodies, Commissions, or Other Regulatory Agencies

.01 Many governmental bodies, commissions, or other regulatory agencies have established requirements, such as standards, guides, rules, and regulations, that *members* are required to follow in the preparation of *financial statements* or related information. For example, the SEC, the Federal Communications Commission, state insurance commissions, and other regulatory agencies have established such requirements.

.02 If a *member* prepares *financial statements* or related information (for example, management's discussion and analysis) for purposes of reporting to such bodies, commissions, or regulatory agencies, the *member* should follow the requirements of such organizations in addition to the applicable financial reporting framework.

.03 A *member's* material departure from such requirements would be considered a violation of the "Acts Discreditable Rule" [2.400.001] unless the *member* discloses in the *financial statements* or related information that such requirements were not followed and the applicable reasons. [Prior reference: paragraph .06 of ET section 501]

## 2.400.060 Indemnification and Limitation of Liability Provisions

.01 Certain governmental bodies, commissions, or other regulatory agencies (collectively, regulators) have established requirements through laws, regulations, or published interpretations that

- a. prohibit entities subject to their regulation (regulated entity) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators; or
- b. provide that the existence of such provisions disqualifies a *member* from rendering such services to these entities.

For example, federal banking regulators, state insurance commissions, and the SEC have established such requirements.

.02 If a *member* enters into, or directs or knowingly permits another individual to enter into, a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the *member* should not include, or knowingly permit or direct another individual to include,



an indemnification or limitation of liability provision that would cause the regulated entity or a *member* to be in violation of such requirements or disqualify a *member* from providing such services to the regulated entity. A *member* who enters into, or directs or knowingly permits another individual to enter into, such an agreement for the performance of audit or other attest services would be considered in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .09 of ET section 501]

## 2.400.070 Confidential Information Obtained From Employment or Volunteer Activities

**.01** A *member* should maintain the confidentiality of his or her employer's confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer's vendors, customers, or lenders (for example, any confidential information pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the *member* is working in a volunteer capacity).

**.02** For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the *member* may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

**.03** A *member* should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or *close relative* or *immediate family member*. The *member* should also take reasonable steps to ensure that staff under his or her control or others within the *employing organization* and persons from whom advice and assistance are obtained are aware of the confidential nature of the information.

**.04** When a *member* changes employment, a *member* should not use confidential employer information acquired as a result of a prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain the confidentiality of an employer's confidential information continues even after the end of the relationship between a *member* and the employer. However, the *member* is entitled to use experience and expertise gained through prior employment relationships.

**.05** A *member* would be considered in violation of the "Acts Discreditable Rule" [2.400.001] if the *member* discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the *member* may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

**.06** The following are examples of situations in which *members* are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the employer.
- b. Disclosure is required by law, for example, to
  - i. comply with a validly issued and enforceable subpoena or summons or
  - ii. inform the appropriate public authorities of violations of law that have been discovered.

- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
  - i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;
  - ii. protect the *member's* professional interests in legal proceedings;
  - iii. comply with professional standards and other ethics requirements; or
  - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the employer's confidential complaint hotline or *those charged with governance*.
- d. Disclosure is permitted on behalf of the employer to
  - i. obtain financing with lenders;
  - ii. communicate with vendors, *clients*, and customers; or
  - iii. communicate with the employer's external accountant, attorneys, regulators, and other business professionals.

**.07** In deciding whether to disclose confidential employer information, relevant factors to consider include the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable. When the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, the member should use professional judgment in determining the type of disclosure to be made, if any.
- b. Whether the parties to whom the communication may be addressed are appropriate recipients.

**.08** A *member* may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information.

**.09** Refer to the "Subordination of Judgment" interpretation [2.130.020] of the "Integrity and Objectivity Rule" [2.100.001] for additional guidance. [Prior reference: paragraph .10 of ET section 501]

## **2.400.090 False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services**

**.01** A *member* would be in violation of the "Acts Discreditable Rule" [2.400.001] if the *member* promotes or markets the *member's* abilities to provide *professional services* or makes claims about the *member's* experience or qualifications in a manner that is false, misleading, or deceptive.

**.02** Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body. [Prior reference: paragraph .11 of ET section 501]

## 2.400.100 Use of the CPA Credential

**.01** A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .12 of ET section 501].

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## ET Part 3

### *Other Members*

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## 3.000 Introduction

.01 Part 3 of the Code of Professional Conduct (the code) applies to *members* who are not in *public practice* and are not *members in business*. Accordingly, when the term *member* is used in part 3 of the code, the requirements apply only to such *members*. [No prior reference: new content]

### **Effective Date**

.02 Effective December 15, 2014.

## 3.000.030 Applicability

.01 Part 3 of the code applies to *members* who are neither *members in public practice* nor *members in business*, for example *members* who are retired or not currently employed. These *members* are subject to the "Acts Discreditable Rule" [3.400.001]. [No prior reference: new content]

### **Effective Date**

.02 Effective December 15, 2014.

## 3.400 Acts Discreditable

### 3.400.001 Acts Discreditable Rule

.01 A *member* shall not commit an act discreditable to the profession. [Prior reference: paragraph .01 of ET section 501]

## Interpretations Under the Acts Discreditable Rule

### 3.400.010 Discrimination and Harassment in Employment Practices

.01 A *member* would be presumed to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [3.400.001] if a final determination, no longer subject to appeal, is made by a court or an administrative agency of competent jurisdiction that a *member* has violated any antidiscrimination laws of the United States, state, or municipality, including those related to sexual and other forms of harassment. [Prior reference: paragraph .03 of ET section 501]

### 3.400.020 Solicitation or Disclosure of CPA Examination Questions and Answers

.01 A *member* who solicits or knowingly discloses the Uniform CPA Examination question(s) or answer(s), or both, without the AICPA's written authorization shall be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [3.400.001]. [Prior reference: paragraph .07 of ET section 501]

### 3.400.030 Failure to File a Tax Return or Pay a Tax Liability

.01 A *member* who fails to comply with applicable federal, state, or local laws or regulations regarding (a) the timely filing of the *member's* personal tax returns or (b) the timely remittance of all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to

the profession, in violation of the "Acts Discreditable Rule" [3.400.001]. [Prior reference: paragraph .08 of ET section 501]

### **3.400.070 Confidential Information Obtained From Former Employment or Previous Volunteer Activities**

**.01** A *member* should maintain the confidentiality of his or her former employer's confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer's vendors, customers, or lenders (for example, any confidential information pertaining to a previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the *member* worked in a volunteer capacity).

**.02** For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the former employer or any organization for whom the *member* may have worked in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

**.03** A *member* should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or *close relative* or *immediate family member*.

**.04** A *member* should not use confidential employer information acquired as a result of a prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain the confidentiality of an employer's confidential information continues even after the end of the relationship between a *member* and the employer. However, the *member* is entitled to use experience and expertise gained through prior employment relationships.

**.05** A *member* would be considered in violation of the "Acts Discreditable Rule" [3.400.001] if the *member* discloses or uses any confidential employer information acquired as a result of former employment or volunteer relationships without the proper authority or specific consent of the former employer or organization for whom the *member* may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

**.06** The following are examples of situations in which *members* are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the former employer.
- b. Disclosure is required by law, for example, to
  - i. comply with a validly issued and enforceable subpoena or summons or
  - ii. inform the appropriate public authorities of violations of law that have been discovered.
- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
  - i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;



- ii. protect the *member's* professional interests in legal proceedings;
  - iii. comply with professional standards and other ethics requirements; or
  - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the former employer's confidential complaint hotline or *those charged with governance*.
- d. Disclosure is permitted on behalf of the former employer to
- i. obtain financing with lenders;
  - ii. communicate with vendors, *clients*, and customers; or
  - iii. communicate with the former employer's external accountant, attorneys, regulators, and other business professionals.

**.07** In deciding whether to disclose confidential employer information, relevant factors to consider include the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable. When the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, the member should use professional judgment in determining the type of disclosure to be made, if any.
- b. Whether the parties to whom the communication may be addressed are appropriate recipients.

**.08** A *member* may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information. [Prior reference: paragraph .10 of ET section 501]

### **3.400.090 False, Misleading, or Deceptive Acts in Promoting or Marketing Services**

**.01** A *member* would be in violation of the "Acts Discreditable Rule" [3.400.001] if the *member* promotes or markets the *member's* abilities to provide services or makes claims about the *member's* experience or qualifications in a manner that is false, misleading, or deceptive.

**.02** Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body. [No prior reference: new content]

#### ***Effective Date***

**.03** Effective December 15, 2014.

### **3.400.100 Use of the CPA Credential**

**.01** A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the

CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Acts Discreditable Rule" [3.400.001]. [Prior reference: paragraph .12 of ET section 501]

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**APPENDIXES**

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## ET Appendix A

# ***Council Resolution Designating Bodies to Promulgate Technical Standards***

[As amended January 12, 1988; Revised April 1992, October 1999, May 2004, October 2007, May 2008, October 2012 and May 2013.]

## **Federal Accounting Standards Advisory Board**

RESOLVED: That the Federal Accounting Standards Advisory Board, with respect to its statements of federal accounting standards and concepts adopted and issued in March of 1993 and subsequently, in accordance with its rules of procedure, the memorandum of understanding, and public notice designating FASAB's standards and concepts as having substantial authoritative support, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for federal governmental entities pursuant to the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code.<sup>1</sup>

[Added by *Council* October 1999.]

## **Financial Accounting Standards Board**

WHEREAS: In 1959 the *Council* designated the Accounting Principles Board to establish accounting principles, and

WHEREAS: The *Council* is advised that the Financial Accounting Standards Board (FASB) has become operational, it is

RESOLVED: That as of the date hereof the FASB, in respect of statements of financial accounting standards finally adopted by such board in accordance with its rules of procedure and the bylaws of the Financial Accounting Foundation, be, and hereby is, designated by this *Council* as the body to establish accounting principles pursuant to the "Accounting Principles Rule," (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) and standards on disclosure of financial information for such entities outside *financial statements* in published financial reports containing *financial statements* under the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct of the American Institute of Certified Public Accountants provided, however, any accounting research bulletins, or opinions of the accounting principles board issued or approved for exposure by the accounting principles board prior to April 1, 1973, and finally adopted by such board on or before June 30, 1973, shall constitute statements of accounting principles promulgated by a body designated by *Council* as contemplated in the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code unless and until such time as they are expressly superseded by action of the FASB.<sup>1</sup>

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<sup>1</sup> The changes to this appendix as of December 15, 2014 are administrative changes that were made to conform to the reformatted Code of Professional Conduct.

## Governmental Accounting Standards Board

WHEREAS: The Governmental Accounting Standards Board (GASB) has been established by the board of trustees of the Financial Accounting Foundation (FAF) to issue standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities, and

WHEREAS: The American Institute of Certified Public Accountants is a signatory to the agreement creating the GASB as an arm of the FAF and has supported the GASB professionally and financially, it is

RESOLVED: That as of the date hereof, the GASB, with respect to statements of governmental accounting standards adopted and issued in July 1984 and subsequently, in accordance with its rules of procedure and the bylaws of the FAF, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for state and local governmental entities, pursuant to the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code of Professional Conduct, and standards on disclosure of financial information for such entities outside *financial statements* in published financial reports containing *financial statements* under the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct.<sup>1</sup>

## Public Company Accounting Oversight Board

WHEREAS: The Public Company Accounting Oversight Board (PCAOB) has been established pursuant to the Sarbanes-Oxley Act of 2002 (the Act), and

WHEREAS: The PCAOB has authority under the Act to establish or adopt, or both, by PCAOB rule, auditing and related attestation standards, quality control, ethics, *independence* and other standards relating to the preparation and issuance of audit reports for issuers as defined in the Act.

RESOLVED: That the PCAOB be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish standards relating to the preparation and issuance of audit reports for entities within its jurisdiction as defined by the Act pursuant to the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct.<sup>1</sup>

[Added by *Council* May 2004.]

## International Accounting Standards Board

RESOLVED: That the International Accounting Standards Board (IASB) is hereby designated as the body to establish professional standards with respect to international financial accounting and reporting principles pursuant to the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) and the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code of Professional Conduct; and

BE IT FURTHER RESOLVED: That the *Council* shall reassess, no sooner than three years but no later than five years after the effective date of this

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<sup>1</sup> The changes to this appendix as of December 15, 2014 are administrative changes that were made to conform to the reformatted Code of Professional Conduct.

resolution, whether continued recognition of the IASB as the body designated to establish professional standards with respect to international financial accounting and reporting principles under the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) and the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code of Professional Conduct is appropriate.<sup>1</sup>

[Added by *Council* May 18, 2008; readopted by Council, May 19, 2013.]

## AICPA COMMITTEES AND BOARDS

WHEREAS: The membership of the *Institute* has adopted the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) of the Code of Professional Conduct, which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is<sup>1</sup>

### Accounting and Review Services Committee

RESOLVED: That the AICPA accounting and review services committee is hereby designated to promulgate standards under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct with respect to unaudited *financial statements* or other unaudited financial information of an entity that is not required to file *financial statements* with a regulatory agency in connection with the sale or trading of its securities in a public market.<sup>1</sup>

### Auditing Standards Board

RESOLVED: That, with respect to standards relating to the preparation and issuance of audit reports not included within the resolution on the Public Company Accounting Oversight Board, the AICPA auditing standards board is hereby designated as the body authorized under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct to promulgate auditing, attestation, and quality control standards and procedures.

RESOLVED: That the auditing standards board shall establish under statements on auditing standards, the responsibilities of *members* with respect to standards for disclosure of financial information outside of the *financial statements* in published financial reports containing *financial statements*.<sup>1</sup>

[Revised May 2004.]

### Management Consulting Services Executive Committee

RESOLVED: That the AICPA management consulting services executive committee is hereby designated to promulgate standards under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct with respect to the offering of management consulting services, provided, however, that such standards do not deal with the broad question of what, if any, services should be proscribed.

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<sup>1</sup> The changes to this appendix as of December 15, 2014 are administrative changes that were made to conform to the reformatted Code of Professional Conduct.

AND FURTHER RESOLVED: That any *Institute* committee or board now or in the future authorized by the *Council* to issue enforceable standards under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct must observe an exposure process seeking comment from other affected committees and boards, as well as the general membership.<sup>1</sup>

[Revised April 1992.]

### **Attestation Standards**

RESOLVED: That the AICPA accounting and review services committee, auditing standards board, and management consulting services executive committee are hereby designated as bodies authorized under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct to promulgate attestation standards in their respective areas of responsibility.<sup>1</sup>

[Added by *Council*, May 1988; revised April 1992.]

### **Tax Executive Committee**

RESOLVED: That the Tax Executive Committee is hereby designated as the body authorized under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct to promulgate professional practice standards with respect to tax services.<sup>1</sup>

[Added by *Council*, October 1999.]

### **Forensic and Valuation Services Executive Committee**

RESOLVED: That the Forensic and Valuation Services Executive Committee is hereby designated as the body to promulgate professional standards with respect to forensic and valuation services under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct.<sup>1</sup>

[Added by *Council*, October 2007.]

### **Personal Financial Planning Executive Committee**

RESOLVED: That the Personal Financial Planning Executive Committee is hereby designated as the body to promulgate professional standards with respect to personal financial planning services under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.310.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct.<sup>1</sup>

[Added by *Council*, October 2012.]

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<sup>1</sup> The changes to this appendix as of December 15, 2014 are administrative changes that were made to conform to the reformatted Code of Professional Conduct.



## ET Appendix B

# ***Council Resolution Concerning the Form of Organization and Name Rule***

[As adopted May 23, 1994; revised May 7, 1997, May 15, 2000, May 22, 2006 and August 2011.]

- A. RESOLVED: That with respect to a *member* engaged in *public practice*<sup>1</sup> in a *firm* or organization which performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards, (2) any review of a *financial statement* performed in accordance with the Statements on Standards for Accounting and Review Services, or (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements, or which holds itself out as a *firm* of certified public accountants or uses the term "certified public accountant(s)" or the designation "CPA" in connection with its name, the characteristics of such a *firm* or organization under the "Form of Organization and Name Rule" (AICPA, *Professional Standards*, ET sec. 1.800.001) of the Code of Professional Conduct are as set forth below:
1. A majority of the ownership of the *member's firm* in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the *firm* or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the *firm* or its affiliates is against the public interest and continues to be prohibited.
  2. There must be a CPA who has ultimate responsibility for all the services described in A above, compilation services and other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, and non-CPA owners could not assume ultimate responsibility for any such services or engagements.
  3. Non-CPA owners would be permitted to use the title "principal," "owner," "officer," "member" or "shareholder" or any other title permitted by state law, but not hold themselves out to be CPAs.
  4. A *member* shall not knowingly permit a person, whom the *member* has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the *member*, would place the *member* in violation of the rules. Further, a *member*

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<sup>1</sup> The change to this term is a conforming change to the Code of Professional Conduct. Specifically, the phrase "practice of public accounting" was replaced with the phrase "*public practice*" which is the term used in the Codification of the Code of Professional Conduct.

may be held responsible for the acts of all persons associated with him or her in the *public practice*<sup>1</sup> whom the *member* has the authority or capacity to control.

5. Owners shall at all times own their equity in their own right and shall be the beneficial owners of the equity capital ascribed to them. Provision would have to be made for the ownership to be transferred, within a reasonable period of time, to the *firm* or to other qualified owners if the owner ceases to be actively engaged in the *firm* or its affiliates.
  6. Non-CPA owners would not be eligible for regular membership in the AICPA, unless they meet the requirements in BL section 2.2.1.<sup>2</sup>
- B. RESOLVED: The characteristics of all other *firms* or organizations are deemed to be whatever is legally permissible under applicable law or regulation, except as otherwise provided in paragraph C below.
- C. RESOLVED: That with respect to a *member* engaged in *public practice*<sup>1</sup> in a *firm* or organization which is not within the description of a *firm* or organization set forth in paragraph A above, but who performs compilations of *financial statements* performed in accordance with the Statements on Standards for Accounting and Review Services, the characteristics of such a *firm* or organization under the "Form of Organization and Name Rule" of the Code are as set forth below.
1. There must be a CPA who has ultimate responsibility for any *financial statement* compilation services provided by the *firm* and by each business unit performing such compilation services and non-CPA owners could not assume ultimate responsibility for any such services.
  2. Any compilation report must be signed individually by a CPA, and may not be signed in the name of the *firm* or organization.

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<sup>1</sup> The change to this term is a conforming change to the Code of Professional Conduct. Specifically, the phrase "practice of public accounting" was replaced with the phrase "*public practice*" which is the term used in the Codification of the Code of Professional Conduct.

<sup>2</sup> The change to this appendix is an administrative change to conform to subparagraph 2.2.1 of BL section 220, *2.2 Requirements for Admission to Membership* [BL sec. 220 par. .01], of the Bylaws of the American Institute of Certified Public Accountants.

## ET Appendix C

### *Revision History Table*

Revisions made to the Code of Professional Conduct subsequent to June 1, 2014, appear below in the Revision History Table. In addition to identifying the numeric citation for the change, the effective date is identified and a link to the marked version of the content is provided when available. If the revision changes guidance that is already authoritative, the action taken (see "Action" column) will be identified as "revised." If the revision is new guidance, the action taken will be identified as "added."

The "New and Revised Interpretations and Other Guidance" [0.600.010] section and the "Pending Interpretations and Other Guidance" [0.600.020] section provide a listing of current activity.

<i>Revision History</i>			
<b>Citation</b>	<b>Action</b>	<b>Effective Date</b>	<b>Official Release</b>
0.200.020	Revised June 2014	September 30, 2014	<a href="http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/DownloadableDocuments/2014/2014AugustOfficialReleases.pdf">http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/DownloadableDocuments/2014/2014AugustOfficialReleases.pdf</a>
1.110.010	Revised June 2014	September 30, 2014	<a href="http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/DownloadableDocuments/2014/2014AugustOfficialReleases.pdf">http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/DownloadableDocuments/2014/2014AugustOfficialReleases.pdf</a>
2.110.010	Revised June 2014	September 30, 2014	<a href="http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/DownloadableDocuments/2014/2014AugustOfficialReleases.pdf">http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/DownloadableDocuments/2014/2014AugustOfficialReleases.pdf</a>



## ET Appendix D

### Mapping Document

[As of December 31, 2013]

On June 1, 2014, the AICPA issued a codification of the code's principles, rules, *interpretations* and rulings (revised code). To assist users in understanding where the content from the prior code appears in the revised code, this mapping document was created. The first two columns identify the citation and title where the content resided in the prior code and the second two columns identify the citation and title where the content now resides *in the revised code*. The "Prior Code Citations" box *has been left blank where* the content did not exist in the prior code and is new to the revised code. "New Titles" that appear in regular roman text are effective December 15, 2014, in bold italic December 15, 2015, and in italic have components that are effective both December 15, 2014, and December 15, 2015.

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
		0.100	Overview of the Code of Professional Conduct
Introduction	Composition, Applicability, and Compliance	0.100.010	Principles and Rules of Conduct
Introduction	Other Guidance	0.100.020	Interpretations and Other Guidance
		0.200.010	Structure of the AICPA Code
		0.200.020.01	Application of the AICPA Code
ET section 91	Applicability	0.200.020.02–.05	Application of the AICPA Code
		0.200.030	Citations
		0.200.040	Transition Provisions
		0.200.050	Drafting Conventions
ET section 51	Preamble	0.300.010	Preamble
ET section 52	Article I—Responsibilities	0.300.020	Responsibilities
ET section 53	Article II—The Public Interest	0.300.030	The Public Interest
ET section 54	Article III—Integrity	0.300.040	Integrity
ET section 55	Article IV—Objectivity and Independence	0.300.050	Objectivity and Independence

(continued)

<b><i>Prior Code Citations</i></b>	<b><i>Title in Prior Code</i></b>	<b><i>New Citation</i></b>	<b><i>New Title</i></b>
ET section 56	Article V—Due Care	0.300.060	Due Care
ET section 57	Article VI—Scope and Nature of Services	0.300.070	Scope and Nature of Services
ET section 92	Definitions	0.400	Definitions
ET section 100-1	Conceptual Framework for AICPA Independence Standards—Introduction	0.400.01	Acceptable level
		0.400.01	Acceptable level
ET section 101.20	Application of the Independence Rules to Affiliates—Definitions	0.400.02	Affiliate
		0.400.03	Attest Client
ET section 92.01	Attest engagement	0.400.04	Attest Engagement
ET section 92.02	Attest engagement team	0.400.05	Attest Engagement Team
ET section 101.17	Financial Relationships—Definitions	0.400.06	Beneficially Owned
ET section 92.03	Client	0.400.07	Client
ET section 92.04	Close relative	0.400.08	Close Relative
ET section 92.05	Confidential Client Information	0.400.09	Confidential Client Information
Various locations		0.400.10	Control (s) (led)
ET section 92.06	Council	0.400.11	Council
ET section 92.07	Covered Member	0.400.12	Covered Member
ET section 101.17	Financial Relationships—Definitions	0.400.13	Direct financial interest
		0.400.14	Employing organization
ET section 101.17	Financial Relationships—Definitions	0.400.15	Financial interest
ET section 101.20	Application of the Independence Rules to Affiliates—Definitions	0.400.16	Financial statement attest client
ET section 92.10	Financial statements	0.400.17	Financial statements
ET section 92.11	Firm	0.400.18	Firm
ET section 92.13	Immediate family	0.400.19	Immediate family
ET section 100-1 paragraph .09	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.20	Impair(ed)(ing)

<b><i>Prior Code Citations</i></b>	<b><i>Title in Prior Code</i></b>	<b><i>New Citation</i></b>	<b><i>New Title</i></b>
ET section 100-1 paragraphs .06–.08	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.21	Independence
ET section 101.17	Financial Relationships—Definitions	0.400.22	Indirect financial interest
ET section 92.14	Individual in a position to influence the attest engagement	0.400.23	Individual in a position to influence the attest engagement
ET section 92.15	Institute	0.400.24	Institute
ET section 92.16	Interpretation of a rules of conduct	0.400.25	Interpretation
ET section 92.17	Joint closely held investment	0.400.26	Joint Closely-Held Investments
ET section 92.18	Key position	0.400.27	Key position
ET section 92.09	Financial institution	0.400.28	Lending institution
ET section 92.19	Loan	0.400.29	Loan
ET section 92.20	Manager	0.400.30	Manager
ET section 92.21	Member	0.400.31	Member
ET section 92.22	Member in business	0.400.32	Member in business
ET section 92.23	Network	0.400.33	Network
ET section 92.24	Network Firm	0.400.34	Network Firm
ET section 92.25	Normal Lending Procedures, Terms, and Requirements	0.400.35	Normal lending procedures, terms, and requirements
ET section 92.26	Office	0.400.36	Office
ET section 92.27	Partner	0.400.37	Partner
ET section 92.28	Partner Equivalents	0.400.38	Partner Equivalents
ET section 92.29	Period of the professional engagement	0.400.39	Period of the professional engagement
ET section 92.31	Professional services	0.400.40	Professional Services
ET section 100-1 paragraph .20	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.41	Public interest entities
ET section 92.30	Practice of public accounting	0.400.42	Public Practice (also referred to as the practice of public accounting)
ET section 100-1 paragraph .20	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.43	Safeguards

(continued)

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.02	Interpretation of Rule 101— Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated with a Client	0.400.44	Share-based compensation arrangements
ET section 92.32	Significant influence	0.400.45	Significant influence
ET section 101.05	Performance of nonattest services— Management Responsibilities	0.400.46	Source Documents
ET section 191.224–.225	Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services	0.400.47	Third-party service provider
ET section 291.023–.024	Applicability of General and Technical Standards When Using a Third-Party Service Provider	0.400.47	Third-party service provider
ET section 391.001–.002	Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member	0.400.47	Third-party service provider
ET section 92.33	Those Charged with Governance	0.400.48	Those Charged With Governance
		0.400.49	Threats
		0.500	Nonauthoritative Guidance
		0.600.010	New and Revised Interpretations and Other Guidance
		0.600.020	Pending Interpretations and Other Guidance
		0.700	Deleted Interpretations and Other Guidance
		1.000	Members in Public Practice— Introduction
		1.000.010	<b><i>Conceptual Framework for Members in Public Practice</i></b>



<b>Prior Code Citations</b>	<b>Title in Prior Code</b>	<b>New Citation</b>	<b>New Title</b>
		1.000.020	Members in Public Practice—Ethical Conflicts
ET section 102.01	Integrity and Objectivity	1.100.001	Integrity and Objectivity Rule
		1.100.005	<i>Integrity and Objectivity Rule—Application of the Conceptual Framework for Members in Public Practice and the Ethical Conflicts</i>
ET section 102.03	Conflicts of Interest	1.110.010	Conflicts of Interest
ET section 191.186–.187	Service on Board of Directors of Federated Fund-Raising Organization	1.110.010.01j	Conflicts of Interest
ET section 191.198–.199	Member Providing Services for Company Executives	1.110.010.01k	Conflicts of Interest
ET section 191.220–.221	Member is Connected With an Entity That has a Loan to or From a Client	1.110.010.01l	Conflicts of Interest
ET section 191.170–.171	Bank Director	1.110.020	Director Positions
ET section 191.226–.227	Acceptance or Offering of Gifts or Entertainment	1.120.010	Offering or Accepting Gifts or Entertainment
ET section 102.02	Knowing misrepresentations in the preparation of financial statements or records	1.130.010	Knowing Misrepresentations in the Preparation of Financial Statements or Records
ET section 102.05	Subordination of judgment by a member	1.130.020	Subordination of Judgment
ET section 102.07	Professional Services involving client advocacy	1.140.010	Client Advocacy
ET section 191.224–.225	Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services	1.150.040	Use of a Third-Party Service Provider
ET section 101.01	Rule 101—Independence	1.200.001	Independence Rule

(continued)

<b><i>Prior Code Citations</i></b>	<b><i>Title in Prior Code</i></b>	<b><i>New Citation</i></b>	<b><i>New Title</i></b>
ET section 101.02	Interpretation of Rule 101—Other Considerations	1.200.005.01–.02	Application of the Conceptual Framework for Independence and Ethical Conflicts Interpretation
		1.200.005.03	Application of the Conceptual Framework for Independence and Ethical Conflicts Interpretation
ET section 101.02	Interpretation of Rule 101—Other Considerations	1.210.010.01	Conceptual Framework for Independence
ET section 100-1	Conceptual Framework for AICPA Independence Standards—Introduction	1.210.010.02–.08	Conceptual Framework for Independence
ET section 101.02	Interpretation of Rule 101—Other Considerations	1.210.010.09	Conceptual Framework for Independence
ET section 100-1	Conceptual Framework for AICPA Independence Standards—Introduction	1.210.010.10–.21	Conceptual Framework for Independence
ET section 101.19	Network and network firms	1.220.010.01–.05	Network and Network Firms
ET section 101.19	Network and network firms—Characteristics of a Network	1.220.010.06–.19	Characteristics of a Network
ET section 101.16	The effect of alternative practice structures on the applicability of independence rules	1.220.020	Alternative Practice Structures
ET section 191.142–.143	Use of Nonindependent CPA Firm on an Engagement	1.220.030	Use of a Nonindependent CPA Firm on an Engagement
ET section 101.20	Application of the Independence Rules to Affiliates	1.224.010	Client Affiliates
ET section 101.12	The effect of independence of relationships with entities included in the governmental financial statements	1.224.020	Entities Included in State and Local Government Financial Statements
ET section 191.200–.201	Actions Permitted When Independence is Impaired	1.226.010	Consenting to the Use of a Previously Issued Report

<b><i>Prior Code Citations</i></b>	<b><i>Title in Prior Code</i></b>	<b><i>New Citation</i></b>	<b><i>New Title</i></b>
ET section 191.188–.189	Indemnification Clause in Engagement Letters	1.228.010	Indemnification of a Covered Member
ET section 191.204–.205	Indemnification of a Client	1.228.020	Indemnification of an Attest Client
ET section 191.190–.191	Agreement with Attest Client to Use ADR Techniques	1.228.030.01–.02	Alternative Dispute Resolution
ET section 191.192–.193	Commencement of ADR Proceeding	1.228.030.03	Alternative Dispute Resolution
New		1.230.010.01	Unpaid Fees
ET section 191.103–.104	Unpaid Fees	1.230.010.02–.03	Unpaid Fees
New		1.230.020	Fees and Other Types of Remuneration
ET section 101.02(A)(1)	Interpretation of Rule 101-A1	1.240.010.01–.02	Overview of Financial Interests
ET section 101.17	Financial Relationships—Financial Interests	1.240.010.01–.02	Overview of Financial Interests
ET section 101.02(B)	Interpretation of Rule 101-B	1.240.010.03	Overview of Financial Interests
ET section 101.17	Financial Relationships—Unsolicited Financial Interest	1.240.020	Unsolicited Financial Interests
ET section 101.17	Financial Relationships—Mutual Funds	1.240.030	Mutual Funds
ET section 101.17	Financial Relationships—Retirement, Savings, Compensation, or Similar Plans	1.240.040	Retirement, Savings, Compensation, or Similar Plans
ET section 101.17	Financial Relationships—Partnerships	1.240.050	Partnerships
ET section 101.17	Financial Relationships—Limited Liability Companies	1.240.060	Limited Liability Companies
ET section 101.17	Financial Relationships—Section 529 Plans	1.240.070	Section 529 Plans
ET section 191.021–.022	Member Designated to Serve as Executor or Trustee	1.245.010.01	Trustee or Executor
ET section 101.02(A)(2)	Interpretation of Rule 101-A2	1.245.010.02	Trustee or Executor

(continued)

<b><i>Prior Code Citations</i></b>	<b><i>Title in Prior Code</i></b>	<b><i>New Citation</i></b>	<b><i>New Title</i></b>
ET section 101.17	Financial Relationships—Trust Investments	1.245.020	Trust Investments
ET section 191.214–.215	Participation in Employee Benefit Plan Sponsored by Client	1.250.010.01	Plan is an Attest Client or is Sponsored by an Attest Client
ET section 101.17	Financial Relationships—Retirement, Savings, Compensation, or Similar Plans	1.250.010.02	Plan is an Attest Client or is Sponsored by an Attest Client
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# Bylaws of the American Institute of Certified Public Accountants

As Amended October 28, 1997, unless otherwise indicated

## DEFINITIONS

As used in these bylaws, implementing resolutions of Council thereunder, or the Code of Professional Conduct, masculine terms shall be understood to include the feminine; "state" shall be understood to include the District of Columbia, Puerto Rico, and the territories, or territorial possessions of the United States of America; "firm" shall be understood to mean any organization permitted by law or regulation; "owner" shall be understood to include partners, partner equivalents, shareholders, or other owners of a firm; "official records of the Institute" shall be understood to mean the records of the membership department; and "committee" shall be understood to include any board (except the AICPA Board of Directors), division, task force, or any subdivision thereof.

[As revised May 15, 2000; revised November 6, 2007.]

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# BL Section 100

## 1. NAME AND PURPOSE

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**BL Section 101*****Name and Purpose***

**As amended  
January 12, 1988**

**.01** The name of this organization shall be the American Institute of Certified Public Accountants. In keeping with the Institute's certificate of incorporation, its objectives shall be to unite certified public accountants in the United States; to promote and maintain high professional standards of practice; to assist in the maintenance of standards for entry to the profession; to promote the interests of CPAs; to develop and improve accounting education; and to encourage cordial relations between CPAs and professional accountants in other countries.

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**BL Section 200****2. ADMISSION TO, AND RETENTION OF,  
MEMBERSHIP AND ASSOCIATION**

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## **BL Section 210**

### ***2.1 Members***

**As amended  
January 12, 1988**

**.01** Members of the Institute shall be

**2.1.1** Members of the Institute at the effective date of these bylaws,  
and

**2.1.2** Persons who shall qualify for admission as provided in section 2.2  
of this article and who shall be admitted under procedures adopted by the  
Board of Directors.

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## BL Section 220

### **2.2 Requirements for Admission to Membership**

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Persons may qualify for admission as members of the Institute if they satisfy the criteria listed below:

**2.2.1** They are in possession of a valid and unrevoked certified public accountant certificate issued by a legally constituted authority, or at any time possessed the certificate described herein and the certificate was not revoked as a result of a disciplinary action, or meet the education, examination, and experience requirements set out in the Uniform Accountancy Act and who are of good moral character and have never been granted a right to practice,

**2.2.2** They have passed an examination in accounting and other related subjects satisfactory to the Board of Directors, and

**2.2.3** With respect to those persons who are engaged in the practice of public accounting as an owner or as an employee who has been licensed as a CPA for more than two years, either they are practicing in a firm that is enrolled in an Institute-approved practice-monitoring program if the services performed by such a firm are within the scope of the AICPA's practice-monitoring standards and the firm issues reports purporting to be in accordance with AICPA professional standards, or if authorized by Council, are themselves enrolled in such a program.

[As amended October 28, 1997, May 15, 2000, and October 8, 2010.]

(See section 220R.)

**2.2.4** With respect to persons who first become eligible to take the examination required by section 2.2.2 after the year 2012, they shall have obtained 150 semester hours of education at an accredited college or university including a bachelor's degree or its equivalent. After 2012, a person who does not meet the educational requirement set out in this section shall, nonetheless, be eligible for membership upon enactment (regardless of the effective date) of the education requirement set out in this section by the state which grants the certificate required under section 2.2.1.

[As revised May 15, 2000; revised November 6, 2007.]





**BL Section 220R*****Implementing Resolution Under Section 2.2  
Requirements for Admission to Membership***

As amended  
October 24, 1994,  
unless otherwise  
indicated

**Under Sections 2.2.3 and 2.3.4 to Implement the  
Practice-Monitoring Requirement*****Resolved:***

.01 That the Board of Directors is authorized to establish within the Institute a peer review division governed by an executive committee named the "peer review board" having senior status with authority to carry out the activities of the division. The primary activities of the division will be to establish and conduct, in cooperation with state CPA societies, practice-monitoring programs for AICPA and state society members engaged in the practice of public accounting. Such activities shall not conflict with the policies and standards of the AICPA and shall be subject to the oversight of the Board of Directors. The nominees to serve on the peer review board shall be selected by the AICPA nominations committee and elected by Council.

[As revised by Council May 15, 2000.]

***Further Resolved:***

.02 A firm within the description of subparagraph A of Council Resolution Concerning Rule 505 shall be required to enroll in an Institute-approved practice-monitoring program. An individual engaged in the practice of public accounting in a firm not within the description of Subparagraph A of Council Resolution Concerning Rule 505, but who performs compilations of financial statements in accordance with the Statements on Standards for Accounting and Review Services shall be enrolled in an Institute-approved practice-monitoring program. A firm or individual enrolled in a practice-monitoring program established herein shall be deemed to be enrolled in an approved practice-monitoring program under sections 2.2.3 and 2.3.4 of the bylaws. A firm or individual which is dropped for disciplinary reasons from enrollment in a practice-monitoring program established herein is ineligible to enroll in another Institute-approved practice-monitoring program until the cause of the disciplinary action is removed.

[As amended by Council October 28, 1997; revised May 15, 2000; revised November 6, 2007.]

***Further Resolved:***

[.03] [Deleted May 15, 2000.]



**BL Section 230*****2.3 Requirements for Retention of Membership***

**As amended  
January 8, 1990,  
unless otherwise  
indicated**

**.01** Members of the Institute shall

**2.3.1** Pay dues as established by Council.

**2.3.2** Conform with these bylaws and the Rules of the Code of Professional Conduct.

**2.3.3** Complete continuing professional education requirements established by Council.

(See section 230R.)

**2.3.4** Engage in the practice of public accounting with a firm that is enrolled in an Institute-approved practice-monitoring program if the services performed by such a firm are within the scope of the AICPA's practice-monitoring standards and the firm issues reports purporting to be in accordance with AICPA professional standards or, if authorized by Council, themselves enroll in such a program.

[As amended October 28, 1997; revised May 15, 2000.]

(See section 220R, as amended October 24, 1994.)

**2.3.5**

[Deleted November 6, 2007.]

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## BL Section 230R

### ***Implementing Resolutions Under Section 2.3 Requirements for Retention of Membership***

As amended  
January 12, 1988,  
unless otherwise indicated

#### **Under Sections 2.2.3 and 2.3.4 to Implement the Practice-Monitoring Requirement**

[.01-.03] [Deleted March 1995. See section 220R.]

#### **Under Section 2.3.3 Continuing Professional Education for Members**

***Resolved:***

.04 That pursuant to section 2.3.3 of the bylaws the continuing professional education requirement for membership in the American Institute of Certified Public Accountants shall be as follows:

From January 1, 2001, forward and for each three-year reporting period thereafter, all AICPA members shall complete 120 hours, or its equivalent, of continuing professional education. Compliance can be achieved either by a formal program of education or by any other means, however measured, that would be reasonably expected to maintain professional competencies in the member's area of practice or employment. Members shall report compliance with such requirement to the AICPA each year and shall keep appropriate records and submit copies of such on request of the Institute.

[As amended by Council September 23, 1989 and May 7, 1997.]

[.05-.06] [Deleted January 1, 2001.]

***Further Resolved:***

.07 That the Board of Directors, or a body designated or appointed by it, shall have the power and authority to

- a. Identify and accept methods of learning to meet and measure this continuing professional education requirement.
- b. Grant exceptions for reasons such as retirement, inactive dues status, health, military service, foreign residency, or any other reason it deems appropriate.

[As amended by Council May 7, 1997.]

#### **Under Section 2.3.5, Definition of "SEC Client"**

[.08] [Deleted November 6, 2007.]



**BL Section 240*****2.4 Certificate of Membership***

**As amended  
January 12, 1988**

**.01** Upon admission each member shall be entitled to a certificate setting forth that the person is a member of the Institute, but no certificate shall be issued until receipt of dues for the current year. Certificates of membership shall be returned upon the demand of the secretary of the Institute in the event of suspension or termination of membership.

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**BL Section 250*****2.5 Right of Members to Describe  
Themselves as Such***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** A member of the Institute shall be entitled to use the designation "Member of the American Institute of Certified Public Accountants." A firm shall be entitled to use the designation "Members of the American Institute of Certified Public Accountants" only if all of its CPA owners are members.

[As revised May 15, 2000.]

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**BL Section 260*****2.6 International Associates***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** International associates shall include those who were international associates on or before January 12, 1988. Thereafter, citizens of other countries who shall satisfy such requirements as the Council may prescribe may be admitted as international associates. The Council shall adopt rules governing such association and indications thereof.

[As revised May 15, 2000.]

(See section 260R.)

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**BL Section 260R*****Implementing Resolution Under Section 2.6  
International Associates***

**As adopted  
May 7, 1997,  
unless otherwise indicated**

***Resolved:***

**.01** That membership in the nonvoting international associate category created pursuant to bylaw section 2.6 shall be available to any individual who holds a valid non-U.S. accounting credential from a professional organization, governmental entity, or similar accountancy body with which the AICPA Board of Directors has approved a recognition agreement, and who is of good moral character and does not hold a CPA certificate issued by a U.S. jurisdiction and who meets either the CPE requirement for a CPA or its equivalent in the individual's home country or for an AICPA member. If reasonably practicable and appropriate, all member benefits will be made available to international associates, except for voting, eligibility for a seat on Council and as a nonpublic member of the Board of Directors.

[As revised by Council May 24, 2010.]

***Further Resolved:***

**.02** That any individual who was an international associate as of May 25, 2010, shall be eligible to continue as a member of the international associate category.

[As adopted by Council May 24, 2010.]

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**BL Section 300**

**3. ORGANIZATION AND PROCEDURE**

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## BL Section 310

### 3.1 General

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** The organization of the Institute shall include the members, the Council, the Board of Directors, officers, and committees.

**.02** The Board of Directors may from time to time organize the committees and staff of the Institute into divisions and, subject to section 3.6, may adopt rules of procedure and operating policies for such divisions.

#### **3.1.1 Communications With Members**

Any communication, notification or other action required by these by-laws to be provided or undertaken by mail or in writing, to or from the members, may be provided or undertaken by any means including but not limited to electronic or telephonic means, as authorized by Council. Except for determining a member's residence for voting purposes under section 3.2.3, a member's mailing address for purposes of these bylaws may be an electronic or other form of address, in lieu of a postal address.

[As adopted May 15, 2000.]

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## BL Section 320

### 3.2 Membership

As amended  
June 17, 1996,  
unless otherwise  
indicated

**.01** The rights and powers of the membership of the Institute shall be as defined herein.

#### **3.2.1 Attendance at Meetings**

Every member and international associate of the Institute shall be entitled to attend all meetings of the Institute.

#### **3.2.2 Voting Rights**

Every member, but no international associate, shall be entitled to vote in person, when in attendance, upon all questions brought before duly called meetings of the Institute, and by mail ballot for the election of Council members pursuant to sections 6.1 through 6.1.6, on proposed amendments to these bylaws or to the Code of Professional Conduct as provided in article 8, and upon proposed resolutions of the membership as provided in section 5.1.4.

#### **3.2.3 Residence for Voting Purposes**

The state from which a member may vote shall be that indicated by the member's mailing address as carried in the official records of the Institute, and may be either the state in which the member resides or that in which the member's office is located.

#### **3.2.4 Resolutions of the Membership**

As provided in section 5.1.4, the members by mail ballot may enact resolutions of the membership, not inconsistent with these bylaws, which shall be binding upon the membership, the Council, the Board of Directors, officers, committees, and staff.

#### **3.2.5 Certain Positions to Be Held Only by Members**

With the exceptions noted below, only members of the Institute, as defined in section 2.1, may serve as members of the Council, the Board of Directors, or any committee or board designated as "senior" by the Council (see section 3.6.1) or as "permanent" by these bylaws (see section 3.6.2). Exceptions to this rule are as follows:

1. Three representatives of the public, none of whom shall be members of the Institute, shall be members of the Board of Directors and Council.
2. Council may authorize the appointment of persons who are not Institute members to any senior or permanent committee or board provided the non-Institute members do not constitute more than twenty-five percent of its membership.

[As revised May 15, 2000.]



## BL Section 320R

# *Implementing Resolution Under Section 3.2 Membership*

As adopted  
May 15, 2000,  
unless otherwise  
indicated

### **Under Section 3.2.5 Certain Positions to Be Held Only by Members**

***Resolved:***

**.01** That pursuant to bylaw section 3.2.5, persons who are not Institute members may be appointed to the following senior or permanent committees or boards:

- Board of Examiners
- Professional Ethics Executive Committee
- Auditing Standards Board
- Financial Reporting Executive Committee
- Center for Audit Quality Governing Board
- Peer Review Board
- Personal Financial Planning Executive Committee
- Information Management and Technology Assurance Executive Committee
- Forensic and Valuation Services Executive Committee
- National Accreditation Commission

[As revised by Council October 21, 2003; revised October 24, 2005; revised May 21, 2006; revised May 24, 2010; revised May 20, 2013.]

***Further Resolved:***

**.02** That except as otherwise provided by Council, and except for committees of the Board of Directors, such as the Committee on Audit, no public member on a senior or permanent committee or board may serve as its chair.

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## BL Section 330

### 3.3 Council

As amended  
January 12, 1988

.01 The governing body of the Institute shall be the Council.

#### **3.3.1 Composition**

The Council shall be composed of

**3.3.1.1** Members of the Institute directly elected by the membership in each state in accordance with sections 6.1.1 through 6.1.6;

**3.3.1.2** Representatives of the recognized state societies of certified public accountants selected in accordance with section 6.2;

**3.3.1.3** Twenty-one members-at-large selected in accordance with section 6.3;

**3.3.1.4** All members of the Board of Directors of the Institute;

**3.3.1.5** All past presidents of the American Institute of Certified Public Accountants who served prior to December 31, 1973, and are members of the Institute;

**3.3.1.6** All past chairmen of the board of the American Institute of Certified Public Accountants who are members of the Institute.

#### **3.3.2 Powers**

The Council may exercise all powers requisite for the purposes of the Institute, not inconsistent with these bylaws or with duly enacted resolutions of the membership, including but not limited to the authority to prescribe the policies and procedures of the Institute and to enact resolutions binding upon the Board of Directors, the officers, committees, and staff.

#### **3.3.3 Reports to Membership**

The actions of the Council shall be reported to the membership at least annually.

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## BL Section 340

### *3.4 Board of Directors*

**As amended  
January 12, 1988**

**.01** Between meetings of the Council, the activities of the Institute shall be directed by the Board of Directors, the composition of which shall be prescribed by the Council.

(See section 340R.)

#### **3.4.1 Powers**

The Board of Directors shall act as the executive committee of Council between meetings of Council, shall control and manage the property, business, and activities of the Institute, and shall take whatever action it deems desirable including the establishment of policies for the conduct of the affairs of the Institute consistent with the provisions of these bylaws, resolutions of the membership, or actions of the Council.

#### **3.4.2 Reports to Council**

The actions of the Board of Directors shall be reported to the Council at least semiannually.

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**BL Section 340R*****Implementing Resolution Under Section 3.4  
Board of Directors***

**As amended  
May 23, 1994**

***Resolved:***

- .01** That the Board of Directors shall be composed of
- (a) The chairman, the vice chairman, and the immediate past chairman of the Board of Directors;
  - (b) The president of the Institute;
  - (c) Sixteen present or former members of the Council elected pursuant to section 6.3 to serve for three years or until the election of their successors; and
  - (d) Three representatives of the public, who are not members of the Institute.
-



**BL Section 350*****3.5 Officers Elected by Council***

**As amended  
June 17, 1996**

.01 The officers of the Institute elected by the Council shall be a chairman of the Board of Directors and a vice chairman of the board, who shall be the chairman of the board nominee, both of whom shall be members possessing valid and unrevoked certified public accountant certificates. The chairman and the vice chairman of the board shall have such terms of office, powers, and privileges as the Council may prescribe.

(See section 350R.)

**3.5.1 Officers Appointed by the Board of Directors**

The officers of the Institute appointed by the Board of Directors shall be a president, who shall be a full-time employee of the Institute and who shall be a member possessing a valid and unrevoked certified public accountant certificate, and a secretary, who shall be a full-time employee of the Institute, but need not be a member of the Institute. The president and the secretary shall have such terms of office, powers, and privileges as the Board of Directors may prescribe. The Board of Directors may also appoint staff vice presidents who shall be neither members of the board nor of the Council and who shall perform such duties as may be assigned to them by the president.

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**BL Section 350R*****Implementing Resolution Under Section  
3.5 Officers Elected by Council***

As amended  
January 14, 1992

***Resolved:*****Term of Office**

.01 That the chairman and the vice chairman of the Board of Directors shall each be elected annually by the Council for a term of one year or until the election of that person's successor. Neither may succeed oneself in the same office after serving a full term of one year. The term of the president and the secretary shall be determined by the Board of Directors.

**Chairman of the Board**

.02 That the chairman of the Board of Directors shall preside at meetings of members of the Institute, the Council, and the Board of Directors. The chairman shall appoint committees and boards as provided in section 3.6 of the bylaws. The chairman shall act as a spokesperson for the Institute and appear on its behalf before other organizations.

**Vice Chairman of the Board**

.03 That the vice chairman shall be chairman-nominee of the Board of Directors and shall preside in the absence of the chairman at meetings of the Institute, the Council, and the Board of Directors. The vice chairman shall familiarize oneself with the duties of the office of chairman and shall perform such other related duties as may be assigned to the vice chairman by the chairman.

**President**

.04 That the president shall have full responsibility for the execution of the policies and programs of the Institute, act as a spokesperson for the Institute, and perform such other services as may be assigned to the president by the Council and the Board of Directors.

**Secretary**

.05 That the secretary of the Institute shall have the usual duties of a corporate secretary and shall perform such other related duties as may be assigned to the secretary by the president. An assistant secretary to serve in the secretary's absence, who need not be a member of the Institute, may be appointed by the Board of Directors.

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## BL Section 360

### 3.6 Committees

**As amended  
June 17, 1996,  
unless otherwise indicated**

**.01** Except as otherwise provided by these bylaws or the Council (see section 3.6.1), the chairman of the Board of Directors, or the chairman's delegate, may appoint committees and boards with such duties, powers, responsibilities, and procedures as the chairman may prescribe. The chairman of the board and the president shall have the privilege of the floor at meetings of all committees.

(See section 360R.)

#### **3.6.1 Senior Committees**

The Council may designate any committee as a "senior" committee. The appointment by the chairman of the Board of Directors of members and any appointed pursuant to bylaw 3.2.5, to senior committees shall require the approval of the Board of Directors. The scope of responsibility of senior committees shall be as the Council may prescribe consistent with the specific provisions of these bylaws. The Board of Directors shall prescribe the duties, powers, and procedures of such committees.

[As revised November 6, 2007.]

(See section 360R.)

#### **3.6.2 Permanent Committees, Boards, and Divisions**

The following shall be permanent committees, boards, or divisions of the Institute: the nominations committee (see section 3.6.2.1); the professional ethics division (see section 3.6.2.2); the trial board (see section 3.6.2.3); and the board of examiners (see section 3.6.2.4).

(See section 360R.)

##### **3.6.2.1 Nominations Committee**

There shall be a nominations committee composed of eleven persons, including any appointed pursuant to bylaw 3.2.5 and members of the Institute, elected by the Council in such manner as the Council shall prescribe. It shall be the responsibility of the committee to make nominations for the offices of chairman of the Board of Directors, vice chairman of the Board of Directors, the elected members of the Board of Directors, the joint trial board, the peer review board, and the Council, as elsewhere provided in these bylaws, and to apportion among the states directly elected Council seats pursuant to section 6.1.2.

(See section 360R.)

##### **3.6.2.2 Professional Ethics Division**

The executive committee of the professional ethics division, including any appointed pursuant to bylaw 3.2.5, shall serve as the ethics committee of the Institute, and there shall be such other committees

within the division as the Board of Directors shall authorize. The executive committee shall (1) subject to amendment, suspension, or revocation by the Board of Directors, adopt rules governing procedures consistent with these bylaws or actions of Council to investigate potential disciplinary matters involving members, (2) arrange for presentation of a case before the trial board where the committee finds prima facie evidence of infraction of these bylaws or of the Code of Professional Conduct, (3) interpret the Code of Professional Conduct, (4) propose amendments thereto, and (5) perform such related services as the Council may prescribe.

(See section 360R.)

### **3.6.2.3 Joint Trial Board**

There shall be a trial board that, in addition to any appointed pursuant to bylaw 3.2.5, shall consist of members possessing a valid and unrevoked certified public accountant certificate, each of whom shall have been a member for at least five consecutive years prior to that person's appointment to the joint trial board, to adjudicate disciplinary charges against members of the Institute pursuant to section 7.4. Members of the trial board shall be elected by the Council for such terms as the Council may prescribe.

The trial board is empowered to adopt rules, consistent with these bylaws or actions of the Council, governing procedure in cases heard by any hearing panel, and in connection with any application for review of a decision of a hearing panel.

Decisions of any hearing panel shall be subject to review only by the trial board.

(See section 360R.)

### **3.6.2.4 Board of Examiners**

There shall be a board of examiners, that, in addition to any appointed pursuant to bylaw 3.2.5, shall consist of persons who have passed the Uniform CPA Examination and who possess valid and unrevoked certified public accountant certificates, appointed by the chairman of the Board of Directors subject to the approval of the Board of Directors. It shall supervise the preparation of a uniform examination which may be adopted by the legally constituted authorities of the states in examining candidates for the certified public accountant certificate and the conduct of the grading service offered by the Institute. The board of examiners shall formulate the necessary rules and regulations for the conduct of its work, but all such rules and regulations may be amended, suspended, or revoked by the Board of Directors. The board of examiners may delegate to members of the Institute's staff or other duly qualified persons the preparation of examination questions and the operation of the grading service conducted by the Institute.

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**BL Section 360R*****Implementing Resolutions Under  
Section 3.6 Committees***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** (1) That the following be designated as senior committees and boards:\*

- Accounting and review services committee\*
- Assurance services executive committee\*
- Auditing standards board\*
- Board of examiners
- Center for audit quality governing board\*
- Employee benefit plans audit quality center executive committee
- Financial reporting executive committee\*
- Forensic and valuation services executive committee\*
- Government audit quality center executive committee
- Information management and technology assurance executive committee
- Management consulting services executive committee\*
- National Accreditation Commission
- Peer review board\*
- Personal financial planning executive committee\*
- Private companies practice executive committee\*
- Professional ethics executive committee\*
- Tax executive committee\*

[As amended by Council May 1988 and May 1991; revised April 1992; amended October 1994; revised June 1996; revised May 1997; revised October 21, 2003; revised October 24, 2005; revised October 2007; revised May 24, 2010; revised October 2012.]

**[.02]**

[As amended by Council May 1988 and May 1991; revised April 1992; amended October 24, 1994; revised May 1997; revised October 21, 2003; revised October 24, 2005; deleted October 2007.]

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\* Note: \* Indicates a senior committee which is authorized to make statements, without clearance with the Council or the Board of Directors, in matters related to its area of practice.

## Under Section 3.6.2.1 Nominations Committee

### *Resolved:*

.03 That the nominations committee shall be chaired by the immediate past chairman of the Board and shall consist of ten additional members serving two-year terms. At the Council meeting held in conjunction with the annual meeting, the Board of Directors, after having considered at least ten candidates, shall recommend five members for election to the nominations committee, each for a two-year term. At any one time, no more than seven members shall be members of Council, and none except the chairman shall be a member of the Board of Directors. Other nominations from the floor shall be permitted. Voting shall be by voice vote of the incoming Council, or, if requested by a majority of those present, by written ballot. A majority vote shall elect. With the exception of its chairman, no member, having served on the nominations committee, shall be eligible again to serve on the nominations committee until the passage of five years.

[As amended by Council May 1991; revised May 15, 2000.]

### *Further Resolved:*

.04 That the nominations committee shall not select any of its members for positions to be filled by the committee.

## Under Section 3.6.2.2 Professional Ethics Division

### *Resolved:*

.05 That in cases where the professional ethics executive committee concludes that a prima facie violation of the Code of Professional Conduct or by-laws is not of sufficient gravity to warrant further formal action, the committee may direct the member or members concerned to complete specified continuing professional education courses, or to take other remedial or corrective action, provided, however, that there will be no publication of such action in the Institute's principal membership periodical and the member concerned is notified of the member's right to reject such direction. In the case of such a rejection, the professional ethics executive committee shall determine whether to bring the matter to a hearing panel of the trial board for a hearing.

### *Further Resolved:*

.06 That in cases where there is prima facie evidence of one or more actions by or with respect to a member as described in subparagraphs 7.4.1 through and including 7.4.6 of bylaw section 7.4, the professional ethics executive committee may decide to offer the member or members concerned the opportunity to avoid further investigation and a possible hearing before the trial board by entering into a settlement agreement under such terms and conditions as the committee deems appropriate including but not limited to agreement by the member or members (a) to resign from membership or (b) to complete specified continuing professional education courses and/or to submit to independent preissuance review of some or all financial statements and accountant's reports and/or submit to an accelerated practice-monitoring review, and/or to perform other remedial or corrective action as the committee may determine and/or (c) to submit to disciplinary action with publication by the Institute as provided in Council resolutions under bylaw section 7.6. The committee shall monitor compliance with the settlement agreement and may initiate an investigation where it finds there has been noncompliance.

[As revised by Council April 28, 2003; revised November 6, 2007.]

.07 A member's rejection of the terms and conditions of a proposed settlement agreement will not in any way affect the rights of a member under the bylaws and implementing resolutions in any subsequent investigation by the professional ethics executive committee in a hearing before the trial board.

[As adopted by Council May 26, 1993.]

### Under Section 3.6.2.3 Joint Trial Board

***Resolved:***

.08 That the joint trial board shall consist of at least thirty-six members elected for a three-year term by Council on a staggered basis on nomination of the nominations committee. No member shall serve more than two full successive terms. The size of the trial board shall be determined by the Board of Directors. No member of the Institute's professional ethics division, of a state society ethics committee, or of a state board of accountancy shall be a member of the trial board.

[As revised by Council June 17, 1996.]

.09 The trial board shall elect from its membership a chairman and a vice chairman, the vice chairman to serve as chairman during any period of unavailability of the chairman. It shall also elect a secretary who need not be a member.

.10 The chairman or vice chairman, when acting as chairman, pursuant to the trial board rules of practice and procedure, may appoint from the members of the trial board a panel consisting of not less than three members, which may, but need not, include the chairman to sit as a hearing panel and hear and adjudicate charges against members, or an ad hoc committee consisting of not less than three members of the trial board to consider requests for nonapplication of sections 7.2 and 7.3. Decisions of hearing panels shall be reviewable by the trial board under the conditions and procedures as provided for in Council resolution under section 7.4 of the bylaws.

[As revised by Council May 15, 2000.]

***Resolved:***

.11 That the trial board is authorized to receive and act on petitions requesting review of a decision of the peer review board terminating a firm's or an individual's enrollment in the practice-monitoring program or of an AICPA peer review committee's decision terminating a firm's or an individual's enrollment in another Institute-approved practice-monitoring program. Following such review, the trial board may affirm, modify, or reverse all or any part of the peer review board's or an AICPA peer review committee's decision, but it may not increase the severity of the peer review board's or an AICPA peer review committee's sanction.

[As revised by Council June 17, 1996; revised October 24, 2005; revised November 6, 2007.]

***Resolved:***

.12 That the trial board is authorized to receive and act on petitions requesting review of a decision by the Center for Audit Quality Governing Board which imposed a sanction upon, or denied a reinstatement request by, a member or associate member of the Center for Audit Quality. Following such review, the trial board may affirm or reverse the Board's decision.

[As adopted by Council October 24, 2005.]

***Resolved:***

**.13** That the trial board may hear and adjudicate charges involving alleged violations of a state CPA society's bylaws or code of professional conduct when there is in force a written agreement for such procedure between the Institute and the state CPA society concerned.

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**BL Section 400****4. FINANCIAL MANAGEMENT AND CONTROLS**

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**BL Section 401**

***Financial Management and Controls***

**As amended  
January 12, 1988**

**.01** The Council shall have authority to prescribe such procedures as it deems appropriate to assure adequate budgetary and financial controls. Budgets shall be prepared and presented as the Council shall prescribe.

(See section 401R.)

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**BL Section 401R*****Implementing Resolution Under Article 4  
Financial Management and Controls***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** That annual budget of revenues and expenditures for the succeeding fiscal year shall be prepared by the Institute's staff, reviewed and approved by the Board of Directors, and presented to Council for approval; such budgets shall be in a form indicating the costs of the principal programs and activities of the Institute; material variations from the annual budget shall be reported to the Council by the Board of Directors; receipt of such report without rejection shall constitute authority to continue expenditures for purposes indicated in the annual budget, as modified and presented to Council, until a new budget for the following fiscal year is approved by the Council. However, the Board of Directors may, between meetings of Council, authorize additional expenditures in total not to exceed 5 percent of budgeted revenues from all sources.

[As revised by Council May 15, 2000.]

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## **BL Section 410**

### ***4.1 Audit***

**As amended  
January 12, 1988**

**.01** The Council shall, for each fiscal year, appoint a certified public accountant or certified public accountants to express an opinion on the financial statements of the Institute and its affiliated organizations. The financial statements of the Institute and the report of the auditor or auditors for each fiscal year shall be published for the information of the membership.

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**BL Section 420*****4.2 Committee on Audit***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** The chairman of the board shall appoint from among the members of the Board of Directors, other than the officers, a committee on audit to make arrangements with the auditor or auditors for their examination, to review the audit report, and to perform such other duties appropriate for such a committee as directed by the Board of Directors.

[As revised May 15, 2000.]

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**BL Section 430*****4.3 Execution of Instruments on Behalf  
of the Institute***

**As amended  
January 12, 1988**

**.01** All checks, drafts, deeds, mortgages, bonds, contracts, reports, proxies, and other instruments may be executed on behalf of the Institute by such officers or employees as the Council or the Board of Directors may from time to time designate, either generally or in specific instances.

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**BL Section 440****4.4 Indemnification**

**As amended  
January 12, 1988**

**.01** The Institute shall indemnify to the full extent authorized by law for the good faith exercise of judgment in the performance of assigned duties any person made or threatened to be made a party to any action, suit, or proceeding, whether criminal, civil, administrative, or investigative, by reason of the fact that the person, the person's testator, or intestate is or was a member of Council, the Board of Directors, or any committee, trustee, officer, employee, or agent of the Institute or any affiliated entity or serves or served any other enterprise as a director, trustee, officer, employee, or agent at the request of the Institute.

**.02** Without limiting the generality of the foregoing, the Institute may contract for insurance against all or a portion of any liabilities and expenses, if any, resulting from the indemnification of any of the foregoing persons pursuant to this section or otherwise as permitted by law, and may also contract for companion insurance directly insuring any or all of such persons against liabilities and expenses.

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## BL Section 450

### *4.5 Dues*

**As amended  
January 14, 1992**

**.01** The Council shall determine the annual dues which shall be paid by each member and international associate in accordance with such classifications as it deems appropriate, and may require dues of a different amount for each class so created.

**.02** Dues shall be payable on or before the first day of each fiscal year of the Institute or in such other manner as the Council shall prescribe. For new members or international associates, dues shall be apportioned to the end of the fiscal year.

**.03** No dues shall be paid by members or international associates of the Institute while they are engaged in military service of the United States or its allies during war. Individual members or international associates may be excused from payment of dues for reasonable cause by the chairman of the Finance Committee.

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## **BL Section 460**

### ***4.6 Fiscal Year***

**As amended  
January 12, 1988**

**.01** The fiscal year of the Institute shall be as the Council shall prescribe.

(See section 460R.)

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**BL Section 460R**

***Implementing Resolution Under Section 4.6  
Fiscal Year***

**As amended  
January 12, 1988**

***Resolved:***

**.01** That the fiscal year of the Institute shall be the twelve months beginning August 1 and ending July 31.

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**BL Section 500****5. MEETINGS OF THE INSTITUTE AND  
THE COUNCIL**

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## **BL Section 501**

### ***Meetings of the Institute and the Council***

**As amended  
January 12, 1988**

**.01** This article shall govern meetings of the Institute and of the Council. The Board of Directors shall determine the dates of meetings of Council and the matters to be presented for action.

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## BL Section 510

### *5.1 Meetings of the Institute*

As amended  
January 12, 1988

.01 The membership shall meet pursuant to sections 5.1.1 through 5.1.3, conduct its business pursuant to section 5.1.3, and may adopt resolutions pursuant to section 5.1.4. Meetings of the membership shall be known as meetings of the Institute.

#### **5.1.1 Regular Meetings of the Institute**

There shall be a regular meeting of the Institute within three months after the close of the fiscal year, on a date to be fixed by the Board of Directors. This meeting shall also be known as the annual meeting of the Institute.

#### **5.1.2 Special Meetings of the Institute**

The chairman of the board shall call special meetings of the Institute when so requested by the Council or the Board of Directors, or upon the written request of at least 5 percent of the membership of the Institute or any thirty members of Council. Special meetings of the Institute shall be held at places designated by the Board of Directors. No business shall be transacted at a special meeting of the Institute other than that for which the meeting shall have been convened.

#### **5.1.3 Notice of Meetings of the Institute**

Notice of each meeting of the Institute, whether regular or special, shall be mailed to each member of the Institute, at the member's mailing address as shown on the official records of the Institute, at least thirty days prior to the date of such meeting.

#### **5.1.4 Resolution of the Membership by Mail Ballot**

A majority of the members of the Institute, assembled at any duly called corporate meeting of the Institute at which a quorum is present, may direct that the chairman of the board submit any question to the entire membership for a vote by mail. Any resolution enacted in such a mail ballot by two-thirds of the members voting shall be declared by the chairman of the board a resolution of the membership and shall be binding, if consistent with these bylaws, upon the Council, the Board of Directors, committees, officers, and staff. Mail ballots shall be valid and counted only if received within sixty days after the date of the mailing of ballot forms.

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## BL Section 520

### *5.2 Meetings of Council*

As amended  
January 12, 1988,  
unless otherwise  
indicated

.01 Meetings of the Council shall be governed by sections 5.2.1 through 5.2.5, section 5.3, and section 6.6.

#### **5.2.1 Regular Meetings of Council**

A regular meeting of the Council shall be held in conjunction with the annual meeting of the Institute and on such other dates as the Council or the Board of Directors may designate.

[As revised May 15, 2000.]

#### **5.2.2 Special Meetings of Council**

The chairman of the board shall call special meetings of the Council when requested to do so by the Board of Directors or when requested in writing by at least thirty members of the Council. Special meetings of the Council shall be held at places designated by the Board of Directors.

#### **5.2.3 Mail Ballot in Lieu of Special Meeting of Council**

In lieu of a special meeting of the Council, the chairman of the board, with the approval of the Board of Directors, may submit any question to the Council for a vote by mail, and any action therein approved in writing by not less than two-thirds of those voting shall be declared by the chairman of the board an act of the Council and shall be recorded in the minutes of the Council provided, however, that at least a majority of the Council must have cast ballots on the question.

[As revised November 6, 2007.]

#### **5.2.4 Notice**

Notice of each meeting of the Council shall be sent to each member of the Council, at the member's mailing address as shown in the official records of the Institute, at least twenty-one days before such meeting. Such notice, as far as practicable, shall contain a statement of the business to be transacted.

#### **5.2.5 Minutes**

A copy of the minutes of each meeting of the Council shall be forwarded to each member of the Council within forty-five days after such meeting.



**BL Section 530****5.3 General Provisions Governing Meetings**

**As amended  
January 12, 1988**

**.01** The following general provisions shall govern quorum and parliamentary procedure.

**5.3.1 Meetings—Quorum**

Five hundred members of the Institute shall constitute a quorum for the transaction of any business duly presented at any meeting of the Institute. Thirty members of Council shall constitute a quorum of the Council at any duly called meeting of the Council. Eleven members of the Board of Directors shall constitute a quorum of the board.

**5.3.2 Meetings—Rules of Parliamentary Procedure Applicable**

The rules of parliamentary procedure contained in *Robert's Rules of Order Revised* shall govern all meetings of the Institute and of the Council.

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**BL Section 600**

**6. ELECTION OF COUNCIL, BOARD OF DIRECTORS, AND OFFICERS OF THE INSTITUTE**

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## BL Section 601

# *Election of Council, Board of Directors, and Officers of the Institute*

As amended  
January 12, 1988

.01 Except for ex officio members of Council (see sections 3.3.1.4 through 3.3.1.6), the election of members of the Council, the Board of Directors, and officers of the Institute shall be in accordance with the provisions of this article.

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## BL Section 610

# ***6.1 Members of Council Directly Elected by Members of the Institute***

As amended  
June 17, 1996,  
unless otherwise  
indicated

**.01** Members of Council directly elected by the membership in the respective states (see section 3.3.1.1) shall be elected in accordance with sections 6.1.1 through 6.1.6 as supplemented by Council resolution.

### **6.1.1 At Least One Member of Council Directly Elected by Membership of Each State**

There shall be at least one member of Council directly elected by the members of the Institute in each state having one or more persons enrolled upon the membership lists of the Institute.

### **6.1.2 Number and Allocation of Directly Elected Council Seats Among the States**

The total number of directly elected members of Council, in addition to those provided for by section 6.1.1, shall be eighty-five except as modified by section 6.1.2.1. The number of seats, excluding those extended by section 6.1.2.1, shall be equitably allocated among the states in direct proportion to the number of Institute members enrolled from each state.

#### **6.1.2.1 Unexpired Terms Unaffected by Reduced Allocation**

No member of Council directly elected by the membership in any state shall lose the member's seat for the term the member then serves should the allocation of that state be diminished by virtue of section 6.1.2; but, no state's allocation of directly elected Council seats shall be extended by this section beyond the natural expiration of a seat's full term or its vacation by the member filling it, whichever first occurs.

#### **6.1.2.2 Allocation to Be Made by Nominations Committee**

The nominations committee shall make the allocation provided in section 6.1.2. It shall be made at five-year intervals, at least nine months prior to annual meetings to be held each calendar year which ends in one and in six, and shall govern the five annual elections immediately following. It shall be based upon the membership figures and addresses carried on the books of the Institute the last day of the fiscal year immediately preceding the date of such determination.

If a state gains an additional seat from such allocation, the state society may request the nominations committee to authorize election for an initial term of less than three years in order to promote orderly rotation of Council members from that state. Upon receipt of such request, the nominations committee may authorize such shortened term. Following the expiration of such shortened term, subsequent terms for the seat shall be for three years, as provided in section 6.1.3.

In the event that a state has three or more directly elected members whose terms are not evenly staggered over a three-year cycle, the state society may request the nominations committee, for the election following the year these bylaws are adopted and thereafter in calendar years ending in one and in six, to approve the election of a nominee to fill a vacancy for a term of less than three years in order to effect a more orderly rotation of the Council members from that state. The nominations committee may authorize such shortened term. Subsequent terms for such a seat shall be three years, as provided in section 6.1.3.

### **6.1.3 Term of Office**

Except as specified by this section 6.1.3, the term of office of a directly elected member of the Council shall commence when the member's election is announced by the chairman of the Board of Directors at the meeting of the Council held in conjunction with the annual meeting of the Institute, as prescribed by section 6.6, and shall run until the announcement of the election of new directly elected members of the Council at the meeting of the Council held in conjunction with the annual meeting of the Institute three years after the member's election. If any such member of the Council shall not serve that member's full term, the vacancy so created may be filled pursuant to section 6.5. The term of office of any member directly elected by the members in that member's state to fill such vacancy shall be the remainder of the three-year term with respect to which the vacancy occurred.

No member having served for two consecutive full terms as a directly elected member of the Council shall be eligible to serve another such term until at least one year after the completion of the member's second consecutive full term.

### **6.1.4 Number of Council Seats to Be Filled by Election**

The number of Council seats to be filled in a state's quota of directly elected members of the Council for any given year shall be the number of its allocation of directly elected Council seats less the number of members of the Council from that state filling such seats for terms running through that year.

### **6.1.5 Nominations**

At least eight months prior to the annual meeting of the Institute, the nominations committee shall request, from the recognized society of certified public accountants in each state for which any vacancies (see section 6.1.4) will arise in the coming year, the names of suggested candidates from the state represented by such society to fill each such vacancy. The committee shall give due consideration to the names so submitted, but shall not be required to select its nominees from among such names. In the absence of a satisfactory response from any such state society, the nominations committee shall select the nominees from such state.

The nominations committee shall make its nominations for directly elected members of the Council at least six months prior to the annual meeting of the Institute. Notice of such nominations shall be published to the membership by the secretary at least five months prior to the annual meeting of the Institute. Five percent, but in no event less than twenty members of the Institute from any given state for which a vacancy shall arise, may submit to the secretary independent nominations for directly

elected members of the Council from that state provided that such nominations be filed with the secretary at least four months prior to the annual meeting of the Institute.

[As revised November 6, 2007.]

#### **6.1.6 Election**

The nominees of the nominations committee for directly elected seats on Council shall be declared elected by the secretary if no independent nominations are filed for such seats as required by section 6.1.5.

If independent nominations are received, the secretary shall mail to all members of the Institute in each state in which there is a contest for a directly elected seat on Council, at least ninety days prior to the annual meeting of the Institute, mail ballots containing the names and relevant background information of nominees from that state nominated by the nominations committee and the names and relevant background information of nominees independently nominated. Each ballot shall contain an announcement that votes will be counted only if received by the secretary at least forty-five days before the annual meeting of the Institute. Election to contested seats on Council shall be determined by a plurality of the votes received from each jurisdiction by that date. Mail ballots shall be counted by the secretary, who shall certify the results for publication to the membership. Newly elected members shall be notified promptly and advised to attend the meeting of Council held in conjunction with the annual meeting of the Institute. They shall take office as provided in section 6.6.

[As revised May 15, 2000; revised November 6, 2007]

(See section 610R.)

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## **BL Section 610R**

# ***Implementing Resolution Under Section 6.1 Members of Council Directly Elected by Members of the Institute***

As amended  
January 12, 1988

## **Under Section 6.1.6 Election**

### ***Resolved:***

**.01** That the withdrawal of a nomination for whatever reason after the balloting has commenced will not be acted upon until the certification of election has been completed. Vacancies then arising will be filled in accordance with section 6.5 of the bylaws, except that in states where the number of nominees exceeds the number of vacancies, the vacancy created by any withdrawal will be filled by that nominee having the highest number of votes after all other vacancies have been filled.

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**BL Section 620*****6.2 Selection of Members of Council to Represent State Societies***

**As amended  
June 17, 1996,  
unless otherwise  
indicated**

**.01** Each recognized state society of certified public accountants shall designate, in a manner it deems appropriate, an Institute member to represent it on the Council. The term of each member of the Council so designated shall commence at the meeting of Council held in conjunction with the annual meeting of the Institute after notification to the secretary by the society designating the member. The term shall run for one year or until the commencement of the successor's term, provided that no such member of the Council shall represent a state society for more than six consecutive years.

[As revised May 15, 2000.]

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**BL Section 630****6.3 Election of Members-at-Large of Council,  
Board of Directors, Chairman of the Board,  
and Vice Chairman of the Board**

As amended  
January 14, 1992,  
unless otherwise  
indicated

.01 At the meeting of the Council held in conjunction with the annual meeting of the Institute, following the completion of such other business as the Council may transact, seven Institute members, without regard to the states in which they reside, shall be elected annually by the Council as members-at-large of the Council. This election shall occur prior to the installation of the members of the Council newly elected under section 6.1. The at-large members shall serve for a term of three years or until the election of their successors. At the same meeting, but after all newly elected and designated Council members have been installed, the Council shall elect the chairman of the board, the vice chairman of the board, one-third (or as near to one-third as mathematically possible) of the elected members of the Board of Directors. The elected members of the Board of Directors shall serve for a term of three years or until election of their successors. The Council shall also elect one representative of the public, who is not a member of the Institute, to the Board of Directors for a term of three years, or until election of a successor. Nominations for all these positions on the Board of Directors shall be made by the nominations committee at least six months prior to the annual meeting of the Institute. Notice of those nominations shall be published to the membership of the Institute at least five months prior to such annual meeting. Independent nominations may be made by any twenty members of the Council if filed with the secretary at least four months prior to the annual meeting of the Institute. No nominations from the floor will be recognized. A majority of votes shall elect. Nominees may be invited to the meeting at which the election is to be held, and those elected shall take office as prescribed in section 6.6.

[As amended June 17, 1996; revised May 15, 2000.]

.02 No member having served for two consecutive full terms as a member-at-large of the Council shall be eligible to serve another such term until at least one year after the completion of the member's second consecutive full term.

**6.3.1. Re-election to Board of Directors**

No elected member of the Board of Directors who has served a full three-year term shall be eligible for re-election to such a term until the meeting of the Council one year after the completion of the member's full three-year term, provided, however, that a public member may be elected to serve a second three-year term.



## **BL Section 640**

### ***6.4 Forfeiture of Office for Nonattendance***

**As amended  
January 12, 1988**

**.01** Any directly elected member or member-at-large of Council who shall be absent from three consecutive meetings shall forfeit that member's seat.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

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## BL Section 650

### 6.5 Vacancies

**As amended  
June 17, 1996**

**.01** Vacancies in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute elected by the Council, occurring between annual meetings of the Institute, may be filled by election of replacements by the Council, either at a meeting of Council or by mail ballot, under such conditions as the Council may prescribe. If the Council should so replace a directly elected member of the Council, such interim appointment will run only until the member's seat is filled by direct election of the membership of that member's state as provided in these bylaws.

**.02** Pending action by the Council to fill a vacancy among any of the officers of the Institute who are elected by the Council, the Board of Directors may appoint a temporary successor to act in the capacity indicated.

(See section 650R.)

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

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**BL Section 650R*****Implementing Resolution Under Section 6.5  
Vacancies***

**As amended  
June 17, 1996**

***Resolved:***

**.01** That if a vacancy occurs in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute elected by the Council between annual meetings of the Institute, the Board of Directors shall recommend replacements for election by Council. Voting on such replacement may be conducted by mail ballot, in which case provision shall be made for write-in votes, or at the next meeting of Council, as may appear most desirable in the circumstances. If the voting takes place at a Council meeting, nominations from the floor shall be permitted; voting may be by voice vote, or, at the request of a majority of those present, by written ballot. A majority vote shall elect. In any event, persons elected to fill vacancies in the Board of Directors, in the Council, or in any of the offices of the Institute elected by the Council shall serve only for the remainder of the unexpired term of the previous incumbent or until a successor is elected.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

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**BL Section 660*****6.6 Election Meeting of Council***

**As amended  
June 17, 1996,  
unless otherwise  
indicated**

**.01** New members-at-large of Council elected pursuant to section 6.3 shall take office as soon as their election is completed, replacing those members-at-large whose terms shall have expired. Then the presiding officer shall announce the installation of members of the Council newly elected under section 6.1, at which time they shall take office, replacing those directly elected members of Council whose terms shall have expired. Election of officers who are elected by the Council, new members of the Board of Directors, and others shall then be held, and each officer or member of the Board of Directors so elected shall replace that person's predecessor upon such election, provided, however, that the retiring chairman of the board shall continue in office through the end of the annual meeting of the Institute.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996; as revised May 15, 2000.]

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## BL Section 670

### ***6.7 Term Limit***

**As adopted  
November 6, 2007**

**.01** Regardless of whether a member has served as a designated, directly elected, or at-large member of Council, no Council member who has served in any, or all, of the foregoing categories may serve more than seven consecutive years. A member who has served seven consecutive years shall not be eligible to serve on Council as a designated, directly elected, or at-large member of the Council until at least one year after the seventh consecutive year the member last served on the Council. Notwithstanding anything to the contrary in any section of these bylaws, any period during which an individual served as an ex officio Council member, such as president or a member of the Board of Directors, shall not be included in any determination of eligibility under this section.

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**BL Section 700****7. TERMINATION OF MEMBERSHIP AND  
DISCIPLINARY SANCTIONS**

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**BL Section 701*****Termination of Membership and Disciplinary Sanctions***

**As amended  
January 12, 1988**

**.01** This article shall govern the termination or suspension of membership in the Institute, whether imposed as a matter of discipline or voluntarily sought, and the imposition of any other disciplinary sanction, or administrative reprimand, whether public or private, or imposition of conditions for retention of membership.

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## BL Section 710

### *7.1 Resignation of Membership*

**As amended  
January 12, 1988,  
unless otherwise indicated**

**.01** Resignations of members shall be in writing and may be offered at any time. Actions on such resignations and applications for reinstatement of resigned members shall be taken by the Board of Directors under such provisions as the Council may prescribe. Council may make separate provision for action on resignations of members not in good standing or against whom disciplinary proceedings or investigations are pending or as to whom or to whose firm a practice-monitoring review has begun but has not been completed, and the resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program, and on applications for reinstatement of persons whose resignation was accepted when in such classification.

[As revised November 6, 2007]

(See section 710R.)

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**BL Section 710R*****Implementing Resolution Under Section 7.1  
Resignation of Membership***

**As amended,  
January 12, 1988,  
unless otherwise indicated**

***Resolved:***

.01 That the Board of Directors shall act upon resignation of members, which shall become effective on the date of acceptance, but no action shall be taken on the resignation of a member with respect to whom charges are under investigation by the professional ethics division, or against whom a complaint is pending before the trial board, or as to whom or whose firm a practice-monitoring review has begun but has not been completed, and the resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program unless the division, the trial board, or the Peer Review Board or peer review committee, as the case may be, recommends that such resignation be accepted. If a person whose resignation was accepted when that person was under investigation or the object of a complaint or during the pendency of a practice-monitoring review when that resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program, should subsequently apply for reinstatement, the Board of Directors shall not reinstate such person without the consent of the division or the trial board, or the Peer Review Board or committee as the case may be.

[As revised November 6, 2007.]

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**BL Section 720*****7.2 Termination of Membership for  
Nonpayment of Financial Obligation  
or for Failure to Comply With  
Membership-Retention Requirements***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** The Board of Directors may, in its discretion, terminate the membership of a member who fails to pay dues or any other obligation to the Institute within five months after such debt has become due and terminate the membership of a member who fails to comply with the practice-monitoring or continuing education membership-retention requirements. The Council shall provide for consideration and disposition by the trial board, with or without hearing, of a timely written petition that membership should not be terminated pursuant to this section. Any membership so terminated may be reinstated by the Board of Directors, under such conditions and procedures as the Council may prescribe.

(See section 720R.)

**7.2.1 Termination of Association of International Associate**

The Board of Directors may terminate the affiliation of an international associate at its discretion.

[As revised May 15, 2000.]

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**BL Section 720R*****Implementing Resolution Under  
Section 7.2 Termination of Membership  
for Nonpayment of Financial Obligation  
or for Failure to Comply With  
Membership-Retention Requirements***

As amended  
January 12, 1988

***Resolved:***

**.01** That if a person whose membership has terminated for nonpayment of dues or other financial obligation shall apply for reinstatement, the Board of Directors, in its discretion, may reinstate the member, provided that all dues and other obligations owing to the Institute at the time membership was terminated shall have been paid.

***Further Resolved:***

**.02** That if a person whose membership has terminated for failure to comply with membership-retention requirements relating to CPE or practice-monitoring shall apply for reinstatement, the Board of Directors, in its discretion, may reinstate the person as a member provided the person shall have satisfactorily demonstrated that the failure to comply with the CPE or practice-monitoring requirements has been rectified.

***Further Resolved:***

**.03** That no person shall be considered to have resigned in good standing if at the time of resignation the person was in debt to the Institute for dues or other obligations. A member submitting a resignation after the beginning of the fiscal year, but before expiration of the time limit for payment of dues or other obligations, may attain good standing by paying dues prorated according to the portion of the fiscal year which has elapsed, provided obligations other than dues shall have been paid in full.

**.04** A member who has resigned or whose membership has terminated in any manner may not file a new application for admission but may apply for reinstatement under this resolution or applicable provisions of the bylaws.

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**BL Section 730****7.3 Disciplinary Action Without a Hearing**

As amended  
January 12, 1988,  
unless otherwise indicated

.01 Membership in the Institute shall be suspended or terminated without a hearing for disciplinary purposes, or a member may be subjected to other disciplinary actions, as provided in sections 7.3.1 and 7.3.2, under such conditions and by such procedure as shall be prescribed by the Council.

[As revised October 18, 2003.]

(See section 730R.)

**7.3.1 Criminal Conviction of Member**

Membership in the Institute shall be suspended without a hearing should there be filed with the secretary of the Institute a judgment of conviction imposed upon any member for

**7.3.1.1** A crime punishable by imprisonment for more than one year;

**7.3.1.2** The willful failure to file any income tax return which the member, as an individual taxpayer, is required by law to file;

**7.3.1.3** The filing of a false or fraudulent income tax return on the member's or a client's behalf; or

**7.3.1.4** The willful aiding in the preparation and presentation of a false and fraudulent income tax return of a client; and

shall be terminated in like manner upon the similar filing of a final judgment of conviction; however, the Council shall provide for the consideration and disposition by the trial board, with or without hearing, of a timely written petition of any member that the member's membership should not be suspended or terminated pursuant to section 7.3.1.1, herein.

**7.3.2 Other Disciplinary Action**

**7.3.2.1** Membership in the Institute shall be suspended without a hearing should a member's certificate as a certified public accountant or license or permit to practice as such or to practice public accounting be suspended as a disciplinary measure; however, such suspension of membership shall terminate upon reinstatement of the certificate, license or permit. Membership in the Institute shall be terminated without a hearing should such certificate, license, or permit be revoked, withdrawn, surrendered, indefinitely suspended, or cancelled as a disciplinary measure or in connection therewith.

[As revised October 18, 2003.]

**7.3.2.2** The professional ethics executive committee and the Board of Directors may jointly approve certain governmental agencies and other organizations whose disciplinary actions against a member will permit the Institute to take disciplinary action against that member without a hearing. To be eligible for approval, the governmental

agency must be one which has the authority to prohibit a member from either practicing before it or serving as a director, officer or trustee of an entity. To be eligible for approval, an organization other than a governmental agency must be one which has been granted the authority by statute or regulation to regulate accountants. If such approved governmental agency or organization temporarily suspends, prohibits or restricts a member from practicing before it or another governmental agency, or from serving as a director, officer or trustee of any entity, the member's membership in the Institute shall be suspended; however, such suspension of membership shall terminate upon such agency's or organization's termination of the suspension, prohibition or restriction. If such approved governmental agency or organization bars or permanently or indefinitely suspends, prohibits or restricts a member from practicing before it or another governmental agency, or from serving as a director, officer or trustee of any entity, the member's membership in the Institute shall be terminated.

[As adopted October 18, 2003.]

**7.3.2.3** A member who has been subjected to any sanction as a disciplinary measure other than or in addition to those sanctions addressed above, by an authority covered in section 7.3.2.1 or section 7.3.2.2, may also be subjected to discipline by the Institute without a hearing pursuant to guidelines established by the professional ethics executive committee and approved by the Board of Directors.

[As adopted October 18, 2003.]

**7.3.2.4** Council shall permit the trial board, with or without a hearing, to consider a timely written petition by the professional ethics executive committee or the member that the member should not be disciplined pursuant to this section 7.3.2.

[As revised October 18, 2003.]

### **7.3.3 Trial Board Disciplining Not Precluded**

Application of the provisions of section 7.3.1 and section 7.3.2 shall not preclude the summoning of the member concerned to appear before a hearing panel of the trial board pursuant to section 7.4.

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**BL Section 730R*****Implementing Resolution Under Section 7.3  
Disciplinary Action Without a Hearing***

As amended  
January 12, 1988,  
unless otherwise  
indicated

***Resolved:***

**.01** (1) That the membership of a member who is convicted by a court of any of the criminal offenses enumerated in section 7.3.1 of the bylaws shall become automatically suspended upon the mailing of a notice of such suspension, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a certified copy of a judgment of conviction of such criminal offense has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

**.02** (2) That the membership of a member who has been convicted by a court of any of the offenses enumerated in section 7.3.1 of the bylaws, and which conviction has become final, shall become automatically terminated upon the mailing of a notice of such termination, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a certified copy of such conviction and evidence that it has become final has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

**.03** (3) That the membership of a member (a) whose certificate, license or permit to practice public accounting or as a certified public accountant has been suspended as a disciplinary measure or (b) who is subject to a temporary suspension, prohibition or restriction by an approved governmental agency or organization covered in section 7.3.2 as a disciplinary measure shall, except as provided in paragraph (7) of this resolution, become automatically suspended upon the expiration of thirty days after the mailing of a notice of such suspension, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a statement by such authority showing the suspension, prohibition or restriction and specifying the cause and duration of such authority's action has been filed with the secretary of the Institute. Such automatic suspension shall cease upon the expiration of the period of suspension, prohibition or restriction so specified.

[As revised by Council October 18, 2003.]

**.04** (4) That the membership of a member (a) whose certificate, license or permit to practice public accounting or as a certified public accountant has been revoked, withdrawn, indefinitely suspended, surrendered or cancelled as a disciplinary measure, or (b) who has been subjected to a bar, to a permanent or indefinite suspension, prohibition or restriction by an approved governmental agency or organization covered in section 7.3.2 shall, except as provided in paragraph (7) of this resolution, become automatically terminated upon the expiration of thirty days after the mailing of a notice of such termination, as provided in paragraph (6) of this resolution. Such notice shall be mailed within

a reasonable time after a statement by such authority showing the revocation, withdrawal, surrender, cancellation, bar, permanent or indefinite suspension, prohibition or restriction and specifying the cause of such authority's action, has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

**.05** (5) That, if a member has been subjected to any sanction as a disciplinary measure, other than or in addition to those set out in paragraph (1), (2), (3) or (4), the member shall, except as provided in paragraph (7), have their membership suspended or terminated or be otherwise disciplined upon the expiration of thirty days after the mailing of a notice of such disciplinary action taken pursuant to guidelines developed by the professional ethics executive committee and approved by the Board of Directors, under section 7.3.2.

[As adopted by Council October 18, 2003.]

**.06** (6) That notices of disciplinary action pursuant to paragraph (1), (2), (3), (4) or (5) of this resolution shall be signed by the secretary of the Institute and mailed by registered or certified mail, postage prepaid, addressed to the member concerned at the member's last known address according to the official records of the Institute, which are the records of the membership department.

[As revised by Council June 17, 1996; revised October 18, 2003.]

**.07** (7) That the operation of paragraph (1), (2), (3), (4) or (5) of this resolution shall become postponed if, before the expiration of thirty days after mailing the notice of disciplinary action, the secretary of the Institute receives a written petition from either the member concerned or the professional ethics executive committee that the pertinent provision not become operative. The petition shall state briefly the facts and reasons relied upon. All such petitions shall be referred to the trial board for action thereon by a panel of the trial board consisting of at least three members appointed by the chairman of the trial board or vice chairman, when acting as chairman. If the petition is denied, the disciplinary action shall become effective upon such denial, and the party that made the petition shall be so notified in writing by the secretary of the Institute. No appeal shall be allowable with respect to a denial of such a petition. If the petition is granted, the disciplinary action shall not become effective. In such event, the secretary shall transmit the matter to the professional ethics division to take whatever action it considers proper in the circumstances. A determination that paragraph (1), (2), (3), (4) or (5) of this resolution shall not become operative shall be made only when it clearly appears that, because of exceptional or unusual circumstances, it would be inequitable to permit such automatic disciplinary action.

[As revised by Council May 15, 2000; revised October 18, 2003.]

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**BL Section 740*****7.4 Disciplining of Member by Trial Board***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Under such conditions and by such procedure as the Council may prescribe, a hearing panel of the trial board, by a two-thirds vote of the members present and voting, may expel a member (except as otherwise provided in section 7.4.3), or by a majority vote of the members present and voting, may suspend a member for a period not to exceed two years not counting any suspension imposed under sections 7.3.1 and 7.3.2, or may impose such lesser sanctions as the Council may prescribe on any member if the member

**7.4.1** Infringes any of these bylaws or any rule of the Code of Professional Conduct;

**7.4.2** Is declared by a court of competent jurisdiction to have committed any fraud;

**7.4.3** Is held by a hearing panel of the trial board to have been guilty of an act discreditable to the profession, or to have been convicted of a criminal offense which tends to discredit the profession; provided that should a hearing panel of the trial board find by a majority vote that the member has been convicted by a criminal court of an offense involving moral turpitude, or any of the offenses enumerated in section 7.3.1, the penalty shall be expulsion;

**7.4.4** Is declared by any competent court to be insane or otherwise incompetent;

**7.4.5** Is subject to a disciplinary action by an authority covered in section 7.3.2 that could result in automatic discipline under section 7.3.2; or

[As revised October 18, 2003.]

**7.4.6** Fails to cooperate with the professional ethics division in any disciplinary investigation of the member, owner or employee of the firm by not making a substantive response to interrogatories or a request for documents from a committee of the professional ethics division or by not complying with the educational and remedial or corrective action determined to be necessary by the professional ethics executive committee, within thirty days after the posting of notice of such interrogatories, or a request for documents, or directive to take CPE or corrective action by registered or certified mail, postage prepaid, to the member at the member's last known address shown in the official records of the Institute.

[As revised May 15, 2000.]

**.02** With respect to a member residing in a state in which the state society has entered into an agreement approved by the Institute's Board of Directors

**2416**      **Termination of Membership and Disciplinary Sanctions**

to deal with complaints against society members in cooperation with the professional ethics division, disciplinary hearings shall be conducted before a hearing panel of the joint trial board.

(See section 740R.)

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**BL Section 740R*****Implementing Resolution Under Section 7.4  
Disciplining of Member by Trial Board***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** (1) Any complaint preferred against a member under section 7.4 of the bylaws shall be submitted to the professional ethics division, which in turn may refer the complaint for investigation and recommendation to an ethics committee (or its equivalent) of a state society of certified public accountants that has made an agreement with the Institute of the type authorized in section 7.4 of the bylaws. If, upon consideration of the complaint, investigation and/or recommendation thereon, it appears that a prima facie case is established showing a violation of any applicable bylaws or any rule of the Code of Professional Conduct of the Institute or any state society making an agreement with the Institute referred to above or showing any conduct discreditable to a certified public accountant, the professional ethics division or the ethics committee of such state society, except as provided in the implementing resolution under section 3.6.2.2 of the bylaws, shall report the matter to the secretary of the joint trial board who shall summon the member involved to respond to the charges preferred against the member, which response may include the entering of a plea of guilty without a hearing, in accordance with rules established by the trial board, provided, however, that with respect to a case in which the trial board has granted a petition that automatic discipline shall not become operative under the provisions of paragraph (7) in the implementing resolution under section 7.3.2 of the bylaws, the division or such state society ethics committee shall have discretion as to whether and when to report the matter to the secretary for such summoning.

[As revised by Council October 18, 2003.]

**.02** (2)

- (a) If the professional ethics division or state society ethics committee dismisses any complaint preferred against a member or shall fail to initiate its inquiry within ninety days after such complaint is presented to it in writing, the member preferring the complaint may present the complaint in writing to the trial board, provided, however, that this provision shall not apply to a case falling within the scope of section 7.3.
- (b) The chairman of the trial board shall cause such investigation to be made of the matter as the chairman may deem necessary, and shall either dismiss the complaint or refer it to the secretary of the trial board who shall summon the member to answer the complaint in accordance with the provisions in paragraph (1) hereof.
- (c) Prior to causing the investigation referred to in paragraph (b), the chairman of the trial board shall designate six members of the trial

board who shall not be involved in such investigation in order that not less than three of them may be appointed to an independent hearing panel if necessary. The chairman shall report the names of such members to the secretary of the trial board prior to any action under paragraph (b).

[As revised by Council May 15, 2000.]

**.03** (3) For the purpose of adjudicating charges against members of the Institute, as provided in the foregoing paragraphs of this resolution, the following must take place:

- (a) The secretary shall mail to the member concerned, at least thirty days prior to the proposed meeting of a panel appointed to hear the case, written notice of the charges to be adjudicated. Such notice, when mailed by registered or certified mail, postage prepaid, addressed to the member concerned at the member's last known address according to the official records of the Institute, which are the records of the membership department, shall be deemed properly served.
- (b) After considering the evidence presented by the professional ethics division or other complainant and by the defense, the panel hearing the case, a quorum present, by vote of the members present and voting, may, in a manner consistent with section 7.4 of the bylaws, admonish, suspend for a period of not more than two years, or expel the member against whom the complaint is made and take such other disciplinary, remedial or corrective action as the panel deems appropriate.
- (c) In a case decided by a panel, the member concerned may request a review by the trial board of the decision of the panel, provided such a request for review is filed with the secretary of the trial board within thirty days after the decision of the panel, and that such information as may be required by the rules of the trial board shall be filed with such request. Such a review shall not be a matter of right. Each such request for a review shall be considered by an ad hoc committee to be appointed by the chairman of the trial board, or its vice chairman in the event of the chairman's unavailability, and to consist of not less than three members of the trial board who did not participate in the prior proceedings in the case. The ad hoc committee shall have power to decide whether such request for review by the trial board shall be granted, and such committee's decision that such request shall not be granted shall be final and subject to no further review. A quorum of such ad hoc committee shall consist of a majority of the appointed. If such request for review is granted, the trial board shall review the decision of the panel in accordance with its rules of practice and procedure. On review of such decision, the trial board may affirm, modify, or reverse all or any part of such decision or make such other disposition of the case as it deems appropriate. The trial board may, by general rule, indicate the character of reasons that may be considered to be of sufficient importance to warrant an ad hoc committee granting a request for review of a decision of a panel.

[As revised by Council May 15, 2000.]



- (d) Any decision of the trial board, including any decision reviewing a decision of a panel, shall become effective when made, unless the trial board's decision indicates otherwise, in which latter event it shall become effective at the time determined by the trial board. Any decision of a panel shall become effective as follows:
- (i) Upon the expiration of thirty days after it is made, if no request for review is properly filed within such thirty-day period.
  - (ii) Upon the denial of a request for review, if such request has been properly filed within such thirty-day period and is denied by an ad hoc committee.
  - (iii) Upon the date of a decision of a review panel affirming the decision of a hearing panel in cases where a review has been granted by an ad hoc committee.
- (e) A plea of guilty, if it conforms to the rules and procedures of the trial board, shall become effective upon acceptance by the trial board.

[As revised by Council June 17, 1996.]

**.04** (4) In the case of a settlement agreement between a member and the professional ethics executive committee that provides for disciplinary action pursuant to the Council resolution implementing bylaw section 3.6.2.2, the matter shall be referred to a panel of the trial board which, upon finding that there has been a waiver of the member's rights under Article 7.4, shall recognize such settlement agreement and arrange for publication of such disciplinary action under section 7.6 of the bylaws.

[As revised by Council May 26, 1993; revised April 28, 2003.]

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## **BL Section 750**

### ***7.5 Reinstatement***

**As amended  
January 12, 1988**

**.01** The Council may prescribe the conditions and procedures under which members suspended or terminated under sections 7.3 and 7.4 may be reinstated.

(See section 750R.)

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**BL Section 750R*****Implementing Resolution Under  
Section 7.5 Reinstatement***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** (1) That at any time after the publication by the Institute of a statement of a case and decision, including cases in which a guilty plea was entered without a hearing, on application of the member concerned to the secretary of the trial board, the appropriate panel of the trial board that last heard the case and whose decision provided the basis for the publication or, where the original panel cannot be reappointed, or in the case of a guilty plea, a newly formed panel, may, by a two-thirds vote of the members present and voting, rescind or modify such decision. Any such action shall be published by the Institute. The denial of an application under this section shall not be published and shall not prevent the member concerned from applying for reinstatement under section (2) hereof.

[As revised by Council May 26, 1993; revised May 15, 2000.]

**.02** (2) That

- (a) Should an order, judgment of conviction, decision or action on which the suspension or termination of membership was based under section 7.3 of the bylaws be reversed or otherwise set aside or invalidated, such suspension shall terminate or such member shall become reinstated when a certified copy of the order reversing or otherwise setting aside or invalidating such order, conviction, decision or action is filed with the secretary of the joint trial board, who shall refer the matter to the professional ethics division for whatever action it deems appropriate.

[As revised by Council October 18, 2003.]

- (b) A member who has been suspended or expelled by the trial board pursuant to section 7.4 of the bylaws may request that the suspension terminate or may request reinstatement if an order, judgment of conviction, decision or action on which the suspension or termination was based has been reversed or otherwise set aside or invalidated. Such request shall be referred to the trial board whereupon a hearing panel composed of five members designated by the chairman of the trial board may, after investigating all related circumstances, terminate the suspension or reinstate the member concerned by a majority vote of the members present and entitled to vote.

[As revised by Council October 18, 2003.]

- (c) Except as provided in subparagraphs (a) and (b) of this paragraph (2), a member whose membership has been automatically terminated

**Termination of Membership and Disciplinary Sanctions**

under section 7.3, or who has been expelled by or had the member's resignation accepted by a panel of the trial board may, at any time after three years from the effective date of such termination, expulsion, or acceptance of resignation, request reinstatement of their membership. Such request shall be referred to the trial board, whereupon the chairman shall designate five members of the board to a hearing panel which may, after investigation, reinstate such member on such terms and conditions as it shall determine to be appropriate. If an application for reinstatement under this subparagraph is denied, the member concerned may again apply for reinstatement at any time after two years from the date of such denial.

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**BL Section 760*****7.6 Publication of Disciplinary Action***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Notice of disciplinary action pursuant to section 7.3 or 7.4 or of termination of enrollment of a member or a member's firm in an Institute-approved practice-monitoring program, together with a statement of the reasons therefore, shall be published in such form and manner as the Council may prescribe. Council also may prescribe any additional disclosures regarding any matter within the jurisdiction of the professional ethics executive committee.

[As revised May 15, 2000; revised October 18, 2003; revised November 6, 2007.]

(See section 760R.)

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**BL Section 760R*****Implementing Resolution Under Section 7.6  
Publication of Disciplinary Action***

**As amended  
May 26, 1993,  
unless otherwise  
indicated**

***Resolved:***

**.01** That notice of disciplinary action taken under section 7.3 or 7.4 of the bylaws or of termination of enrollment of a member or a member's firm in an Institute-approved practice monitoring program, and the basis therefore shall be published by the Institute and that the professional ethics division, the Peer Review Board or peer review committee as appropriate shall maintain a record of such information and disclose that information upon request. In the case of disciplinary action pursuant to section 7.3 of the bylaws, such notice shall be in a form approved by the chairman of the trial board and consistent with this Council resolution. In any action pursuant to section 7.4 of the bylaws in which the member is found guilty or has entered into a settlement agreement with the professional ethics executive committee, the trial board or panel hearing the case shall decide on the form of the notice of the case and the decision to be published. All notices shall disclose, at least, the name of the member involved and, when appropriate, the terms and conditions of any settlement agreement and the nature of the violation. The statement and decision, as released by the chairman, trial board, or hearing panel, shall be published by the Institute. No such publication shall be made until such decision has become effective. The professional ethics executive committee may inform the complainant of the outcome of its investigation without regard to whether the action taken results in publication under section 7.6 of the bylaws.

[As revised by Council May 15, 2000; revised October 18, 2003; revised November 6, 2007.]

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**BL Section 770*****7.7 Disciplinary Sections Not to Be Applied Retroactively***

**As amended  
January 12, 1988**

**.01** Sections 7.3 and 7.4 shall not be applied to offenses of wrongful conduct occurring prior to their effective dates, but such offenses shall be subject to discipline under the bylaws of the Institute in effect at the time of their occurrence.

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# BL Section 800

## 8. AMENDMENTS

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## **BL Section 801**

### ***Amendments***

**As amended  
January 12, 1988**

**.01** Amendments to these bylaws and the Code of Professional Conduct shall be accomplished in a manner consistent with this article.

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## BL Section 810

### *8.1 Proposals to Amend the Bylaws*

**As amended  
June 17, 1996**

.01 Proposals to amend the bylaws may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, by the Board of Directors, or by petition of 5 percent of the membership as of the end of the prior fiscal year. Any such petition shall include the member's name (typed or printed), membership number and the date it is signed, and the signature of a member on such a petition shall be valid for one year from the date thereof. The changes to this provision will not apply to petitions, regardless of when they are signed, submitted pursuant to efforts to gather such petitions which were ongoing as of July 13, 1995.

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**BL Section 820*****8.2 Proposals to Amend the Code of Professional Conduct***

**As amended  
June 17, 1996**

**.01** Proposals to amend the Code of Professional Conduct may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, by the Board of Directors, by the professional ethics division, or by petition of 5 percent of the membership as of the end of the prior fiscal year. Any such petition shall include the member's name (typed or printed), membership number and the date it is signed, and the signature of a member on such a petition shall be valid for one year from the date thereof. The changes to this provision will not apply to petitions, regardless of when they are signed, submitted pursuant to efforts to gather such petitions which were ongoing as of July 13, 1995.

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**BL Section 830*****8.3 Submission to Council via  
Board of Directors***

**As amended  
January 12, 1988**

**.01** All such proposals to amend the bylaws or the Code of Professional Conduct, unless made at a meeting of the Council or the Board of Directors, shall be submitted in writing to the Board of Directors. The Board of Directors shall submit all such proposals, accompanied by its recommendation, to the Council for action.

**8.3.1 Proposals Not Requiring Council Approval**

Following discussion at a meeting of the Council, proposals sponsored by at least 5 percent of the membership shall be submitted to the membership of the Institute for vote by mail ballot pursuant to section 8.4.

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**BL Section 840*****8.4 Submission to Membership by Mail Ballot***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Amendments proposed under section 8.3.1 and those authorized by the Council under section 8.3 shall be submitted to all of the members of the Institute for a vote by mail ballot no later than 180 days following discussion or authorization by the Council. If at least two-thirds of those voting approve such proposal, it shall become effective as an amendment to the bylaws or to the Code of Professional Conduct, as applicable. Mail ballots shall be considered valid and counted only if received as instructed by the Institute for the return of such votes within sixty days from the date of mailing the ballots to the members.

[As revised May 15, 2000; revised November 6, 2007.]

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# BL Section 900

## GENERAL

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## BL Section 911

### ***AICPA Mission Statement***\*

.01 The American Institute of Certified Public Accountants is the national professional organization for all Certified Public Accountants. Its mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients.

In fulfilling its mission, the AICPA works with state CPA organizations and gives priority to those areas where public reliance on CPA skills is most significant.

To achieve its mission, the Institute:

#### *Advocacy*

- Serves as the national representative of CPAs before governments, regulatory bodies and other organizations in protecting and promoting members' interests.

#### *Certification and Licensing*

- Seeks the highest possible level of uniform certification and licensing standards and promotes and protects the CPA designation.

#### *Communications*

- Promotes public awareness and confidence in the integrity, objectivity, competence, and professionalism of CPAs and monitors the needs and views of CPAs.

#### *Recruiting and Education*

- Encourages highly qualified individuals to become CPAs and supports the development and outstanding academic programs.

#### *Standards and Performance*

- Establishes professional standards; assists members in continually improving their professional conduct, performance, and expertise; and monitors such performance to enforce current standards and requirements.

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\* **Note:** The Mission Statement, developed in 1986 by the Mission of AICPA Special Committee, was revised by the Strategic Planning Committee and approved by Council in May 1991. The Strategic Objectives were revised in November 1993 and again in November 1995.



## BL Section 921

# *A Description of the Professional Practice of Certified Public Accountants*

- .01** Certified public accountants practice in the broad field of accounting.
- .02** Accounting is a discipline which provides financial and other information essential to the efficient conduct and evaluation of the activities of any organization.
- .03** The information which accounting provides is essential for (1) effective planning, control, and decision-making by management, and (2) discharging the accountability of organizations to investors, creditors, government agencies, taxing authorities, association members, contributors to welfare institutions, and others.
- .04** Accounting includes the development and analysis of data, the testing of their validity and relevance, and the interpretation and communication of the resulting information to intended users. The data may be expressed in monetary or other quantitative terms, or in symbolic or verbal forms.
- .05** Some of the data with which accounting is concerned are not precisely measurable, but necessarily involve assumptions and estimates as to the present effect of future events and other uncertainties. Accordingly, accounting requires not only technical knowledge and skill, but even more important, disciplined judgment, perception, and objectivity.
- .06** Within this broad field of accounting, certified public accountants are the identified professional accountants. They provide leadership in accounting research and education. In the practice of public accounting CPAs bring competence of professional quality, independence, and a strong concern for the usefulness of the information and advice they provide, but they do not make management decisions.
- .07** The professional quality of their services is based upon experience and the requirements for the CPA certificate—education and examination—and upon the ethical and technical standards established and enforced by their profession.
- .08** CPAs have a distinctive role in auditing financial statements submitted to investors, creditors, and other interested parties, and in expressing independent opinions on the fairness of such statements. This distinctive role has inevitably encouraged a demand for the opinions of CPAs on a wide variety of other representations, such as compliance with rules and regulations of government agencies, sales statistics under lease and royalty agreements, and adherence to covenants in indentures. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]
- .09** The audit of financial statements requires CPAs to review many aspects of an organization's activities and procedures. Consequently they can advise clients of needed improvements in internal control and make constructive suggestions on financial, tax, and other operating matters. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]

**.10** In addition to furnishing advice in conjunction with their independent audits of financial statements, CPAs are engaged to provide objective advice and consultation on various management problems. Many of these involve information and control systems and techniques, such as budgeting, cost control, profit planning, internal reporting, automatic data processing, and quantitative analysis. CPAs also assist in the development and implementation of programs approved by management. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]

**.11** Among the major management problems depending on the accounting function is compliance with tax requirements. An important part of the practice of CPAs includes tax planning and advice, preparation of tax returns, and representation of clients before government agencies.

**.12** CPAs also participate in conferences with government agencies such as the Securities and Exchange Commission, and with other interested parties, such as bankers.

**.13** Like other professionals, CPAs are often consulted on business, civic, and other problems on which their judgment, experience, and professional standards permit them to provide helpful advice and assistance.

**.14** The complexities of an industrial society encourage a high degree of specialization in all professions. The accounting profession is no exception. Its scope is so wide and varied that many individual CPAs choose to specialize in particular types of service.

**.15** Although their activities may be diverse, all CPAs have demonstrated basic competence of professional quality in the discipline of accounting. It is this which unites them as members of one profession, and provides a foundation for extension of their services into new areas.

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## Select PCAOB Releases

The full text of the releases issued by the PCAOB can be found in the AICPA's *PCAOB Standards and Related Rules*.

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## VS Section

# STATEMENTS ON STANDARDS FOR VALUATION SERVICES

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## VS Section 100

# Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset

June 2007

## Foreword

### Why Issued

Valuations of businesses, business ownership interests, securities, or intangible assets (hereinafter collectively referred to in this Foreword as *business valuations*) may be performed for a wide variety of purposes including the following:

1. Transactions (or potential transactions), such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share based plans, partner and shareholder buy-ins or buyouts, and stock redemptions.
2. Litigation (or pending litigation) relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, and employment and intellectual property disputes.
3. Compliance-oriented engagements, including (a) financial reporting and (b) tax matters such as corporate reorganizations; S corporation conversions; income, estate, and gift tax compliance; purchase price allocations; and charitable contributions.
4. Planning oriented engagements for income tax, estate tax, gift tax, mergers and acquisitions, and personal financial planning.

In recent years, the need for business valuations has increased significantly. Performing an engagement to estimate value involves special knowledge and skill.

Given the increasing number of members of the AICPA who are performing business valuation engagements or some aspect thereof, the AICPA Consulting Services Executive Committee has written this standard to improve the consistency and quality of practice among AICPA members performing business valuations. AICPA members will be required to follow this standard when they perform engagements to estimate value that culminate in the expression of a conclusion of value or a calculated value.

The Consulting Services Executive Committee is a body designated by AICPA Council to promulgate technical standards under Rule 201, *General Standards* [ET section 201.01], and Rule 202, *Compliance With Standards* [ET section 202.01], of the AICPA *Code of Professional Conduct*.

## Introduction and Scope

.01 This Statement establishes standards for AICPA members (hereinafter referred to in this Statement as *members*) who are engaged to, or, as part of another engagement, estimate the value of a **business**,<sup>1</sup> *business ownership*

<sup>1</sup> This Statement includes two glossaries. Appendix B [paragraph .81] is the International Glossary of Business Valuation Terms (IGBVT), jointly developed by the AICPA, the American Society of Appraisers (ASA), the Canadian Institute of Chartered Business Valuators, the National Association

(continued)

*interest, security, or intangible asset* (hereinafter collectively referred to in this Statement as **subject interest**). For purposes of this Statement, the definition of a business includes not-for-profit entities or activities.

**.02** As described in this Statement, the term **engagement to estimate value** refers to an engagement or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement) that involves estimating the value of a subject interest. An engagement to estimate value culminates in the expression of either a **conclusion of value** or a **calculated value** (see paragraph .21). A member who performs an engagement to estimate value is referred to, in this Statement, as a **valuation analyst**.

**.03** Valuation analysts should be aware of any governmental regulations and other professional standards applicable to the engagement, including the AICPA *Code of Professional Conduct* and the Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* [CS section 100], and the extent to which they apply to engagements to estimate value. Compliance is the responsibility of the valuation analyst.

**.04** In the process of estimating value as part of an engagement, the valuation analyst applies **valuation approaches** and **valuation methods**, as described in this Statement, and uses professional judgment. The use of professional judgment is an essential component of estimating value.

## Exceptions From This Statement

**.05** This Statement is not applicable to a member who participates in estimating the value of a subject interest as part of performing an attest engagement defined by Rule 101 of the AICPA *Code of Professional Conduct* [ET section 101.01] (for example, as part of an audit, review, or compilation engagement).

**.06** This Statement is not applicable when the value of a subject interest is provided to the member by the client or a third party, and the member does not apply valuation approaches and methods, as discussed in this Statement.

**.07** This Statement is not applicable to internal use assignments from employers to employee members not in the practice of public accounting, as that term is defined in the AICPA *Code of Professional Conduct* [ET section 92.29]. (Interpretation No. 1, "Scope of Applicable Services," [VS section 9100], Illustrations 24 and 25 [VS section 9100.78–.81].)

**.08** This Statement is not applicable to engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) unless those determinations include an engagement to estimate value. See also Interpretation No. 1, Illustrations 1, 2, and 3 [VS section 9100.06–.11].

**.09** (a) This Statement is not applicable to mechanical computations that do not rise to the level of an engagement to estimate value; that is, when the member does not apply valuation approaches and methods and does not use professional judgment. See Interpretation No. 1, Illustration 8 [VS section 9100.20–.23].

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(footnote continued)

of Certified Valuation Analysts, and the Institute of Business Appraisers. The IGBVT is reproduced verbatim in Appendix B, "International Glossary of Business Valuation Terms [paragraph .81]. Appendix C [paragraph .82] provides definitions for terms included in this Statement, but not defined in the IGBVT. The terms defined in Appendix B [paragraph .81] are in boldface type the first time they appear in this Statement; the terms defined in Appendix C [paragraph .82] are in italicized boldface type the first time they appear in this Statement.

(b) This Statement is not applicable when it is not practical or not reasonable to obtain or use relevant information; as a result, the member is unable to apply valuation approaches and methods that are described in this Statement.<sup>2</sup>

### **Jurisdictional Exception**

.10 If any part of this Statement differs from published governmental, judicial, or accounting authority, or such authority specifies valuation development procedures or valuation reporting procedures, then the valuation analyst should follow the applicable published authority or stated procedures with respect to that part applicable to the valuation in which the member is engaged. The other parts of this Statement continue in full force and effect (Interpretation No. 1 [VS section 9100.01–.89]).

## **Overall Engagement Considerations**

### **Professional Competence**

.11 Rule 201A, *Professional Competence*, of the AICPA Code of Professional Conduct [ET section 201.01], states that a member shall "undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence." Performing a valuation engagement with professional competence involves special knowledge and skill. A valuation analyst should possess a level of knowledge of valuation principles and theory and a level of skill in the application of such principles that will enable him or her to identify, gather, and analyze data, consider and apply appropriate valuation approaches and methods, and use professional judgment in developing the estimate of value (whether a single amount or a range). An in-depth discussion of valuation theory and principles, and how and when to apply them, is not within the scope of this Statement.

.12 In determining whether he or she can reasonably expect to complete the valuation engagement with professional competence, the valuation analyst should consider, at a minimum, the following:

- a. Subject entity and its industry
- b. Subject interest
- c. **Valuation date**
- d. Scope of the valuation engagement
  - i. Purpose of the valuation engagement
  - ii. **Assumptions and limiting conditions** expected to apply to the valuation engagement (paragraph .18)
  - iii. Applicable **standard of value** (for example, **fair value** or **fair market value**), and the applicable **premise of value** (for example, going concern)
  - iv. Type of valuation report to be issued (paragraph .48), intended use and users of the report, and restrictions on the use of the report
- e. Governmental regulations or other professional standards that apply to the subject interest or to the valuation engagement

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<sup>2</sup> Unless prohibited by statute or by rule, a member may use the client's estimates for compliance reporting to a third party if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member). See Interpretation No. 1 [VS section 9100.01–.89]," and Statement for Standards on Tax Services No. 4, *Use of Estimates* [TS section 400].

## Nature and Risks of the Valuation Services and Expectations of the Client

.13 In understanding the nature and risks of the *valuation services* to be provided, and the expectations of the client, the valuation analyst should consider the matters in paragraph .12, and in addition, at a minimum, the following:

- a. The proposed terms of the valuation engagement
- b. The identity of the client
- c. The nature of the interest and ownership rights in the business, business interest, security, or intangible asset being valued, including **control** characteristics and the degree of **marketability** of the interest
- d. The procedural requirements of a valuation engagement and the extent, if any, to which procedures will be limited by either the client or circumstances beyond the client's or the valuation analyst's control
- e. The use of and limitations of the report, and the conclusion or calculated value
- f. Any obligation to update the valuation

## Objectivity and Conflict of Interest

.14 The AICPA *Code of Professional Conduct* requires objectivity in the performance of all professional services, including valuation engagements. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest. If necessary, where a potential conflict of interest may exist, a valuation analyst should make the disclosures and obtain consent as required under Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* [ET section 102.03].

## Independence and Valuation

.15 If valuation services are performed for a client for which the valuation analyst or valuation analyst's firm also performs an attest engagement (defined by Rule 101 of the AICPA *Code of Professional Conduct*), the valuation analyst should meet the requirements of Interpretation No. 101-3, "Performance of Nonattest Services," under Rule 101, *Independence* [ET section 101.05], so as not to impair the member's independence with respect to the client.

## Establishing an Understanding With the Client

.16 The valuation analyst should establish an understanding with the client, preferably in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the working papers. (If the engagement is being performed for an attest client, AICPA Ethics Interpretation 101-3 requires the engagement understanding to be in writing.) Regardless of whether the understanding is written or oral, the valuation analyst should modify the understanding if he or she encounters circumstances during the engagement that make it appropriate to modify that understanding.

.17 The understanding with the client reduces the possibility that either the valuation analyst or the client may misinterpret the needs or expectations of the other party. The understanding should include, at a minimum, the nature,



purpose, and objective of the valuation engagement, the client's responsibilities, the valuation analyst's responsibilities, the applicable assumptions and limiting conditions, the type of report to be issued, and the standard of value to be used.

### **Assumptions and Limiting Conditions**

.18 Assumptions and limiting conditions are common to valuation engagements. Examples of typical assumptions and limiting conditions for a business valuation are provided in Appendix A, "Illustrative List of Assumptions and Limiting Conditions for a Business Valuation" [paragraph .80]. The assumptions and limiting conditions should be disclosed in the valuation report (paragraphs .52*l*, .68*g*, and .71*m*).

### **Scope Restrictions or Limitations**

.19 A restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis, may be present and known to the valuation analyst at the outset of the valuation engagement or may arise during the course of a valuation engagement. Such a restriction or limitation should be disclosed in the valuation report (paragraphs .52*m*, .68*e*, and .71*n*).

## **Using the Work of Specialists in the Engagement to Estimate Value**

.20 In performing an engagement to estimate value, the valuation analyst may rely on the work of a third party specialist (for example, a real estate or equipment appraiser). The valuation analyst should note in the assumptions and limiting conditions the level of responsibility, if any, being assumed by the valuation analyst for the work of the third party specialist. At the option of the valuation analyst, the written report of the third party specialist may be included in the valuation analyst's report.

## **Development**

### **Types of Engagement**

.21 There are two types of engagements to estimate value—a **valuation engagement** and a **calculation engagement**. The valuation engagement requires more procedures than does the calculation engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value. The type of engagement is established in the understanding with the client (paragraphs .16 and .17):

- a. *Valuation engagement*—A valuation analyst performs a valuation engagement when (1) the engagement calls for the valuation analyst to estimate the value of a subject interest and (2) the valuation analyst estimates the value (as outlined in paragraphs .23–.45) and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation as a conclusion of value; the conclusion may be either a single amount or a range.
- b. *Calculation engagement*—A valuation analyst performs a calculation engagement when (1) the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the

process of calculating the value of a subject interest (these procedures will be more limited than those of a valuation engagement) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. A calculation engagement does not include all of the procedures required for a valuation engagement (paragraph .46).

## Hypothetical Conditions

.22 Hypothetical conditions affecting the subject interest may be required in some circumstances. When a valuation analyst uses hypothetical conditions during a valuation or calculation engagement, he or she should indicate the purpose for including the hypothetical conditions and disclose these conditions in the valuation or calculation report (paragraphs .52*n*, .71*o*, and .74).

## Valuation Engagement

.23 In performing a valuation engagement, the valuation analyst should:

- Analyze the subject interest (paragraphs .25–.30)
- Consider and apply appropriate valuation approaches and methods (paragraphs .31–.42)
- Prepare and maintain appropriate documentation (paragraphs .44–.45)

.24 Even though the list in paragraph .23 and some requirements and guidance in this Statement are presented in a manner that suggests a sequential valuation process, valuations involve an ongoing process of gathering, updating, and analyzing information. Accordingly, the sequence of the requirements and guidance in this Statement may be implemented differently at the option of the valuation analyst.

### *Analysis of the Subject Interest*

.25 The analysis of the subject interest will assist the valuation analyst in considering, evaluating, and applying the various valuation approaches and methods to the subject interest. The nature and extent of the information needed to perform the analysis will depend on, at a minimum, the following:

- Nature of the subject interest
- Scope of the valuation engagement
- Valuation date
- Intended use of the valuation
- Applicable standard of value
- Applicable **premise of value**
- Assumptions and limiting conditions
- Applicable governmental regulations or other professional standards

.26 In analyzing the subject interest, the valuation analyst should consider financial and nonfinancial information. The type, availability, and significance of such information vary with the subject interest.

*Nonfinancial information*

.27 The valuation analyst should, as available and applicable to the valuation engagement, obtain sufficient nonfinancial information to enable him or her to understand the subject entity, including its:

- Nature, background, and history
- Facilities
- Organizational structure
- Management team (which may include officers, directors, and key employees)
- Classes of **equity** ownership interests and rights attached thereto
- Products or services, or both
- Economic environment
- Geographical markets
- Industry markets
- Key customers and suppliers
- Competition
- **Business risks**
- Strategy and future plans
- Governmental or regulatory environment

***Ownership Information***

.28 The valuation analyst should obtain, where applicable and available, ownership information regarding the subject interest to enable him or her to:

- Determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics
- Analyze the different ownership interests of other owners and assess the potential effect on the value of the subject interest
- Understand the classes of equity ownership interests and rights attached thereto
- Understand the rights included in, or excluded from, each intangible asset
- Understand other matters that may affect the value of the subject interest, such as:
  - *For a business, business ownership interest, or security:* shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the subject interest
  - *For an intangible asset:* legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations

***Financial Information***

.29 The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as:

- Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years
- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding:
  - Advantageous or disadvantageous contracts
  - Contingent or off-balance-sheet assets or liabilities
  - Information on prior sales of company stock

.30 The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

### ***Valuation Approaches and Methods***

.31 In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

- **Income (Income-based) approach**
- **Asset (Asset-based) approach** (used for businesses, business ownership interests, and securities) or **cost approach** (used for intangible assets)
- **Market (Market-based) approach**

.32 The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods appears in paragraphs .33–.41, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this Statement.

.33 *Income Approach.* Two frequently used valuation methods under the income approach include the **capitalization of benefits method** (for example, earnings or cash flows) and the **discounted future benefits method** (for example, earnings or cash flows). When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

- a. *Capitalization of benefits (for example, earnings or cash flows) method.* The valuation analyst should consider the following:
  - **Normalization** adjustments
  - Nonrecurring revenue and expense items
  - Taxes
  - **Capital structure** and financing costs

- Appropriate capital investments
  - Noncash items
  - Qualitative judgments for risks used to compute discount and **capitalization rates**
  - Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)
- b. *Discounted future benefits method (for example, earnings or cash flows).* In addition to the items in item a above, the valuation analyst should consider:
- Forecast/projection assumptions
  - Forecast/projected earnings or cash flows
  - **Terminal value**
- c. For an intangible asset, the valuation analyst should also consider, when relevant:
- Remaining useful life
  - Current and anticipated future use of the intangible asset
  - Rights attributable to the intangible asset
  - Position of intangible asset in its life cycle
  - Appropriate discount rate for the intangible asset
  - Appropriate **capital or contributory asset charge**, if any
  - Research and development or marketing expense needed to support the intangible asset in its existing state
  - Allocation of income (for example, **incremental income**, **residual income**, or **profit split income**) to intangible asset
  - Whether any tax amortization benefit would be included in the analysis
  - Discounted multi-year excess earnings
  - Market royalties
  - Relief from royalty

### **Asset Approach and Cost Approach**

**.34** A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

**.35** When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.

### Market Approach

.36 Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are:

- **Guideline public company method**
- **Guideline company transactions method**
- Guideline sales of interests in the subject entity, such as business ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are:

- Comparable uncontrolled transactions method (which is based on arm's-length sales or licenses of guideline intangible assets)
- Comparable profit margin method (which is based on comparison of the profit margin earned by the subject entity that owns or operates the intangible asset to profit margins earned by guideline companies)
- **Relief from royalty method** (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

.37 In applying the methods listed in paragraph .36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

.38 The valuation analyst should set forth in the report the rationale and support for the valuation methods used (paragraph .47).

.39 *Rules of Thumb.* Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as **rules of thumb**) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

### Valuation Adjustments

.40 During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a **pre-adjustment** value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability or liquidity** and a **discount for lack of control**. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

.41 When valuing a controlling ownership interest under the income approach, the value of any **nonoperating assets**, nonoperating liabilities, or **excess or deficient operating assets** should be excluded from the computation of the value based on the operating assets and should be added to or

deleted from the value of the operating entity. When valuing a noncontrolling ownership interest under the income approach, the value of any nonoperating assets, nonoperating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the noncontrolling interest. In the asset-based or cost approach, it may not be necessary to separately consider nonoperating assets, nonoperating liabilities, or excess or deficient operating assets.

### Conclusion of Value

- .42 In arriving at a conclusion of value, the valuation analyst should:
- a. Correlate and reconcile the results obtained under the different approaches and methods used.
  - b. Assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.
  - c. Determine, based on items *a* and *b*, whether the conclusion of value should reflect (1) the results of one valuation approach and method or (2) a combination of the results of more than one valuation approach and method.

### Subsequent Events

.43 The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a **subsequent event**. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not include a discussion of those events or conditions because a valuation is performed as of a point in time—the valuation date—and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed (paragraphs .52*p*, .71*r*, and .74). Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

### Documentation

.44 Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs .25–.30)

- Assumptions and limiting conditions (paragraph .18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph .19)
- Basis for using any **valuation assumption** during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph .43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph .39)
- Other documentation considered relevant to the engagement by the valuation analyst

.45 The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

## Calculation Engagement

.46 In performing a calculation engagement, the valuation analyst should consider, at a minimum, the following:

- a. Identity of the client
- b. Identity of the subject interest
- c. Whether or not a business interest has ownership control characteristics and its degree of marketability
- d. Purpose and intended use of the calculated value
- e. Intended users of the report and the limitations on its use
- f. Valuation date
- g. Applicable premise of value
- h. Applicable standard of value
- i. Sources of information used in the calculation engagement
- j. Valuation approaches or valuation methods agreed upon with the client
- k. Subsequent events, if applicable (paragraph .43)

In addition, the valuation analyst should comply with the documentation requirements listed in paragraphs .44 and .45. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.

## The Valuation Report

.47 A valuation report is a written or oral communication to the client containing the conclusion of value or the calculated value of the subject interest. Reports issued for purposes of certain controversy proceedings are exempt from this reporting standard (paragraph .50).

.48 The three types of written reports that a valuation analyst may use to communicate the results of an engagement to estimate value are: for a valuation engagement, a detailed report or a summary report; and for a calculation engagement, a calculation report.



For a Valuation Engagement

- a. *Detailed Report:* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .51).
- b. *Summary Report:* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .71).

For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client.

For a Calculation Engagement

- c. *Calculation Report:* This type of report should be used only to communicate the results of a calculation engagement (calculated value); it should not be used to communicate the results of a valuation engagement (conclusion of value) (paragraph .73).

.49 The valuation analyst should indicate in the valuation report the restrictions on the use of the report (which may include restrictions on the users of the report, the uses of the report by such users, or both) (paragraph .65d).

## Reporting Exemption for Certain Controversy Proceedings

.50 A valuation performed for a matter before a court, an arbitrator, a mediator or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of this Statement. The reporting exemption applies whether the matter proceeds to trial or settles. The exemption applies only to the reporting provisions of this Statement (paragraphs .47–.49 and .51–.78). The developmental provisions of the Statement (paragraphs .21–.46) still apply whenever the valuation analyst expresses a conclusion of value or a calculated value (Interpretation No. 1 [VS section 9100.01–.89]).

## Detailed Report

.51 The *detailed report* is structured to provide sufficient information to permit intended users to understand the data, reasoning, and analyses underlying the valuation analyst's conclusion of value. A detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal
- Table of contents
- Introduction
- Sources of information
- Analysis of the subject entity and related nonfinancial information
- Financial statement/information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments

- Nonoperating assets, nonoperating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendices and exhibits

The above listed report sections and the detailed information within the sections described in the following paragraphs .52–.77 may be positioned in the body of the report or elsewhere in the report at the discretion of the valuation analyst.

## Introduction

**.52** This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the intended user of the report to understand the nature and scope of the valuation engagement, as well as the work performed. The introduction section may include, among other things, the following information:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. Whether the business interest has ownership control characteristics and its degree of marketability
- g. Valuation date
- h. Report date
- i. Type of report issued (namely, a detailed report) (paragraph .51)
- j. Applicable premise of value
- k. Applicable standard of value
- l. Assumptions and limiting conditions (alternatively, these often appear in an appendix) (paragraph .18)
- m. Any restrictions or limitations in the scope of work or data available for analysis (paragraph .19)
- n. Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- o. If the work of a specialist was used in the valuation engagement, a description of how the specialist's work was relied upon (paragraph .20)
- p. Disclosure of subsequent events in certain circumstances (paragraph .43)
- q. Any application of the jurisdictional exception (paragraph .10)
- r. Any additional information the valuation analyst deems useful to enable the user(s) of the report to understand the work performed

If the above items are not included in the introduction, they should be included elsewhere in the valuation report.

### **Sources of Information**

**.53** This section of the report should identify the relevant sources of information used in performing the valuation engagement. It may include, among other things, the following:

- a. For valuation of a business, business ownership interest, or security, whether and to what extent the subject entity's facilities were visited
- b. For valuation of an intangible asset, whether the legal registration, contractual documentation, or other tangible evidence of the asset was inspected
- c. Names, positions, and titles of persons interviewed and their relationships to the subject interest
- d. Financial information (paragraphs .54 and .56)
- e. Tax information (paragraph .55)
- f. Industry data
- g. Market data
- h. Economic data
- i. Other empirical information
- j. Relevant documents and other sources of information provided by or related to the entity

**.54** If the financial information includes financial statements that were reported on (audit, review, compilation, or attest engagement performed under the Statements on Standards for Attestation Engagements (SSAEs) [AT sections 20–701]) by the valuation analyst's firm, the valuation report should disclose this fact and the type of report issued. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs [AT sections 20–701] to the financial information, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for the financial information.

**.55** The financial information may be derived from or may include information derived from tax returns. With regard to such derived information and other tax information (paragraph .53e), the valuation analyst should identify the tax returns used and any existing relationship between the valuation analyst and the tax preparer. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs [AT sections 20–701] to any financial information derived from tax returns that is used during the valuation engagement, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for that derived information.

**.56** If the financial information used was derived from financial statements prepared by management that were not the subject of an audit, review, compilation, or attest engagement performed under the SSAEs, the valuation report should:

- Identify the financial statements
- State that, as part of the valuation engagement, the valuation analyst did not audit, review, compile, or attest under the SSAEs [AT sections 20–710] to the financial information and assumes no responsibility for that information

### ***Analysis of the Subject Entity and Related Nonfinancial Information***

.57 The valuation analyst should include a description of the relevant non-financial information listed and discussed in paragraph .27.

### ***Financial Statement/Information Analysis***

.58 This section should include a description of the relevant information listed in paragraph .29. Such description may include:

- a. The rationale underlying any normalization or ***control adjustments*** to financial information
- b. Comparison of current performance with historical performance
- c. Comparison of performance with industry trends and norms, where available

### ***Valuation Approaches and Methods Considered***

.59 This section should state that the valuation analyst has considered the valuation approaches discussed in paragraph .31.

### ***Valuation Approaches and Methods Used***

.60 In this section, the valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use.

.61 This section should also identify the following for each of the three approaches (if used):

- a. Income approach:
  - Composition of the representative benefit stream
  - Method(s) used, and a summary of the most relevant risk factors considered in selecting the appropriate **discount rate**, the capitalization rate, or both
  - Other factors as discussed in paragraph .33
- b. Asset-based approach or cost approach:
  - *Asset-based approach*: Any adjustments made by the valuation analyst to the relevant balance sheet data
  - *Cost approach*: The type of cost used, how this cost was estimated, and, if applicable, the forms of and costs associated with depreciation and obsolescence used under the approach and how those costs were estimated
- c. Market approach:
  - For the guideline public company method:
    - The selected guideline companies and the process used in their selection
    - The pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
  - For the guideline company transactions method, the sales transactions and pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments

- For the guideline sales of interests in the subject entity method, the sales transactions used, how they were used, and the rationale for determining that these sales are representative of arm's length transactions

**.62** When a rule of thumb is used in combination with other methods, the valuation report should disclose the source(s) of data used and how the rule of thumb was applied (paragraph .39).

### ***Valuation Adjustments***

**.63** This section should (a) identify each valuation adjustment considered and determined to be applicable, for example, discount for lack of marketability, (b) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (c) describe the pre-adjustment value to which the adjustment was applied (paragraph .40).

### ***Nonoperating Assets and Excess Operating Assets***

**.64** When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related nonoperating assets, nonoperating liabilities, or excess or deficient operating assets and their effect on the valuation (paragraph .41).

### ***Representation of the Valuation Analyst***

**.65** Each written report should contain the representation of the valuation analyst. The representation is the section of the report wherein the valuation analyst summarizes the factors that guided his or her work during the engagement. Examples of these factors include the following:

- a. The analyses, opinions, and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions (see paragraph .18), and they are the personal analyses, opinions, and conclusion of value of the valuation analyst.
- b. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable (any exceptions should be noted). The valuation analyst has not performed any corroborating procedures to substantiate that data.
- c. The valuation engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services.
- d. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties (paragraph .49).
- e. The analyst's compensation is fee-based or is contingent on the outcome of the valuation.
- f. The valuation analyst used the work of one or more outside specialists to assist during the valuation engagement. (An outside specialist is a specialist other than those employed in the valuation analyst's firm.) If the work of such a specialist was used, the specialist should be identified. The valuation report should include a statement identifying the level of responsibility, if any, the valuation analyst is assuming for the specialist's work.

- g. The valuation analyst has no obligation to update the report or the opinion of value for information that comes to his or her attention after the date of the report.
- h. The valuation analyst and the person(s) assuming responsibility for the valuation should sign the representation in their own name(s). The names of those providing significant professional assistance should be identified.

### ***Representations Regarding Information Provided to the Valuation Analyst***

**.66** It may be appropriate for the valuation analyst to obtain written representations regarding information that the subject entity's management provides to the valuation analyst for purposes of his or her performing the valuation engagement. The decision whether to obtain a representation letter is a matter of judgment for the valuation analyst.

### ***Qualifications of the Valuation Analyst***

**.67** The report should contain information regarding the qualifications of the valuation analyst.

### ***Conclusion of Value***

**.68** This section should present a reconciliation of the valuation analyst's estimate or various estimates of the value of the subject interest. In addition to a discussion of the rationale underlying the conclusion of value, this section should include the following or similar statements:

- a. A valuation engagement was performed, including the subject interest and the valuation date.
- b. The analysis was performed solely for the purpose described in this report, and the resulting estimate of value should not be used for any other purpose.
- c. The valuation engagement was conducted in accordance with the Statement(s) on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- d. A statement that the estimate of value resulting from a valuation engagement is expressed as a conclusion of value.
- e. The scope of work or data available for analysis is explained, including any restrictions or limitations (paragraph .19).
- f. A statement describing the conclusion of value, either a single amount or a range.
- g. The conclusion of value is subject to the assumptions and limiting conditions (paragraph .18) and to the valuation analyst's representation (paragraph .65).
- h. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- i. The date of the valuation report is included.
- j. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.

**.69** The following is an example of report language that could be used, but is not required, when reporting the results of a valuation engagement:

We have performed a *valuation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of

Certified Public Accountants, of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date]. This valuation was performed solely to assist in the matter of [purpose of the valuation]; the resulting estimate of value should not be used for any other purpose or by any other party for any purpose. This valuation engagement was conducted in accordance with the SSVS. The estimate of value that results from a valuation engagement is expressed as a conclusion of value.

[If applicable] We were restricted or limited in the scope of our work or data available for analysis as follows: [describe restrictions or limitations].

Based on our analysis, as described in this valuation report, the estimate of value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [value, either a single amount or a range]. This conclusion is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our conclusion of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

## Appendixes and Exhibits

.70 Appendixes or exhibits may be used for required information or information that supplements the detailed report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the detailed report.

## Summary Report

.71 A summary report is structured to provide an abridged version of the information that would be provided in a detailed report, and therefore, need not contain the same level of detail as a detailed report. However, a summary report should, at a minimum, include the following:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. The business interest's ownership control characteristics, if any, and its degree of marketability
- g. Valuation date
- h. Valuation report date
- i. Type of report issued (namely, a summary report) (paragraph .48)
- j. Applicable premise of value
- k. Applicable standard of value
- l. Sources of information used in the valuation engagement
- m. Assumptions and limiting conditions of the valuation engagement (paragraph .18)

- n.* The scope of work or data available for analysis including any restrictions or limitations (paragraph .19)
- o.* Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- p.* If the work of a specialist was used in the valuation (paragraph .20), a description of how the specialist's work was used, and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work
- q.* The valuation approaches and methods used
- r.* Disclosure of subsequent events in certain circumstances (paragraph .43)
- s.* Any application of the jurisdictional exception (paragraph .10)
- t.* Representation of the valuation analyst (paragraph .65)
- u.* The report is signed in the name of the valuation analyst or the valuation analyst's firm
- v.* A section summarizing the reconciliation of the estimates and the conclusion of value as discussed in paragraphs .68 and .69
- w.* A statement that the valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the valuation report

**.72** Appendices or exhibits may be used for required information (paragraph .70) or information that supplements the summary report. Often, the assumptions, limiting conditions, and the valuation analyst's representation are provided in appendices to the summary report.

## Calculation Report

**.73** As indicated in paragraph .48, a calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in paragraph .65, but adapted for a calculation engagement.

**.74** The calculation report should identify any hypothetical conditions used in the calculation engagement, including the basis for their use (paragraph .22), any application of the jurisdictional exception (paragraph .10), and any assumptions and limiting conditions applicable to the engagement (paragraph .18). If the valuation analyst used the work of a specialist (paragraph .20), the valuation analyst should describe in the calculation report how the specialist's work was used and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work. The calculation report may also include a disclosure of subsequent events in certain circumstances (paragraph .43).

**.75** Appendices or exhibits may be used for required information (paragraph .72) or information that supplements the calculation report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendices to the calculation report.

**.76** The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:

- a.* Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.



- b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.
- c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.
- d. The calculation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- e. A description of the business interest's characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.
- f. The estimate of value resulting from a calculation engagement is expressed as a calculated value.
- g. A general description of a calculation engagement is given, including that (1) a calculation engagement does not include all of the procedures required for a valuation engagement and (2) had a valuation engagement been performed, the results may have been different.
- h. The calculated value, either a single amount or a range, is described.
- i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- j. The date of the valuation report is given.
- k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report.

.77 The following is an example of report language that could be used, but is not required, in reporting a calculation engagement:

We have performed a *calculation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. We performed certain calculation procedures on [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [calculation date]. The specific calculation procedures are detailed in paragraphs [reference to paragraph numbers] of our calculation report. The calculation procedures were performed solely to assist in the matter of [purpose of valuation procedures], and the resulting calculation of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimate of value that results from a calculation engagement is expressed as a calculated value.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of the subject interest. A calculation engagement does not include all of the procedures required in a *valuation engagement*, as that term is defined in the SVSS. Had a valuation engagement been performed, the results might have been different.

Based on our calculations, as described in this report, which are based solely on the procedures agreed upon as referred to above, the resulting calculated value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [calculated value, either a single amount or a range].

This calculated value is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our calculation of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

## Oral Report

.78 An oral report may be used in a valuation engagement or a calculation engagement. An oral report should include all information the valuation analyst believes necessary to relate the scope, assumptions, limitations, and the results of the engagement so as to limit any misunderstandings between the analyst and the recipient of the oral report. The member should document in the working papers the substance of the oral report communicated to the client.

## Effective Date

.79 This Statement applies to engagements to estimate value accepted on or after January 1, 2008. Earlier application is encouraged.

## Appendix A

### Illustrative List of Assumptions and Limiting Conditions for a Business Valuation

The valuation report or calculation report should include a list of assumptions and limiting conditions under which the engagement was performed. This appendix includes an illustrative list of assumptions and limiting conditions that may apply to a business valuation.

#### Illustrative List of Assumptions and Limiting Conditions

1. The conclusion of value arrived at herein is valid only for the stated purpose as of the date of the valuation.
2. Financial statements and other related information provided by [ABC Company] or its representatives, in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. [Valuation Firm] has not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.
3. Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
4. We do not provide assurance on the achievability of the results forecasted by [ABC Company] because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.
5. The conclusion of value arrived at herein is based on the assumption that the current level of management expertise and effectiveness would continue to be maintained, and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed.
6. This report and the conclusion of value arrived at herein are for the exclusive use of our client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and conclusion of value are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The conclusion of value represents the considered opinion of [Valuation Firm], based on information furnished to them by [ABC Company] and other sources.
7. Neither all nor any part of the contents of this report (especially the conclusion of value, the identity of any valuation specialist(s), or the firm with which such valuation specialists are connected or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media,

sales media, mail, direct transmittal, or any other means of communication without the prior written consent and approval of [Valuation Firm].

8. Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of [Valuation Firm] unless previous arrangements have been made in writing.
9. [Valuation Firm] is not an environmental consultant or auditor, and it takes no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. [Valuation Firm] does not conduct or provide environmental assessments and has not performed one for the subject property.
10. [Valuation Firm] has not determined independently whether [ABC Company] is subject to any present or future liability relating to environmental matters (including, but not limited to CERCLA/Superfund liability) nor the scope of any such liabilities. [Valuation Firm]'s valuation takes no such liabilities into account, except as they have been reported to [Valuation Firm] by [ABC Company] or by an environmental consultant working for [ABC Company], and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, [Valuation Firm] has relied on it without verification and offers no warranty or representation as to its accuracy or completeness.
11. [Valuation Firm] has not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.
12. [*Sample wording for use if the jurisdictional exception is invoked.*] The conclusion of value (or the calculated value) in this report deviates from the Statement on Standards for Valuation Services as a result of published governmental, judicial, or accounting authority.
13. No change of any item in this appraisal report shall be made by anyone other than [Valuation Firm], and we shall have no responsibility for any such unauthorized change.
14. Unless otherwise stated, no effort has been made to determine the possible effect, if any, on the subject business due to future Federal, state, or local legislation, including any environmental or ecological matters or interpretations thereof.
15. If prospective financial information approved by management has been used in our work, we have not examined or compiled the prospective financial information and therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will usually be differences between prospective financial information and actual results, and those differences may be material.
16. We have conducted interviews with the current management of [ABC Company] concerning the past, present, and prospective operating results of the company.

17. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. We have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.

## Appendix B

### International Glossary of Business Valuation Terms\*

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the below identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

**American Institute of Certified Public Accountants**

**American Society of Appraisers**

**Canadian Institute of Chartered Business Valuators**

**National Association of Certified Valuation Analysts**

**The Institute of Business Appraisers**

**Adjusted Book Value Method**—a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values. ¶NOTE: In Canada on a going concern basis

**Adjusted Net Asset Method**—see **Adjusted Book Value Method**.

**Appraisal**—see **Valuation**.

**Appraisal Approach**—see **Valuation Approach**.

**Appraisal Date**—see **Valuation Date**.

**Appraisal Method**—see **Valuation Method**.

**Appraisal Procedure**—see **Valuation Procedure**.

**Arbitrage Pricing Theory**—a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

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\* Reproduced verbatim from the International Glossary of Business Valuation Terms (the Glossary), which appears at [www.aicpa.org/InterestAreas/ForensicAndValuation/Membership/DownloadableDocuments/Intl%20Glossary%20of%20BV%20Terms.pdf](http://www.aicpa.org/InterestAreas/ForensicAndValuation/Membership/DownloadableDocuments/Intl%20Glossary%20of%20BV%20Terms.pdf). Note that the phrase, "we discourage the use of this term," that appears herein is also reproduced verbatim.

**Asset (Asset-Based) Approach**—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

**Beta**—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

**Blockage Discount**—an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

**Book Value**—see **Net Book Value**.

**Business**—see **Business Enterprise**.

**Business Enterprise**—a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

**Business Risk**—the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.

**Business Valuation**—the act or process of determining the value of a business enterprise or ownership interest therein.

**Capital Asset Pricing Model (CAPM)**—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

**Capitalization**—a conversion of a single period of economic benefits into value.

**Capitalization Factor**—any multiple or divisor used to convert anticipated economic benefits of a single period into value.

**Capitalization of Earnings Method**—a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

**Capitalization Rate**—any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

**Capital Structure**—the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

**Cash Flow**—cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

**Common Size Statements**—financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

**Control**—the power to direct the management and policies of a business enterprise.

**Control Premium**—an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a noncontrolling interest in a business enterprise to reflect the power of control.

**Cost Approach**—a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

**Cost of Capital**—the expected rate of return that the market requires in order to attract funds to a particular investment.

**Debt-Free**—*we discourage the use of this term.* See **Invested Capital**.

**Discount for Lack of Control**—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

**Discount for Lack of Marketability**—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

**Discount for Lack of Voting Rights**—an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

**Discount Rate**—a rate of return used to convert a future monetary sum into present value.

**Discounted Cash Flow Method**—a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

**Discounted Future Earnings Method**—a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

**Economic Benefits**—inflows such as revenues, net income, net cash flows, etc.

**Economic Life**—the period of time over which property may generate economic benefits.

**Effective Date**—see **Valuation Date**.

**Enterprise**—see **Business Enterprise**.

**Equity**—the owner's interest in property after deduction of all liabilities.

**Equity Net Cash Flows**—those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

**Equity Risk Premium**—a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

**Excess Earnings**—that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

**Excess Earnings Method**—a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings**.

**Fair Market Value**—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. ¶NOTE: In Canada, the term "price" should be replaced with the term "highest price."g

**Fairness Opinion**—an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

**Financial Risk**—the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.



**Forced Liquidation Value**—liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

**Free Cash Flow**—*we discourage the use of this term.* See **Net Cash Flow**.

**Going Concern**—an ongoing operating business enterprise.

**Going Concern Value**—the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

**Goodwill**—that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

**Goodwill Value**—the value attributable to goodwill.

**Guideline Public Company Method**—a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

**Income (Income-Based) Approach**—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

**Intangible Assets**—nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

**Internal Rate of Return**—a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

**Intrinsic Value**—the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

**Invested Capital**—the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

**Invested Capital Net Cash Flows**—those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

**Investment Risk**—the degree of uncertainty as to the realization of expected returns.

**Investment Value**—the value to a particular investor based on individual investment requirements and expectations. ¶NOTE: in Canada, the term used is "Value to the Owner."<sup>g</sup>

**Key Person Discount**—an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

**Levered Beta**—the beta reflecting a capital structure that includes debt.

**Limited Appraisal**—the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

**Liquidity**—the ability to quickly convert property to cash or pay a liability.

**Liquidation Value**—the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

**Majority Control**—the degree of control provided by a majority position.

**Majority Interest**—an ownership interest greater than 50% of the voting interest in a business enterprise.

**Market (Market-Based) Approach**—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

**Market Capitalization of Equity**—the share price of a publicly traded stock multiplied by the number of shares outstanding.

**Market Capitalization of Invested Capital**—the market capitalization of equity plus the market value of the debt component of invested capital.

**Market Multiple**—the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

**Marketability**—the ability to quickly convert property to cash at minimal cost.

**Marketability Discount**—see **Discount for Lack of Marketability**.

**Merger and Acquisition Method**—a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

**Mid-Year Discounting**—a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

**Minority Discount**—a discount for lack of control applicable to a minority interest.

**Minority Interest**—an ownership interest less than 50% of the voting interest in a business enterprise.

**Multiple**—the inverse of the capitalization rate.

**Net Book Value**—with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

**Net Cash Flows**—when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

**Net Present Value**—the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

**Net Tangible Asset Value**—the value of the business enterprise's tangible assets (excluding excess assets and nonoperating assets) minus the value of its liabilities.

**Nonoperating Assets**—assets not necessary to ongoing operations of the business enterprise. ¶NOTE: in Canada, the term used is "*Redundant Assets*."g

**Normalized Earnings**—economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

**Normalized Financial Statements**—financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

**Orderly Liquidation Value**—liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

**Premise of Value**—an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

**Present Value**—the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

**Portfolio Discount**—an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

**Price/Earnings Multiple**—the price of a share of stock divided by its earnings per share.

**Rate of Return**—an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

**Redundant Assets**—see **Nonoperating Assets**.

**Report Date**—the date conclusions are transmitted to the client.

**Replacement Cost New**—the current cost of a similar new property having the nearest equivalent utility to the property being valued.

**Reproduction Cost New**—the current cost of an identical new property.

**Required Rate of Return**—the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

**Residual Value**—the value as of the end of the discrete projection period in a discounted future earnings model.

**Return on Equity**—the amount, expressed as a percentage, earned on a company's common equity for a given period.

**Return on Investment**—See **Return on Invested Capital** and **Return on Equity**.

**Return on Invested Capital**—the amount, expressed as a percentage, earned on a company's total capital for a given period.

**Risk-Free Rate**—the rate of return available in the market on an investment free of default risk.

**Risk Premium**—a rate of return added to a risk-free rate to reflect risk.

**Rule of Thumb**—a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

**Special Interest Purchasers**—acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

**Standard of Value**—the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

**Sustaining Capital Reinvestment**—the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

**Systematic Risk**—the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

**Tangible Assets**—physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

**Terminal Value**—See **Residual Value**.

**Transaction Method**—See **Merger and Acquisition Method**.

**Unlevered Beta**—the beta reflecting a capital structure without debt.

**Unsystematic Risk**—the risk specific to an individual security that can be avoided through diversification.

**Valuation**—the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

**Valuation Approach**—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

**Valuation Date**—the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

**Valuation Method**—within approaches, a specific way to determine value.

**Valuation Procedure**—the act, manner, and technique of performing the steps of an appraisal method.

**Valuation Ratio**—a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

**Value to the Owner**—see **Investment Value**.

**Voting Control**—*de jure* control of a business enterprise.

**Weighted Average Cost of Capital (WACC)**—the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

## Appendix C

### Glossary of Additional Terms

**Assumptions and Limiting Conditions.** Parameters and boundaries under which a valuation is performed, as agreed upon by the valuation analyst and the client or as acknowledged or understood by the valuation analyst and the client as being due to existing circumstances. An example is the acceptance, without further verification, by the valuation analyst from the client of the client's financial statements and related information.

**Business Ownership Interest.** A designated share in the ownership of a business (business enterprise).

**Calculated Value.** An estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures agreed upon with the client and using professional judgment as to the value or range of values based on those procedures.

**Calculation Engagement.** An engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range.

**Capital or Contributory Asset Charge.** A fair return on an entity's *contributory assets*, which are tangible and intangible assets used in the production of income or cash flow associated with an intangible asset being valued. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income, or operating cash flow before taxes and capital expenditures. A capital charge may be expressed as a percentage return on an economic rent associated with, or a profit split related to, the contributory assets.

**Capitalization of Benefits Method.** A method within the income approach whereby expected future benefits (for example, earnings or cash flow) for a representative single period are converted to value through division by a capitalization rate.

**Comparable Profits Method.** A method of determining the value of intangible assets by comparing the profits of the subject entity with those of similar uncontrolled companies that have the same or similar complement of intangible assets as the subject company.

**Comparable Uncontrolled Transaction Method.** A method of determining the value of intangible assets by comparing the subject transaction to similar transactions in the market place made between independent (uncontrolled) parties.

**Conclusion of Value.** An estimate of the value of a business, business ownership interest, security, or intangible asset, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.

**Control Adjustment.** A valuation adjustment to financial statements to reflect the effect of a controlling interest in a business. An example would be an adjustment to owners' compensation that is in excess of market compensation.

**Engagement to Estimate Value.** An engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as *valuation service*.

**Excess Operating Assets.** Operating assets in excess of those needed for the normal operation of a business.

**Fair Value.** In valuation applications, there are two commonly used definitions for fair value:

(1) For financial reporting purposes only, the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Source:* Financial Accounting Standards Board *Accounting Standards Codification* glossary.

(2) For state legal matters only, some states have laws that use the term *fair value* in shareholder and partner matters. For state legal matters only, therefore, the term may be defined by statute or case law in the particular jurisdiction.

**Guideline Company Transactions Method.** A method within the market approach whereby market multiples are derived from the sales of entire companies engaged in the same or similar lines of business.

**Hypothetical Condition.** That which is or may be contrary to what exists, but is supposed for the purpose of analysis.

**Incremental Income.** Additional income or cash flow attributable to an entity's ownership or operation of an intangible asset being valued, as determined by a comparison of the entity's income or cash flow with the intangible asset to the entity's income or cash flow without the intangible asset. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as license royalty income or operating cash flow before taxes and capital expenditures.

**Normalization.** See *Normalized Earnings* in Appendix B, "International Glossary of Business Valuation Terms." [paragraph .81].

**Pre-adjustment Value.** The value arrived at prior to the application, if appropriate, of valuation discounts or premiums.

**Profit Split Income.** With respect to the valuation of an intangible asset of an entity, a percentage allocation of the entity's income or cash flow whereby (1) a split (or percentage) is allocated to the subject intangible and (2) the remainder is allocated to all of the entity's tangible and other intangible assets. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

**Relief from Royalty Method.** A valuation method used to value certain intangible assets (for example, trademarks and trade names) based on the premise that the only value that a purchaser of the assets receives is the exemption from paying a royalty for its use. Application of this method usually involves estimating the fair market value of an intangible asset by quantifying the present value of the stream of market-derived royalty payments that the owner of the intangible asset is exempted from or "relieved" from paying.

**Residual Income.** For an entity that owns or operates an intangible asset being valued, the portion of the entity's income or cash flow remaining after

subtracting a capital charge on all of the entity's tangible and other intangible assets. *Income or cash flows* can refer to any appropriate measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

**Security.** A certificate evidencing ownership or the rights to ownership in a business enterprise that (1) is represented by an instrument or by a book record or contractual agreement, (2) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (3) either one of a class or series or, by its terms, is divisible into a class or series of shares, participations, interests, rights, or interest-bearing obligations.

**Subject Interest.** A business, business ownership interest, security, or intangible asset that is the subject of a valuation engagement.

**Subsequent Event.** An event that occurs subsequent to the valuation date.

**Valuation Analyst.** For purposes of this Statement, an AICPA member who performs an engagement to estimate value that culminates in the expression of a conclusion of value or a calculated value.

**Valuation Assumptions.** Statements or inputs utilized in the performance of an engagement to estimate value that serve as a basis for the application of particular valuation methods.

**Valuation Engagement.** An engagement to estimate value in which a valuation analyst determines an estimate of the value of a subject interest by performing appropriate valuation procedures, as outlined in the AICPA Statement on Standards for Valuation Services, and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation engagement as a conclusion of value, which may be either a single amount or a range.

**Valuation Service.** See **Engagement to Estimate Value**.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

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## VS Section 9100

# ***Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset: Valuation Services Interpretations of Section 100***

### **1. Scope of Applicable Services**

#### **Background**

.01 The Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* [VS section 100] establishes standards of performance and reporting for all AICPA members performing those valuation services that are within the scope of the Statement. When originally proposed on March 30, 2005, the Exposure Draft contained a list of questions and answers (Appendix A of the March 30, 2005 Exposure Draft) that were intended to assist members in determining if an engagement, particularly with regard to litigation or tax engagements, fell within the scope of the Statement. Through the Exposure Draft process, it was determined that the questions and answers were an integral part of the Statement and should be made authoritative. This Interpretation is part of the AICPA's continuing efforts at self-regulation of its members in valuation practice, and its desire to provide guidance to members when providing valuation services. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards.

#### **General Interpretation**

.02 The SSVSs apply to an engagement to estimate value if, as all or as part of another engagement, a member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraphs 1 and 2 [VS section 100.01–.02]). In the process of estimating value, professional judgment is used to apply valuation approaches and valuation methods as described in the SSVS No. 1, paragraph 4 [VS section 100.04].

.03 In determining whether a particular service falls within the scope of the Statement, a member should consider those services that are specifically excluded:

- Audit, review, and compilation engagements (SSVS No. 1, paragraph 5 [VS section 100.05])
- Use of values provided by the client or a third party (SSVS No. 1, paragraph 6 [VS section 100.06])
- Internal use assignments from employers to employee members not in the *practice of public accounting* (SSVS No. 1, paragraph 7 [VS section 100.07])
- Engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) and that do not include an

engagement to estimate value (SSVS No. 1, paragraph 8 [VS section 100.08])

- Mechanical computations that do not rise to the level of an engagement to estimate value (SSVS No. 1, paragraph 9(a) [VS section 100.09a])
- Engagements where it is not practical or reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods described in this Statement. (SSVS No. 1, paragraph 9(b) [VS section 100.09b])
- Engagements meeting the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10])

**.04** A member should be diligent in determining if an engagement falls within the scope of the Statement. Unless specifically excluded by the SSVS, if the engagement requires a member to apply valuation approaches and methods, and use professional judgment in applying those approaches and methods, the SSVS would apply. In determining the scope and requirements of the engagement, a member should consider the clients needs, or the requirements of a third party for which the valuation is intended, including governmental, judicial, and accounting authorities. In addition, a member should consider other professional standards that might apply.

### Specific Illustrations

**.05** The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in general facts, or to particular facts and circumstances, may lead to different conclusions. In each illustration, there is no authority other than that indicated.

### Illustrations Relating to Litigation Engagements and Certain Controversy Proceedings

**.06** *Illustration 1.* Do lost profits damage computations fall within the scope of the Statement?

**.07** *Conclusion.* No, unless the computations are undertaken as part of an engagement to estimate value (SSVS No. 1, paragraphs 1, 2, and 8 [VS section 100.01, .02, and .08]).

**.08** *Illustration 2.* Is an economic damages computation that incorporates a terminal value within the scope of the Statement?

**.09** *Conclusion.* The use of a terminal value exclusively for the determination of lost profits is not within the scope of this statement unless that determination will be used as part of an engagement to estimate value (*Illustration 1*).

**.10** *Illustration 3.* If a start-up business is destroyed, is the economic damages computation within the scope of the Statement?

**.11** *Conclusion.* There are two common measures of damages: lost profits and loss of value. If a valuation analyst performs an engagement to estimate value to determine the loss of value of a business or intangible asset, the Statement applies. Otherwise, the Statement does not apply (*Illustration 1*). In order to determine whether the Statement applies, a member acting as an expert witness should evaluate whether the particular damages calculation constitutes an engagement to estimate value with respect to the business, business interest, security, or intangible asset or whether it constitutes a lost-profits computation.

**.12 Illustration 4.** Does the Statement include any exceptions relating to litigation or controversy proceedings?

**.13 Conclusion.** Yes, the Statement includes a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50]); however, there is no litigation or controversy proceeding exemption from the developmental provisions of the Statement (SSVS No. 1, paragraphs 21–46 [VS section 100.21–.46]) in circumstances in which an engagement to estimate value is performed (*Illustration 1*).

**.14 Illustration 5.** Is the Statements reporting exemption for litigation or controversy proceedings (see SSVS No. 1, paragraph 50 [VS section 100.50]) the same as the "litigation exemption" in the AICPA attestation standards?

**.15 Conclusion.** No, the so-called "litigation exemption" is provided for in the AICPA attestation standards and is further discussed in the attestation interpretations. The attestation standards do not apply to engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts. This is clarified in the attestation interpretation, which states, in part, that the attestation standards do not apply to litigation services engagements when (among other requirements) the practitioner "has not been engaged to issue and does not issue an examination, a review, or an agreed-upon procedures report on the subject matter, or an assertion about the subject matter that is the responsibility of another party." (Interpretation No. 3, "Applicability of Attestation Standards to Litigation Services," of Chapter 1, "Attest Engagements," of Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*, as revised [AT section 9101.34–.42]. However, unlike the AICPA attestation standards, which do not apply in any capacity to litigation or controversy proceeding situations, as discussed above, the Statements exemption for litigation or certain controversy proceedings is an exemption from the reporting provisions of the Statement (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]).

## Illustrations Relating to Tax Engagements

**.16 Illustration 6.** When does the Statement apply to members who determine values related to tax reporting and planning engagements?

**.17 Conclusion.** The Statement applies when the member is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). The application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

**.18 Illustration 7.** If the sole purpose of an engagement is reporting a value in a tax return and the Statement applies to this engagement, are any separate reports (specifically, valuation reports) required to be issued? To whom are those reports required to be provided? Is a report required to be attached to the tax return? Are any specific disclosures required?

**.19 Conclusion.** The Statement requires the preparation of a written or oral valuation report (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]) that is communicated to the client (SSVS No. 1, paragraph 47 [VS section 100.47]) but does not require that any report be attached to the tax return or mandate any other tax-specific disclosures. In limited circumstances, a taxing authority may require its own report, which would obviate the need for a separate valuation report (SSVS No. 1, paragraph 10 [VS section 100.10] and *Illustration 18*).

There is also a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50] and *Illustration 4*).

**.20 *Illustration 8.*** Are mechanical computations of value, for example, computations using actuarial tables, excluded from the Statement?

**.21 *Conclusion.*** Mechanical computations of value are excluded from the Statement if they do not rise to the level of an engagement to estimate value, that is, if the member does not apply valuation approaches and methods, and does not use professional judgment, as described in the Statement (SSVS No. 1, paragraph 9(a) [VS section 100.09a]).

**.22** Examples of services that do **not** rise to the level of an engagement to estimate value include: (a) computations of a remainder interest under a grantor retained annuity trust (GRAT) using actuarial tables; (b) determining the value of relatively small blocks (relative to the total amount of corporate stock outstanding) of publicly traded stock whose per share price is readily ascertainable; (c) preparing a tax return using the valuation of a business that was provided by a third-party appraiser, or by the client (SSVS No. 1, paragraph, [VS section 100.06]); and (d) calculating cash "hold back" requirements for tax contingencies (SSVS No. 1, paragraphs 4 and 9(a) [VS section 100.01, .04, and .09a]).

**.23** Examples of services that rise to the level of an engagement to estimate value include: (a) valuing a block of publicly traded stock, if the analysis includes consideration of a discount for blockage, lock-up, or other contractual or market restrictions such that valuation approaches and methods are applied, and professional judgment is used to determine the fair value, fair market value, or other applicable standard of value; (b) valuing stock that is not publicly traded; and (c) computing the fair market value of assets in a charitable remainder trust (CRT), if the engagement requires the application of valuation approaches and methods, and the use of professional judgment to estimate the fair market value.

**.24 *Illustration 9.*** Does the "jurisdictional exception" (SSVS No. 1, paragraph 10 [VS section 100.10]) provide that an engagement to estimate value is not subject to the Statement if a member determines and reports values using procedures mandated or allowed by the Internal Revenue Code (IRC), Internal Revenue Service (IRS) regulations, court cases, or other published guidance and other sources of federal, state, and local law solely for purposes of tax return preparation and other tax services using these methods?

**.25 *Conclusion.*** No, the "jurisdictional exception" would not exempt the engagement from this Statement, even if the engagements sole purpose was to value a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]) for tax reporting purposes. Only the portion of the Statement that differs from the published governmental or judicial authority is superseded for purposes of the engagement. The remainder of the Statement applies to the engagement.

**.26 *Illustration 10.*** Is an interest in a publicly traded partnership whose shares are frequently traded considered a "security" under the Statement? Is an interest in a family limited partnership (FLP), or in another nontraded partnership, considered a "security" under the Statement?

**.27 *Conclusion.*** Whether interest constitutes a "security" is a legal determination. However, where the value of a security is readily ascertainable, a valuation analyst does not need to apply valuation approaches and methods and use professional judgment. Accordingly, the valuation of such an interest would not be subject to the Statement (SSVS No. 1, paragraphs 1 and 9(a) [VS section 100.01 and .09a]). An interest in a nonpublicly traded partnership, such

as an FLP, whether considered a security or not, is a business ownership interest. The valuation of such nonpublicly traded interest requires the application of valuation approaches and methods and the use of professional judgment, and, accordingly, would be subject to the Statement (SSVS No. 1, paragraphs 1, 4, [VS section 100.01 and .04], and *Illustration 6*), unless the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b] applies (*Illustration 13e*). If the engagement requires the valuation analyst to consider and apply adjustments, for example, valuation discounts or premiums, then the engagement would be subject to the Statement.

**.28 *Illustration 11.*** A client engages a member to provide advice for planning purposes (such as estate planning, personal financial planning, or merger and acquisitions planning). The client holds an ownership interest in a family business being operated as a limited liability company, an interest in a private real estate limited partnership, publicly traded stock, a personal residence, and a retirement account (not an IRA). Is this a valuation engagement subject to the Statement?

**.29 *Conclusion.*** It depends. Providing technical advice, without reference to values for the various assets, is not subject to the Statement. However, if a member calculates a value to illustrate various planning options, he or she may fall under the Statement with regard to various assets. If one or more of the assets for which value is to be determined for purposes of the plan illustrations is a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the values for these assets, or the member does not use assumed or hypothetical values as part of the overall engagement, the member performing the valuation(s) is subject to the Statement with regard to these assets (SSVS No. 1, paragraph 1, [VS section 100.01] and *Illustration 6*). In this example, if the member applies valuation approaches and methods and uses professional judgment to determine the value of the ownership interest in the family business or the interest in the private real estate limited partnership in order to provide planning advice, the Statement would apply. In contrast, if the client or a third party provides the values for these assets, or the member uses assumed or hypothetical values, the Statement would not apply because the member would not be applying valuation approaches and methods and using professional judgment. In addition, the exception under SSVS No. 1, paragraph 9(b), [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (see *Illustration 13e*). The computation of the "estimated estate tax" or other taxes once the values have been determined, assumed, or provided is not subject to the Statement, as the computation is a tax computation but would be subject to the Statements on Standards for Tax Services [TS sections 100–900] (*Illustration 10* at paragraph .27 of this Interpretation).

**.30 *Illustration 12.*** There are many instances where a tax engagement involves the need for a member to estimate value. The estimation of value may not be the primary purpose of the engagement, but rather a necessary task to perform or item to consider, when making a tax determination concerning the reporting of a transaction on a tax return. Consider the following practice situations:

**.31 *Illustration 12a.*** A member has been engaged to determine the deductibility of interest on a nonrecourse loan. Under applicable regulations, interest on a nonrecourse loan cannot be deducted if it is clear that the company will be unable to service the debt. For purposes of tax reporting, a conclusion must be reached concerning the ability of the company to service the debt. Is this considered a valuation engagement subject to the Statement?

**.32 Conclusion.** This is not a valuation engagement covered by the Statement because it is not the valuation of a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]). This example is a debt-service analysis.

**.33 Illustration 12b.** There are compliance filings that require an estimate of the value of a company. For example, the "market value" of "intangible personal property," as defined by a states taxing authority may need to be reported annually on an intangible personal property tax return. A client has a subject interest that is considered intangible personal property for purposes of the return. The member has been engaged to prepare the tax return. Is this a valuation engagement subject to the Statement?

**.34 Conclusion.** It depends. If the state requires an estimation of the value of a subject interest, and the estimation of value requires the application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]), the Statement applies. If, however, the client or a third-party appraiser provides the value of the subject interest to the member, the Statement does not apply (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06]). In addition, the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (*Illustration 13e*). Alternatively, if the state follows more informal rules where the application of valuation approaches or valuation methods are not necessary, the Statement does not apply (SSVS No. 1, paragraph 4 [VS section 100.04]).

**.35 Illustration 12c.** There are times when a member must allocate value among various assets. For example, IRC sections 1060 and 338 require the allocation to assets, based on relative values, of consideration paid. In partnership taxation, there may be allocations under IRC sections 754, 743, and 734 and special tax basis adjustments for partnerships (sales or exchanges and transfers at or upon death) may require an allocation of value among various partnership assets. Are these types of allocations engagements to estimate value subject to the Statement?

**.36 Conclusion.** It depends. If one or more of the assets to which value is to be allocated is a subject interest (that is, a business, business ownership interest, security, or intangible asset), and the client or a third party did not provide the member with a value for those assets, then the member performing the allocation would be subject to the Statement, and the member is required to apply valuation approaches and methods, and use professional judgment to value those assets (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). For example, in an IRC section 1060 allocation, after the allocation of purchase price to cash, receivables, inventory, and depreciable tangible assets, there is a residual amount of value allocable to goodwill or going concern. The mechanical assignment of the residual amount to goodwill or going concern is not subject to the Statement. However, if the member allocates this residual amount to specific intangible assets (such as to various customer-based and supplier-based intangibles), such allocation is based on the assets relative values. Because the member applies valuation approaches and methods and uses professional judgment to value those specific intangible assets, the Statement applies.

**.37 Illustration 12d.** If the member does not apply any discount and simply computes the fair market value of an interest in a family limited partnership (FLP) for tax purposes, is this a valuation engagement subject to the Statement?

**.38 Conclusion.** Yes, the Statement applies if the member determines the value of the FLP or an interest in an FLP. The application of valuation

approaches and methods, and the use of professional judgment are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). The fact that the member does not apply a discount does not exempt the engagement from the Statement (SSVS No. 1, paragraphs 1–4 and 9(a) [VS section 100.01–.04 and .09a]).

**.39 Illustration 12e.** Would the Statement apply to the computation of the fair market value of assets in, or the computation of the required distribution of, a charitable remainder trust (CRT)?

**.40 Conclusion.** It depends on the underlying assets held by the CRT. The Statement would apply only if the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). To the extent that the CRT holds assets that, to be valued, require the application of valuation approaches and methods, and the use of professional judgment, such as an interest in a limited liability corporation (LLC), the Statement would apply. However, if the CRT only holds publicly traded stock with a readily ascertainable value, the Statement would not apply because valuation approaches and methods and professional judgment would not be needed in the computation (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

**.41 Illustration 12f.** In circumstances in which the value of assets contributed by partners to a partnership differ from their cost basis, each difference must be tracked for tax purposes under IRC section 704(c) so that amounts of gain or loss can be properly assigned to the contributing partners. Are these types of asset value assignments valuation engagements subject to the Statement?

**.42 Conclusion.** It depends. If one or more of the assets for which value is relevant under IRC section 704(c) is a subject interest that is, a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the valuation, and the member applies valuation approaches and methods and uses professional judgment to value these assets for IRC section 704(c) tax purposes, then the Statement applies (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06], and *Illustration 6*).

**.43 Illustration 12g.** A member has been engaged to perform a cost segregation study. The study involves an analysis of the costs of building a structure and the allocation of such costs to the real and personal property components of the structure so that depreciation of those components may be properly computed. Is this a valuation engagement subject to the Statement?

**.44 Conclusion.** No, none of the assets constitutes a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

**.45 Illustration 12h.** A member has been engaged to provide advice to a company regarding the tax planning for income from discharge of indebtedness under IRC section 108. The company has advised the member that the company will be able to negotiate a settlement in complete satisfaction of an obligation at 30 cents on the dollar. Is this a valuation engagement subject to the Statement?

**.46 Conclusion.** It depends. Under IRC section 108(a), gross income of the company excludes income from discharge of indebtedness only under certain circumstances. One of those circumstances is the insolvency of the company. Under IRC section 108(d) (3), insolvency results from an excess of liabilities over the fair market value of assets. If (a) the company must rely on the insolvency provisions of IRC section 108; (b) one or more of the assets for which value is relevant under IRC section 108 is a subject interest (that is, a business, business ownership interest, security, or intangible asset); (c) the company or a third

party does not provide the valuation; and (d) the member applies valuation approaches and methods, and uses professional judgment to value the subject interest(s) for purposes of the IRC section 108(d)(3) insolvency determination, the Statement applies.

**.47 Illustration 13.** An executor has engaged a member to prepare an estate tax return, which requires determining values for the following estate assets: (a) shares in a publicly traded company, "TI Corporation," whose shares are infrequently traded; (b) a large block of stock in "LB Corporation," a publicly traded company; (c) a brokerage account consisting of shares in various publicly traded companies; (d) "CHB Corporation," a closely held business owned by the decedent and the decedent's family; and (e) a 5 percent interest in "RP," a privately held rental real estate partnership. Does the Statement apply to any of the following assets owned by the estate? (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

**.48 Illustration 13a.** Does the Statement apply to shares in a publicly traded company, "TI Corporation," whose shares are traded infrequently?

**.49 Conclusion.** It depends; although the price of a share of publicly traded stock is ascertainable from published sources, there are no definitive criteria that would indicate when the Statement applies to shares that are infrequently traded. A key consideration is the average daily trading volume of TI Corporation stock on or around the valuation date. The concept of fair market value incorporates the notions that (1) cash could have been received for the stock at the valuation date, and (2) the share price of an infrequently traded stock could decrease if a relatively large block of the stock were to be put on the market on that date. If the subject shares held by the estate do not represent a significant percentage of the daily trading volume of TI stock on or around the valuation date, and the price of a share of the stock is readily ascertainable on the valuation date, then the resulting value (the quoted share price times the number of shares owned) represents a cash price that could have been received at the valuation date for the block, and the Statement does not apply because the calculation of value is mechanical (SSVS No. 1, paragraph 9(a) [VS section 100.09a]). If, however, the subject shares held by the estate represent a large percentage of the average daily trading volume of the stock, the quoted market price for a share may not be adequate for purposes of determining the fair market value of the block of shares on the valuation date. In that case, the Statement applies because valuation approaches and methods need to be applied, and professional judgment needs to be used in determining the value of the block (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]) (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

**.50 Illustration 13b.** Does the Statement apply to a large block of stock in "LB Corporation," a publicly traded company?

**.51 Conclusion.** The answer depends on the amount of shares to be valued in relation to the average daily trading volume in LB Corporation on or around the valuation date. There are no definitive criteria that would indicate when the Statement applies to the valuation of a large block of publicly traded stock. The concept of fair market value incorporates the notion that cash could have been received from a sale of the block on the valuation date. A large block could decrease the share price if sold on the valuation date. The Statement would typically not apply to the valuation of a large block (for example, 200,000 shares) of a large and actively-traded public company. Even though the value of the estate's stock may be large in absolute terms, the daily trading volume in such stock on the valuation date may be sufficiently high that a sale of the block on the valuation date would not affect the market price of a company's



shares. In such a case, the quoted market price of a share times the number of shares held by the estate may be considered to reflect the fair market value of the subject block of stock, and because it would not be the case that valuation approaches and methods would need to be applied and professional judgment used, the Statement would not apply. If, however, the large block of publicly traded shares represents a significant percentage of the daily trading volume, the Statement would apply because valuation approaches and methods would need to be applied and professional judgment used to determine the value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.52 *Illustration 13c.*** Does the Statement apply to a brokerage account consisting of shares in various publicly traded companies?

**.53 *Conclusion.*** The Statement would not apply to the determination of the value of a brokerage account consisting of publicly traded securities, except as discussed in paragraphs .49 and .51 of this Interpretation. Absent certain scenarios involving infrequently traded securities or large blocks of stock, the application of valuation approaches and methods and the use of professional judgment are not necessary in that determination (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.54 *Illustration 13d.*** Does the Statement apply to "CHB Corporation," a closely held business owned by the decedent and the decedent's family?

**.55 *Conclusion.*** The Statement would apply to the determination of value of CHB Corporation because valuation approaches and methods need to be applied, and professional judgment needs to be used to determine the fair market value of the ownership interest in CHB (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.56 *Illustration 13e.*** Does the Statement apply to a 5 percent interest in a privately held rental real estate partnership (RP)?

**.57 *Conclusion.*** The Statement would apply to the determination of value of the 5 percent interest in rental real estate partnership (RP) because valuation approaches and methods need to be applied and professional judgment needs to be used to determine the fair market value of the ownership of a fractional interest in a privately held partnership (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, where it is not practical or not reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods, the Statement would not apply. For example, the member has requested from RP's general partner financial information the member needs in order to apply valuation approaches and methods. The general partner is not responsive to the member's requests, and the due date for filing the estate tax return is near. Given the small ownership interest, and given that RP is likely a relatively small percent of the total estate, unless prohibited by statute or by rule, the member may then use the taxpayer's estimates if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member) (SSVS No. 1, paragraph 9(b) [VS section 100.09b]).

**.58 *Illustration 14.*** Would the answers to *Illustration 13* change if the values were provided by the client or a client-engaged third party?

**.59 *Conclusion.*** The Statement would not apply if the values were provided by the client or by a client-engaged third party because the member is not applying valuation approaches and methods and using professional judgment to determine value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300],

in providing appropriate due diligence with respect to the values provided to the member. It is also recommended that the understanding between member and client in these circumstances include documentation of the fact that the member is not determining but rather is being provided with the value of the subject interest.

**.60 *Illustration 15.*** Would the answers to *Illustration 13* change if the values were provided by an outside third-party specialist hired by the member?

**.61 *Conclusion.*** If the member engages an outside third-party specialist to assist with the member's work, and it is the member expressing a conclusion or calculated value, the member will be applying valuation approaches and methods and using professional judgment; thus, the Statement would apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]; SSVS No. 1, paragraph 20, "Using the Work of Specialists in the Valuation Engagement," [VS section 100.20]). If, however, the third-party specialist is determining the value in his or her own name and providing that value to the client, and the member will not be applying valuation approaches and methods or using professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), the Statement would not apply, but the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300] in providing appropriate due diligence with respect to the values provided.

**.62 *Illustration 16.*** The client and the member agree that the member will value a partnership interest and then apply an "average" discount that the member is to determine (based on the results of various studies and case law). Does the Statement apply? If so, is this a valuation engagement or a calculation engagement?

**.63 *Conclusion.*** Yes, the Statement applies because the member determined the value of the partnership interest by applying valuation approaches and valuation methods and using professional judgment. This would be considered a calculation engagement because the member and the client have agreed on the specific valuation approaches or valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform (SSVS No. 1, paragraph 21(b) [VS section 100.21b] and *Illustration 6*).

**.64 *Illustration 17.*** Would the Statement apply if a member has an informal conversation or communicates in writing with a client regarding the alternative tax consequences of gifting versus selling a business using a presumption of a specific value of the business?

**.65 *Conclusion.*** No, the Statement would not apply. The member is providing tax advice using an assumed or hypothetical value of a business and is not determining value, applying valuation approaches and methods, and using professional judgment to value a business (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

**.66 *Illustration 18.*** Would the Statement apply to a transfer pricing study (IRC section 482) that involves the use of specific methodologies, data, terminology, and documentation requirements that are provided in the IRS regulations and procedures, and whose methodologies and documentation requirements differ from those contained in the Statement?

**.67 *Conclusion.*** No. To the extent that the transfer pricing study applies, for example, to the valuation of inventory or services, the Statement would not apply (see SSVS No. 1, paragraph 1 [VS section 100.01] and *Illustration 6*). To the extent that the transfer pricing study applies to the valuation of intangible assets, the Statement would normally apply. However, because the

IRS regulations require that the taxpayer reasonably calculate an arm's-length price according to the best method that is determined using third-party comparable data under explicit IRS rules and documentation procedures, and to the extent these IRS rules and procedures differ from the Statement, the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10]) would exempt the valuation of the intangible assets from the developmental provisions of the Statement (SSVS No. 1, paragraphs 25–48 [VS section 100.25–48]). In addition, to the extent that the IRS regulations (such as IRS regulation section 1.6662-6(d) (2) (iii)) and procedures provide specific documentation requirements for avoiding potential penalties, and if a transfer pricing report is provided to a client according to such IRS documentation requirements, the jurisdictional exception would apply to the reporting provisions of the Statement (SSVS No. 1, paragraphs 50–78 [VS section 100.50–.78]) and thus a valuation report would not be necessary.

**.68 Illustration 19.** In a situation where the Statement applies to members who determine value as part of tax engagements, would the member also be required to be in compliance with the Statements on Standards for Tax Services (SSTSs) [TS sections 100–900]?

**.69 Conclusion.** Yes, the Statement would apply only to the valuation determination and reporting aspects of the engagement but the SSTSs would apply to all aspects of the engagement. For example, even though the Statement would govern the determination of value of an applicable asset reported on a tax return, the member would also have to be in compliance with SSTS No. 1, *Tax Return Positions*, [TS section 100], for that valuation.

**.70 Illustration 21.** Do settlements or negotiations of value in offers-in-compromise or tax disputes fall under the Statement?

**.71 Conclusion.** No, settlements or negotiations of value in offers-in-compromise or tax disputes are part of a tax process. However, if a member prepares a valuation in preparation for a settlement or negotiation of value, and the valuation involves the application of valuation approaches and methods and the use of professional judgment, the valuation would fall under the developmental aspects of the Statement. The settlement or negotiation process itself is not a valuation and would not fall under the Statement. In addition, the Statement's reporting exemption for certain controversy proceedings would apply as the valuation was performed specifically for the administrative matter (SSVS No. 1, paragraph 50 [VS section 100.50]).

## Illustrations Relating to Other Engagements

**.72 Illustration 20.** Does determining the value of accounts receivable fall under the Statement?

**.73 Conclusion.** No, accounts receivable constitute **tangible assets** under the Statement (SSVS No. 1, Appendix B [VS section 100.81], and do not constitute a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

**.74 Illustration 22.** In the course of performing a valuation under the Statement, if a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), does this require the valuation analyst to examine or compile such information in accordance with the Statements on Standards for Attestation Engagements (SSAEs) [AT sections 20–701]?

**.75 Conclusion.** No, Chapter 1, "Attest Engagements," of SSAE No. 10, *Attestation Standards: Revision and Recodification*, as amended [AT section 101.01] states that the attestation standards apply when a practitioner is "engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter..., that is the responsibility of another party." If the valuation analyst has not been engaged to examine, compile, assemble, review, or apply agreed-upon procedures to prospective financial information, and does not issue an examination, compilation, assembly, or agreed-upon report on prospective financial information, the SSAEs [AT sections 20–701] do not apply (SSARS 14 [AR section 120]).

**.76 Illustration 23.** Under a valuation engagement, a valuation analyst is free to select any and all valuation approaches and methods the valuation analyst deems appropriate in the circumstances. Under a calculation engagement, the valuation analyst and the client agree to the specific approaches or methods the valuation analyst will use or the extent of calculation procedures the valuation analyst will perform. (SSVS No. 1, paragraph 21 [VS section 100.21]) Under SSVS No. 1, paragraph 18 [VS section 100.18], a restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis may be present and known to the valuation analyst at the outset of the engagement, or may arise during the course of an engagement (and such restriction or limitation should be disclosed in the report). Is it possible to have a restriction or limitation that is of such a degree that a valuation analyst engaged to perform a valuation engagement should propose altering the engagement to be a calculation engagement?

**.77 Conclusion.** Although the two engagements represent two different types of service performed by valuation analysts, the possibility exists. If, in the course of a valuation engagement, restrictions, or limitations on the scope of the valuation analyst's work or the data available for analysis are so significant that the valuation analyst believes that he or she cannot, even with disclosure in the valuation report of the restrictions or limitations, adequately perform a valuation engagement leading to a conclusion of value, the valuation analyst should determine whether he or she has the ability to adequately complete the engagement as a calculation engagement or should consider resigning from the engagement.

**.78 Illustration 24.** If a member employed in industry, government, or education "moonlights" doing engagements to estimate value, do the Standards apply?

**.79 Conclusion.** Yes, the Standard applies. By moonlighting, the member is holding him or herself out as a certified public accountant and as being in public practice. The Standard would apply just as it would to any other member in public practice unless one of the exceptions applies.

**.80 Illustration 25.** Does the Statement apply to an assignment from an employer to an employee member not in public practice to prepare a valuation for internal financial reporting purposes?

**.81 Conclusion.** No, SSVS No. 1, paragraph 7 [VS section 100.07] exempts internal use assignments from an employer to an employee member not in the practice of public accounting. However, if the valuation is to be used for financial reporting purposes, the employer and the employee may wish to consider whether the work will be accepted by the employer's outside auditors if the statement is not followed.

## Illustrations for PFP-Specific Engagements

*These illustrations assume the member has not been engaged to perform a business valuation.*

**.82 Illustration 26.** When does the Statement apply to members who determine values related to personal financial planning engagements?

**.83 Conclusion.** The Statement applies to personal financial planning engagements when the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]) and in the process of determining the value applies valuation approaches and methods and uses professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

**.84 Illustration 27.** If a member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest, does the Statement apply?

**.85 Conclusion.** No. The Statement does not apply because estimate of future sales proceeds does not in itself constitute a valuation engagement (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.86 Illustration 28.** A member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest. As part of that engagement, the member shares general industry knowledge to assist the client in estimating the current value of the business interest. Does the Statement apply?

**.87 Conclusion:**

(a) If, in the process of determining the current value from which the member estimates future sales proceeds, the member applies valuation approaches and methods and uses professional judgment, the Statement applies to the determination of the current value (SSVS No. 1, paragraph 4 [VS section 100.04]). However, the Statement does not apply when the member shares general industry knowledge with the client instead of applying professional judgment.

(b) If the client or another party provides the current value, and the member does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

(c) If the member uses a hypothetical or assumed value as the starting point for the calculation of future sales proceeds and does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). The Statement does not apply to a general discussion with the client of valuation concepts or industry price multiples based on the member's industry knowledge, which assists the client in determining a hypothetical or assumed value (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

**.88 Illustration 29.** The client has asked the member to prepare a personal financial plan that includes an estimate of future proceeds from a sale of the business interest at retirement. The member estimates the future proceeds based on an estimate of the business' current value by applying a rule of thumb for the business' industry, but the member does not consider the risk factors of the subject interest or exercise other professional judgment in applying the multiple. Does the Statement apply?

**.89 Conclusion.** No, the Statement does not apply because the member did not use professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]). If the member considers specific risk factors of the business interest in applying the price multiple, the Statement applies.

*This Statement titled Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset was unanimously adopted by the assenting votes of the AICPA Consulting Services Executive Committee.*

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## CS Section

# CONSULTING SERVICES

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### STATEMENT ON STANDARDS FOR CONSULTING SERVICES

Statements on Standards for Consulting Services are issued by the AICPA Management Consulting Services Executive Committee, the senior technical committee of the Institute designated to issue pronouncements in connection with consulting services. Council has designated the AICPA Management Consulting Services Executive Committee as a body to establish technical standards under *Rule 202* of the Institute's Code of Professional Conduct. Members should be prepared to justify departures from this Statement.

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## CS Section 100

# ***Consulting Services: Definitions and Standards***

**Effective for engagements accepted on or after January 1, 1992, unless otherwise indicated.**

## **Introduction**

**.01** Consulting services that CPAs provided to their clients have evolved from advice on accounting-related matters to a wide range of services involving diverse technical disciplines, industry knowledge, and consulting skills. Most practitioners, including those who provide audit and tax services, also provide business and management consulting services to their clients.

**.02** Consulting services differ fundamentally from the CPA's function of attesting to the assertions of other parties. In an attest service, the practitioner expresses a conclusion about the reliability of a written assertion that is the responsibility of another party, the asserter. In a consulting service, the practitioner develops the findings, conclusions, and recommendations presented. The nature and scope of work is determined solely by the agreement between the practitioner and the client. Generally, the work is performed only for the use and benefit of the client.

**.03** Historically, CPA consulting services have been commonly referred to as management consulting services, management advisory services, business advisory services, or management services. A series of Statements on Standards for Management Advisory Services (SSMASs) previously issued by the AICPA contained guidance on certain types of consulting services provided by members. This Statement on Standards for Consulting Services (SSCS) supersedes the SSMASs and provides standards of practice for a broader range of professional services, as described in paragraph .05.

**.04** This SSCS and any subsequent SSCSs apply to any AICPA member holding out as a CPA while providing Consulting Services as defined herein.

## **Definitions**

**.05** Terms established for the purpose of SSCSs are as follows:

***Consulting Services Practitioner.*** Any AICPA member holding out as a CPA while engaged in the performance of a Consulting Service for a client, or any other individual who is carrying out a Consulting Service for a client on behalf of any Institute member or member's firm holding out as a CPA.

***Consulting Process.*** The analytical approach and process applied in a Consulting Service. It typically involves some combination of activities relating to determination of client objective, fact-finding, definition of the problems or opportunities, evaluation of alternatives, formulation of proposed action, communication of results, implementation, and follow-up.

**Consulting Services.** Professional services that employ the practitioner's technical skills, education, observations, experiences, and knowledge of the consulting process.<sup>1</sup> Consulting Services may include one or more of the following:

- a. *Consultations*, in which the practitioner's function is to provide counsel in a short time frame, based mostly, if not entirely, on existing personal knowledge about the client, the circumstances, the technical matters involved, client representations, and the mutual intent of the parties. Examples of consultations are reviewing and commenting on a client-prepared business plan and suggesting computer software for further client investigation.
- b. *Advisory services*, in which the practitioner's function is to develop findings, conclusions, and recommendations for client consideration and decision making. Examples of advisory services are an operational review and improvement study, analysis of an accounting system, assistance with strategic planning, and definition of requirements for an information system.
- c. *Implementation services*, in which the practitioner's function is to put an action plan into effect. Client personnel and resources may be pooled with the practitioner's to accomplish the implementation objectives. The practitioner is responsible to the client for the conduct and management of engagement activities. Examples of implementation services are providing computer system installation and support, executing steps to improve productivity, and assisting with the merger of organizations.
- d. *Transaction services*, in which the practitioner's function is to provide services related to a specific client transaction, generally with a third party. Examples of transaction services are insolvency services, valuation services, preparation of information for obtaining financing, analysis of a potential merger or acquisition, and litigation services.
- e. *Staff and other support services*, in which the practitioner's function is to provide appropriate staff and possibly other support to perform tasks specified by the client. The staff provided will be directed by the client as circumstances require. Examples of staff and other support services are data processing facilities management, computer programming, bankruptcy trusteeship, and controllership activities.
- f. *Product services*, in which the practitioner's function is to provide the client with a product and associated professional services in support of the installation, use, or maintenance of the product. Examples of

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<sup>1</sup> The definition of Consulting Services excludes the following:

- a. Services subject to other AICPA Technical Standards such as Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs), or Statements on Standards for Accounting and Review Services (SSARs). (These excluded services may be performed in conjunction with Consulting Services, but only the Consulting Services are subject to the SSCS.)
- b. Engagements specifically to perform tax return preparation, tax planning/advice, tax representation, personal financial planning or bookkeeping services; or situations involving the preparation of written reports or the provision of oral advice on the application of accounting principles to specified transactions or events, either completed or proposed, and the reporting thereof.
- c. Recommendations and comments prepared during the same engagement as a direct result of observations made while performing the excluded services.

product services are the sale and delivery of packaged training programs, the sale and implementation of computer software, and the sale and installation of systems development methodologies.

## Standards for Consulting Services

**.06** The general standards of the profession are contained in Rule 201 of the AICPA Code of Professional Conduct [ET section 201.01] and apply to all services performed by members. They are as follows:

*Professional competence.* Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

*Due professional care.* Exercise due professional care in the performance of professional services.

*Planning and supervision.* Adequately plan and supervise the performance of professional services.

*Sufficient relevant data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

**.07** The following additional general standards for all Consulting Services are promulgated to address the distinctive nature of Consulting Services in which the understanding with the client may establish valid limitations on the practitioner's performance of services. These Standards are established under Rule 202 of the AICPA Code of Professional Conduct [ET section 202.01].

*Client interest.* Serve the client interest by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity.<sup>2</sup>

*Understanding with client.* Establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of services to be performed, and modify the understanding if circumstances require a significant change during the engagement.

*Communication with client.* Inform the client of (a) conflicts of interest that may occur pursuant to interpretations of Rule 102 of the Code of Professional Conduct [ET section 102.03],<sup>3</sup> (b) significant reservations concerning the scope or benefits of the engagement, and (c) significant engagement findings or events.

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<sup>2</sup> Article III of the Code of Professional Conduct [ET section 54.02] describes *integrity* as follows: "Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle."

Article IV of the Code of Professional Conduct [ET section 55.01] differentiates between *objectivity* and *independence* as follows:

"Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services."

<sup>3</sup> Interpretation 102-02 [ET section 102.03] on Conflict of Interest states, in part, the following: "A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a significant relationship with another person, entity, product, or service that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service...."

.08 Professional judgment must be used in applying Statements on Standards for Consulting Services in a specific instance since the oral or written understanding with the client may establish constraints within which services are to be provided. For example, the understanding with the client may limit the practitioner's effort with regard to gathering relevant data. The practitioner is not required to decline or withdraw from a consulting engagement when the agreed-upon scope of services includes such limitations.

## Consulting Services for Attest Clients

.09 The performance of Consulting Services for an attest client does not, in and of itself, impair independence.<sup>4</sup> However, members and their firms performing attest services for a client should comply with applicable independence standards, rules and regulations issued by AICPA, the state boards of accountancy, state CPA societies, and other regulatory agencies.

## Effective Date

.10 This section is effective for engagements accepted on or after January 1, 1992. Early application of the provisions of this section is permissible.

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<sup>4</sup> AICPA independence standards relate only to the performance of attestation services; objectivity standards apply to all services. See footnote 2.

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## QC Section

# QUALITY CONTROL

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## QC Section 10

# A Firm's System of Quality Control

(Supersedes SQCS No. 7.)

Source: SQCS No. 8.

**Effective date:** Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

### NOTE

In February 2014, the Auditing Standards Board issued SAS No. 128, *Using the Work of Internal Auditors* (AU-C sec. 610), which contains amendments to this section.

The amendments are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of December 15, 2014, and can be viewed in appendix B of AU-C section 610 until the effective date, when they will be applied to this section.

## Introduction

### Scope of This Section

**.01** This section addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. This section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

**.02** This section, although applicable to audit and attestation engagements performed by CPA firms in accordance with *Government Auditing Standards*, does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*, which are similar to those of this section.

**.03** Other professional standards set out additional requirements and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements. AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for example, addresses quality control procedures for engagements conducted in accordance with generally accepted auditing standards. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

**.04** A system of quality control consists of policies designed to achieve the objective set out in paragraph .12 and the procedures necessary to implement and monitor compliance with those policies.

## Authority of the SQCSs

**.05** This section applies to all CPA firms with respect to engagements in their accounting and auditing practice. The nature and extent of the policies and procedures developed by an individual firm to comply with this section will depend on various factors, such as the size and operating characteristics of the firm and whether it is part of a network.

**.06** Statements on Quality Control Standards (SQCSs) contain the objective of the firm in following the SQCSs and requirements designed to enable the firm to meet that stated objective. In addition, SQCSs contain related guidance in the form of application and other explanatory material, as discussed further in paragraph .09, and introductory material that provides context relevant to a proper understanding of the SQCSs and definitions.

**.07** The objective provides the context in which the requirements of SQCSs are set and is intended to assist the firm in the following:

- Understanding what needs to be accomplished
- Deciding whether more needs to be done to achieve the objective

**.08** SQCSs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on firms, as follows:

- *Unconditional requirements.* The firm is required to comply with an unconditional requirement in all cases in which such a requirement is relevant. SQCSs use the word *must* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The firm is also required to comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant; however, in rare circumstances, the firm may depart from a presumptively mandatory requirement, provided that the firm documents the justification for the departure and how the alternative policies established, or procedures performed, in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SQCSs use the word *should* to indicate a presumptively mandatory requirement.

If an SQCS provides that a procedure or action is one that the firm "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SQCS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

**.09** When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.
- include examples of policies and procedures that may be appropriate in the circumstances.

The words *may*, *might*, and *could*, among others, are used to describe these actions and procedures. Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in SQCSs. When appropriate, additional

considerations specific to governmental entities or smaller firms are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in SQCSs. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in SQCSs.

.10 SQCSs include, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the SQCSs. These are provided to assist in the consistent application and interpretation of SQCSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. The AU-C glossary contains a complete listing of terms defined in this section. It also includes descriptions of other terms found in this section to assist in common and consistent interpretation. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

## Effective Date

.11 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

## Objective

.12 The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that

- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
- b. reports issued by the firm are appropriate in the circumstances.

## Definitions

.13 For purposes of SQCSs, the following terms have the meanings attributed as follows:

**Accounting and auditing practice.** A practice that performs engagements covered by this section, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under Rule 201, *General Standards* (ET sec. 201 par. .01), or Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

**Engagement documentation.** The record of the work performed, results obtained, and conclusions that the practitioner reached (also known as *working papers* or *workpapers*).

**Engagement partner.** The partner or other person in the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

**Engagement quality control review.** A process designed to provide an objective evaluation, before the report is released, of the significant judgments

the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is only for those engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

**Engagement quality control reviewer.** A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the report.

**Engagement team.** All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external specialists engaged by the firm or a network firm.<sup>1</sup>

**Firm.** A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

**Inspection.** A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Inspection includes a review of completed engagements.

**Monitoring.** A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

**Network.** An association of entities, as defined in ET section 92, *Definitions*.

**Network firm.** A firm or other entity that belongs to a network, as defined in ET section 92.

**Partner.** Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

**Personnel.** Partners and staff.

**Professional standards.** Standards promulgated by the ASB or ARSC under Rules 201 or 202 of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

**Reasonable assurance.** In the context of this section, a high, but not absolute, level of assurance.

**Relevant ethical requirements.** Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA Code of Professional

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<sup>1</sup> Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

**Staff.** Professionals, other than partners, including any specialists that the firm employs.

**Suitably qualified external person.** An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

## Requirements

### Applying and Complying With Relevant Requirements

**.14** Personnel within the firm responsible for establishing and maintaining the firm's system of quality control should have an understanding of the entire text of this section, including its application and other explanatory material, to understand its objective and apply its requirements properly.

**.15** The firm should comply with each requirement of this section unless, in the circumstances of the firm, the requirement is not relevant to the services provided by a firm's accounting and auditing practice. (Ref: par. .A1)

**.16** The requirements are designed to enable the firm to achieve the objective stated in this section. The proper application of the requirements is, therefore, expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the firm should consider whether there are particular matters or circumstances that require the firm to establish policies and procedures in addition to those required by this section to meet the stated objective.

### Elements of a System of Quality Control

**.17** The firm must establish and maintain a system of quality control. The system of quality control should include policies and procedures addressing each of the following elements:

- a. Leadership responsibilities for quality within the firm (the tone at the top)
- b. Relevant ethical requirements
- c. Acceptance and continuance of client relationships and specific engagements
- d. Human resources
- e. Engagement performance
- f. Monitoring

Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control as a whole may still be effective in achieving the objective described in paragraph .12.

**.18** The firm should document its policies and procedures and communicate them to the firm's personnel. (Ref: par. .A2–.A3)

## Leadership Responsibilities for Quality Within the Firm

**.19** The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's leadership (managing partner or board of managing partners, CEO, or equivalent) to assume ultimate responsibility for the firm's system of quality control. (Ref: par. .A4–.A5)

**.20** The firm should establish policies and procedures designed to provide it with reasonable assurance that any person or persons assigned operational responsibility for the firm's system of quality control by the firm's leadership has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: par. .A6)

## Relevant Ethical Requirements

**.21** The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: par. .A7–.A9)

### *Independence*

**.22** The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm; its personnel; and, when applicable, others subject to independence requirements (including network firm personnel) maintain independence when required by relevant ethical requirements. Such policies and procedures should enable the firm to

- a. communicate its independence requirements to its personnel and, when applicable, others subject to them and
- b. identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the engagement when withdrawal is possible under applicable law or regulation.

**.23** Such policies and procedures should require

- a. engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall effect, if any, on independence requirements;
- b. personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
- c. the accumulation and communication of relevant information to appropriate personnel so that
  - i. the firm and its personnel can readily determine whether they satisfy independence requirements,
  - ii. the firm can maintain and update information relating to independence, and
  - iii. the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level.

**.24** The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence

requirements and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for

- a. personnel to promptly notify the firm of independence breaches of which they become aware;
- b. the firm to promptly communicate identified breaches of these policies and procedures to
  - i. the engagement partner who, with the firm, needs to address the breach and
  - ii. other relevant personnel in the firm and, when appropriate, the network and those subject to the independence requirements who need to take appropriate action; and
- c. prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter so that the firm can determine whether it should take further action.

**.25** At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in Rule 101, *Independence* (ET sec. 101 par. .01), and its related interpretations and rulings of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. (Ref: par. .A10)

**.26** The firm should establish policies and procedures for all audit or attestation engagements for which regulatory or other authorities require the rotation of personnel after a specified period, in compliance with such requirements.

## Acceptance and Continuance of Client Relationships and Specific Engagements

**.27** The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only when the firm

- a. is competent to perform the engagement and has the capabilities, including time and resources, to do so; (Ref: par. .A11)
- b. can comply with legal and relevant ethical requirements; and
- c. has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity. (Ref: par. .A12–.A13)

**.28** Such policies and procedures should

- a. require the firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: par. .A14)
- b. require the firm to determine whether it is appropriate to accept the engagement if a potential conflict of interest is identified in accepting an engagement from a new or an existing client.
- c. if issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, require the firm to

- i. consider whether ethical requirements that exist under Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* (ET sec. 102 par. .03), apply, such as disclosure of the relationship to the client and other appropriate parties, and
- ii. document how the issues were resolved.

**.29** To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, the firm should establish policies and procedures that provide for obtaining an understanding with the client regarding those services. (Ref: par. .A15)

**.30** The firm should establish policies and procedures on continuing an engagement and the client relationship that address the circumstances when the firm obtains information that would have caused it to decline the engagement had that information been available earlier. Such policies and procedures should include consideration of the following:

- a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to regulatory authorities
- b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship (Ref: par. .A16)

## Human Resources

**.31** The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to

- a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
- b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A17–.A24)

**.32** The firm's policies and procedures should provide that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities that they will be called on to assume.

## Assignment of Engagement Teams

**.33** The firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that

- a. the identity and role of the engagement partner are communicated to management and those charged with governance;
- b. the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and (Ref: par. .A25–.A30)
- c. the responsibilities of the engagement partner are clearly defined and communicated to that individual.

**.34** The firm should establish policies and procedures to assign appropriate personnel with the necessary competence and capabilities to

- a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
- b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A31)



## Engagement Performance

**.35** The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements and that the firm issues reports that are appropriate in the circumstances. Such policies and procedures should include the following:

- a. Matters relevant to promoting consistency in the quality of engagement performance (Ref: par. .A32–.A33)
- b. Supervision responsibilities (Ref: par. .A34)
- c. Review responsibilities (Ref: par. .A35)

**.36** The firm's review responsibility policies and procedures should be determined on the basis that suitably experienced engagement team members, which may include the engagement partner, review work performed by other engagement team members.

### Consultation

**.37** The firm should establish policies and procedures designed to provide it with reasonable assurance that

- a. appropriate consultation takes place on difficult or contentious issues;
- b. sufficient resources are available to enable appropriate consultation to take place;
- c. the nature and scope of such consultations are documented and are agreed upon by both the individual seeking consultation and the individual consulted; and
- d. the conclusions resulting from consultations are documented, understood by both the individual seeking consultation and the individual consulted, and implemented. (Ref: par. .A36–.A40)

### Engagement Quality Control Review

**.38** The firm should establish criteria against which all engagements covered by this section should be evaluated to determine whether an engagement quality control review should be performed. (Ref: par. .A41)

**.39** The firm's policies and procedures should require that if an engagement meets the criteria established, an engagement quality control review should be performed for that engagement.

**.40** The firm should establish policies and procedures setting out the nature, timing, and extent of an engagement quality control review. Such policies and procedures should require that the engagement quality control review be completed before the report is released. (Ref: par. .A42–.A44)

**.41** The firm should establish policies and procedures to require the engagement quality control review to include

- a. discussion of significant findings and issues with the engagement partner;
- b. reading the financial statements or other subject matter information and the proposed report;
- c. review of selected engagement documentation relating to significant judgments that the engagement team made and the related conclusions it reached; and

- d. evaluation of the conclusions reached in formulating the report and consideration of whether the proposed report is appropriate. (Ref: par. .A45–.A47)

*Criteria for the Eligibility of Engagement Quality Control Reviewers*

**.42** The firm should establish policies and procedures to address the appointment of engagement quality control reviewers and to establish their eligibility through

- a. the technical qualifications required to perform the role, including the necessary experience and authority, and (Ref: par. .A48)
- b. the degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity. (Ref: par. .A49)

**.43** The firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Such policies and procedures should provide that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed. Accordingly, such policies and procedures should provide that the engagement quality control reviewer

- a. when practicable, is not selected by the engagement partner.
- b. does not otherwise participate in the performance of the engagement during the period of review.
- c. does not make decisions for the engagement team.
- d. is not subject to other considerations that would threaten the reviewer's objectivity.

**.44** The firm's policies and procedures should provide for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review is likely to have been impaired. (Ref: par. .A50)

*Documentation of the Engagement Quality Control Review*

**.45** The firm should establish policies and procedures on documentation of the engagement quality control review, which require documentation that

- a. the procedures required by the firm's policies on engagement quality control review have been performed;
- b. the engagement quality control review has been completed before the report is released; and
- c. the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate.

***Differences of Opinion***

**.46** The firm should establish policies and procedures for addressing and resolving differences of opinion within the engagement team; with those consulted; and, when applicable, between the engagement partner and the engagement quality control reviewer. (Ref: par. .A51–.A52)

**.47** Such policies and procedures should enable a member of the engagement team to document that member's disagreement with the conclusions reached after appropriate consultation.

- .48 Such policies and procedures should require the following:
- a. Conclusions reached be documented and implemented
  - b. The report not be released until the matter is resolved

### **Engagement Documentation**

#### *Completion of the Assembly of Final Engagement Files*

.49 The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been released. (Ref: par. .A53–.A54)

#### *Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation*

.50 The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation. (Ref: par. .A55–.A58)

#### *Retention of Engagement Documentation*

.51 The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm, professional standards, laws, and regulations. (Ref: par. .A59–.A62)

## **Monitoring**

### **Monitoring the Firm's Quality Control Policies and Procedures**

.52 The firm should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process should

- a. include an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements;
- b. require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and
- c. assign the performance of monitoring the firm's system of quality control to qualified individuals. (Ref: par. .A63–.A73)

### **Evaluating, Communicating, and Remedying Identified Deficiencies**

.53 Any system of quality control has inherent limitations that can reduce its effectiveness. Deficiencies in individual engagements covered by this section do not, in and of themselves, indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards.

.54 The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either

- a. instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable legal and regulatory requirements and that the reports issued by the firm are appropriate in the circumstances or

- b. systemic, repetitive, or other significant deficiencies that require prompt corrective action.

**.55** The firm should communicate to relevant engagement partners, and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action. (Ref: par. .A74)

**.56** Recommendations for appropriate remedial actions for deficiencies noted should include one or more of the following:

- a. Taking appropriate remedial action in relation to an individual engagement or member of personnel
- b. The communication of the findings to those responsible for training and professional development
- c. Changes to the quality control policies and procedures
- d. Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly

**.57** The firm should establish policies and procedures to address cases when the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement. Such policies and procedures should require the firm to

- a. determine what further action is appropriate to comply with relevant professional standards and legal and regulatory requirements and
- b. consider whether to obtain legal advice.

**.58** The firm should communicate, at least annually, the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm, including the firm's leadership. This communication should be sufficient to enable the firm and these individuals to take prompt and appropriate action, when necessary, in accordance with their defined roles and responsibilities to provide a basis for them to rely on the firm's system of quality control. Information communicated should include the following:

- a. A description of the monitoring procedures performed
- b. The conclusions drawn from the monitoring procedures
- c. When relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies

**.59** Some firms operate as part of a network and, for consistency, may implement some of their monitoring procedures on a network basis. When firms within a network operate under common monitoring policies and procedures designed to comply with this section, and these firms place reliance on such a monitoring system, the firm's policies and procedures should require that

- a. at least annually, the network communicate the overall scope, extent, and results of the monitoring process to appropriate individuals within the network firms and
- b. the network communicate promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

### **Complaints and Allegations**

**.60** The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with

- a. complaints and allegations that the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements and
- b. allegations of noncompliance with the firm's system of quality control.

As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. (Ref: par. .A75)

**.61** If, during the investigations into complaints and allegations, deficiencies in the design or operation of the firm's quality control policies and procedures, or instances of noncompliance with the firm's system of quality control by an individual or individuals are identified, the firm should take appropriate actions, as set out in paragraph .56. (Ref: par. .A76–.A77)

### **Documentation of the System of Quality Control**

**.62** The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control. (Ref: par. .A78–.A80)

**.63** The firm should establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures and peer review of the firm to evaluate the firm's compliance with its system of quality control or for a longer period if required by law or regulation.<sup>2</sup>

**.64** The firm should establish policies and procedures requiring documentation of complaints and allegations described in paragraph .60 and the responses to them.

## **Application and Other Explanatory Material**

### **Applying and Complying With Relevant Requirements**

#### ***Considerations Specific to Smaller Firms (Ref: par. .15)***

**.A1** This section does not call for compliance with requirements that are not relevant (for example, in the circumstances of a sole practitioner with no staff). Requirements in this section, such as those for policies and procedures for the assignment of appropriate personnel to the engagement team (see paragraph .34), for review responsibilities (see paragraph .36), and for the annual communication of the results of monitoring to engagement partners within the firm (see paragraph .58) are not relevant in the absence of staff.

### **Elements of a System of Quality Control (Ref: par. .18)**

**.A2** In general, communication of quality control policies and procedures to firm personnel includes a description of the quality control policies and procedures and the objectives they are designed to achieve and the message that each

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<sup>2</sup> PR section 100, *Standards for Performing and Reporting on Peer Reviews*, is applicable to firms enrolled in the AICPA Peer Review Program.

individual has a personal responsibility for quality and is expected to comply with these policies and procedures. By encouraging firm personnel to communicate their views or concerns on quality control matters, the firm recognizes the importance of obtaining feedback on the firm's system of quality control. Although communication is enhanced if it is in writing, the communication of quality control policies and procedures is not required to be in writing.

### ***Considerations Specific to Smaller Firms***

**.A3** Documentation and communication of policies and procedures for smaller firms may be less formal and extensive than for larger firms.

## **Leadership Responsibilities for Quality Within the Firm**

### ***Promoting an Internal Culture of Quality (Ref: par. .19)***

**.A4** The firm's leadership, and the examples it sets, significantly influences the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures and the requirement to

- a. perform work that complies with professional standards and applicable legal and regulatory requirements.
- b. issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in partner and staff appraisal procedures and the firm's internal documentation and training materials, such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

**.A5** Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs. Promoting such an internal culture includes the following:

- a. Establishment of policies and procedures that address performance evaluation, compensation, and advancement (including incentive systems) with regard to its personnel in order to demonstrate the firm's overarching commitment to quality
- b. Assignment of management responsibilities so that commercial considerations do not override the quality of the work performed
- c. Provision of sufficient and appropriate resources for the development, documentation, and support of its quality control policies and procedures

### ***Assigning Operational Responsibility for the Firm's System of Quality Control (Ref: par. .20)***

**.A6** Sufficient and appropriate experience and ability enables the person or persons responsible for the firm's system of quality control to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

## Relevant Ethical Requirements

### ***Compliance With Relevant Ethical Requirements (Ref: par. .21)***

.A7 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

.A8 Independence requirements are set forth in Rule 101 and its related interpretations and rulings of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the Code of Professional Conduct are set forth in ET section 100-1, *Conceptual Framework for AICPA Independence Standards*.

.A9 The fundamental principles are reinforced, in particular, by the following:

- The leadership of the firm
- Education and training
- Monitoring
- A process for dealing with noncompliance

*Written Confirmation (Ref: par. .25)*

.A10 Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating noncompliance, the firm demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel.

## Acceptance and Continuance of Client Relationships and Specific Engagements

### ***Competence, Capabilities, and Resources (Ref: par. .27a)***

.A11 Consideration of whether the firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, including whether

- firm personnel have knowledge of relevant industries or subject matters or the ability to effectively gain the necessary knowledge;
- firm personnel have experience with relevant regulatory or reporting requirements or the ability to effectively gain the necessary competencies;
- the firm has sufficient personnel with the necessary competence and capabilities;
- specialists are available, if needed;

- individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, when applicable; and
- the firm is able to complete the engagement within the reporting deadline.

### ***Integrity of a Client (Ref: par. .27c)***

.A12 Matters to consider regarding the integrity of a client include, for example, the following:

- The identity and business reputation of the client's principal owners, key management, and those charged with governance
- The nature of the client's operations, including its business practices
- Information concerning the attitude of the client's principal owners, key management, and those charged with governance toward such matters as internal control or aggressive interpretation of accounting standards
- Indications of an inappropriate limitation in the scope of the work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm

The extent of knowledge that a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

.A13 Sources of information on such matters obtained by the firm may include the following:

- Communications with existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements, and discussions with other third parties
- Inquiry of other firm personnel or third parties, such as bankers, legal counsel, and industry peers
- Background searches of relevant databases

### ***Continuance of a Client Relationship (Ref: par. .28a)***

.A14 Deciding whether to continue a client relationship includes consideration of significant issues that have arisen during the current or previous engagements and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess, and cannot obtain, the necessary expertise.

### ***Obtaining an Understanding With the Client (Ref: par. .29)***

.A15 Professional standards applicable to the engagement may contain requirements for obtaining a written understanding with the client.

### ***Withdrawal (Ref: par. .30)***

.A16 Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship may address issues that include the following:



- Discussing with the appropriate level of the client's management and those charged with governance the appropriate action that the firm might take based on the relevant facts and circumstances
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with governance withdrawal from the engagement or from both the engagement and the client relationship and the reasons for the withdrawal
- Considering whether there is a professional, legal, or regulatory requirement for the firm to remain in place or for the firm to report the withdrawal from the engagement or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities
- Documenting significant matters, consultations, conclusions, and the basis for the conclusions

### Human Resources (Ref: par. .31)

**.A17** Personnel issues relevant to the firm's policies and procedures related to human resources include, for example, the following:

- Recruitment and hiring, if applicable
- Performance evaluation, compensation, and advancement
- Determining competencies and capabilities, including time to perform assignments
- Professional development
- The estimation of personnel needs

Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm's work and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.

**.A18** *Competencies and capabilities* are the knowledge, skills, and abilities that qualify personnel to perform an engagement covered by this section. Competencies and capabilities are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by personnel in any given time period. Accordingly, for purposes of this section, a measure of overall competency is qualitative rather than quantitative.

**.A19** Competence can be developed through a variety of methods; these methods include, for example, the following:

- Professional education
- Continuing professional development, including training
- Work experience
- Mentoring by more experienced staff, such as other members of the engagement team

- Independence education for personnel who are required to be independent

**.A20** The continuing competence of the firm's personnel depends, to a significant extent, on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific continuing professional education (CPE) and other professional development activities that enable them to fulfill responsibilities assigned and to satisfy applicable CPE requirements of the AICPA and regulatory agencies. Effective policies and procedures also place importance on passing the Uniform CPA Examination. The firm may provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.

**.A21** The firm may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.

**.A22** Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps that a firm may take in developing and maintaining competence and commitment to ethical principles include the following:

- Making personnel aware of the firm's expectations regarding performance and ethical principles
- Providing personnel with an evaluation of, and counseling on, performance, progress, and career development
- Helping personnel understand that their compensation and advancement to positions of greater responsibility depend upon, among other things, performance quality and adherence to ethical principles and that failure to comply with the firm's policies and procedures may result in disciplinary action.

### ***Considerations Specific to Smaller Firms***

**.A23** The size and circumstances of the firm are important considerations in determining the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

### ***The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Human Resource Element of Quality Control***

**.A24** CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern the practice of public accounting. These jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA), which is a model legislative statute, including related administrative rules, designed by the AICPA and the National Association of State Boards of Accountancy to provide a uniform approach to the regulation of the accounting profession. The UAA provides that "[a]ny individual licensee . . . who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm, shall meet the competency requirements set out in the professional standards for such services." A firm's compliance with this section is intended to enable a practitioner who performs accounting and auditing services on the firm's behalf to meet the competency requirement referred to in the UAA.

## Assignment of Engagement Teams

*Engagement Partners (Ref: par. .33)*

**.A25** In most cases, an engagement partner will have gained the necessary competencies through relevant and appropriate experience in engagements covered by this section. In some cases, however, an engagement partner may have obtained the necessary competencies through disciplines other than the practice of public accounting, such as in relevant industry, governmental, and academic positions. When necessary, the experience of the engagement partner may be supplemented by CPE and consultation. The following are examples:

- An engagement partner whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.
- An engagement partner whose experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining CPE relating to auditing, using consulting sources during the course of performing the audit engagement, or any combination of these.
- A person in academia might obtain the necessary competencies to perform engagements covered by this section by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers and (b) performing a rigorous self-study program or by engaging a consultant to assist on such engagements.

**.A26** The characteristics of a particular client, industry, and the kind of service being provided determine the nature and extent of competencies established by a firm that are expected of the engagement partner. For example

- the competencies expected of an engagement partner to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
- supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than those expected in performing attest services for clients in other industries.
- the engagement partner for an attestation engagement to examine the effectiveness of an entity's internal control over financial reporting that is integrated with an audit of financial statements would be expected to have technical proficiency in understanding and evaluating the effectiveness of controls, whereas an engagement partner of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

**.A27** In practice, the competencies necessary for the engagement partner are broad and varied in both their nature and number. Competencies include the following, as well as other competencies as necessary in the circumstances:

- *Understanding of the role of a system of quality control and the Code of Professional Conduct.* An understanding of the role of a

firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of reports.

- *Understanding of the service to be performed.* An understanding of the performance, supervision, and reporting aspects of the engagement. This understanding is usually gained through actual participation under appropriate supervision in that type of engagement.
- *Technical proficiency.* An understanding of the applicable professional standards, including those standards directly related to the industry in which a client operates, and the kinds of transactions in which a client engages.
- *Familiarity with the industry.* An understanding of the industry in which a client operates to the extent required by professional standards applicable to the kind of service being performed. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates.
- *Professional judgment.* Skills that indicate sound professional judgment. In performing engagements covered by this section, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration, including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report appropriate in the circumstances.
- *Understanding the organization's IT systems.* A sufficient understanding of how the organization is dependent on, or enabled by, information technologies and the manner in which the information systems are used to record and maintain financial information to determine when involvement of an IT professional is necessary for an audit engagement.

### ***Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control***

**.A28** The competencies previously listed are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.

**.A29** In establishing policies and procedures related to the nature of competencies needed by the engagement partner of an engagement, a firm may consider the requirements of policies and procedures established for other elements of quality control. For example, a firm might consider its requirements related to engagement performance in determining the nature of competency requirements that describe the degree of technical proficiency necessary in a given set of circumstances.

**.A30** Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

*Engagement Teams (Ref: par. .34)*

**.A31** The firm's assignment of engagement teams and the determination of the level of supervision required include, for example, consideration of the engagement team's

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
- understanding of professional standards and legal and regulatory requirements;
- technical knowledge and expertise, including knowledge of relevant IT;
- knowledge of relevant industries in which the clients operate;
- ability to apply professional judgment; and
- understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision decreases.

## Engagement Performance

### *Consistency in the Quality of Engagement Performance (Ref: par. .35a)*

**.A32** The firm promotes consistency in the quality of engagement performance through its policies and procedures. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work
- Processes for complying with applicable engagement standards
- Processes of engagement supervision, staff training, and mentoring
- Methods of reviewing the work performed, the significant judgments made, and the type of report being issued
- Appropriate documentation of the work performed and of the timing and extent of the review
- Processes to keep all policies and procedures current

**.A33** Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

### *Supervision (Ref: par. .35b)*

**.A34** Engagement supervision includes the following:

- Tracking the progress of the engagement
- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement

- Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement

**Review (Ref: par. .35c)**

**.A35** A review consists of consideration of whether

- the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- significant findings and issues have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the nature, timing, and extent of the work performed is appropriate and without need for revision;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the report; and
- the objectives of the engagement procedures have been achieved.

**Consultation (Ref: par. .37)**

**.A36** Consultation includes discussion at the appropriate professional level with individuals within or outside the firm who have relevant specialized expertise.

**.A37** Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the firm. Consultation helps promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps promote a culture in which consultation is recognized as a strength and personnel are encouraged to consult on difficult or contentious issues.

**.A38** Effective consultation on significant technical, ethical, and other matters within the firm or, when applicable, outside the firm can be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, authority, and experience

and when conclusions resulting from consultations are appropriately documented and implemented.

**.A39** Documentation that is sufficiently complete and detailed of consultations with other professionals that involve difficult or contentious matters contributes to an understanding of

- the issue on which consultation was sought and
- the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

**Considerations Specific to Smaller Firms**

**.A40** A firm needing to consult externally may take advantage of advisory services provided by the following:

- Other firms
- Professional and regulatory bodies
- Commercial organizations that provide relevant quality control services

Before contracting for such services, consideration of the competence and capabilities of the external provider helps the firm determine whether the external provider is suitably qualified for that purpose.

**Engagement Quality Control Review**

*Criteria for an Engagement Quality Control Review (Ref: par. .38)*

**.A41** The structure and nature of the firm's practice are important considerations in establishing criteria for determining which engagements are to be subject to an engagement quality control review. Such criteria may include, for example, the following:

- The nature of the engagement, including the extent to which it involves a matter of public interest
- The identification of unusual circumstances or risks in an engagement or class of engagements
- Whether laws or regulations require an engagement quality control review

*Nature, Timing, and Extent of the Engagement Quality Control Review (Ref: par. .40-.41)*

**.A42** An engagement quality control review may include consideration of the following:

- The engagement team's evaluation of the firm's independence in relation to the specific engagement
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations
- Whether documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached

**.A43** If the engagement quality control review is completed after the report is dated and identifies instances where additional procedures are needed or additional evidence is required, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with the professional standards applicable to the engagement.

**.A44** Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant issues to be promptly resolved to the engagement quality control reviewer's satisfaction before the report is released.

**.A45** The extent of the engagement quality control review may depend upon, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The performance of

an engagement quality control review does not reduce the responsibilities of the engagement partner.

**.A46** Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review for audits, as well as reviews of financial statements and other assurance and related services engagements, include the following:

- Significant risks identified during the engagement and the responses to those risks
- Judgments made, particularly with respect to materiality and significant risks
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement
- The matters to be communicated to management and those charged with governance and, when applicable, other parties, such as regulatory bodies

**.A47** When the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the firm's procedures for dealing with differences of opinion apply.

#### *Criteria for the Eligibility of Engagement Quality Control Reviewers*

Sufficient and Appropriate Technical Expertise, Experience, and Authority (Ref: par. .42a)

**.A48** What constitutes sufficient and appropriate technical expertise, experience, and authority depends on the circumstances of the engagement.

Consultation With the Engagement Quality Control Reviewer (Ref: par. .42b)

**.A49** The engagement partner may consult the engagement quality control reviewer at any stage during the engagement (for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer). Such consultation avoids identification of differences of opinion at a late stage of the engagement and does not necessarily impair the engagement quality control reviewer's eligibility to perform the role. When the nature and extent of the consultations become significant, the reviewer's objectivity may be impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity. When this is not possible, another individual within the firm or a suitably qualified external person may be appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement.

#### *Objectivity of the Engagement Quality Control Reviewer (Ref: par. .43–.44)*

##### Considerations Specific to Smaller Firms

**.A50** Suitably qualified external persons may be contracted when sole practitioners or small firms identify engagements requiring engagement quality control reviews and no person in the firm meets the eligibility requirements for an engagement quality control reviewer. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. When the firm contracts suitably qualified external persons or other firms, the requirements in paragraphs .43–.44 and the guidance in paragraph .A49 apply.



**Differences of Opinion (Ref: par. .46)**

**.A51** Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines about the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.

**.A52** Procedures to resolve such differences may include consulting with another practitioner or firm or a professional or regulatory body.

**Engagement Documentation**

*Completion of the Assembly of Final Engagement Files (Ref: par. .49)*

**.A53** Professional standards, law, or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. When no such time limits are prescribed, paragraph .49 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis.

**.A54** When two or more different reports are issued regarding the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on financial information prepared in accordance with generally accepted accounting principles and, at a subsequent date, an auditor's report on the same financial information prepared in accordance with a special purpose framework for regulatory purposes.

*Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation (Ref: par. .50)*

**.A55** Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information or a legal or professional duty exists to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly when data of a personal nature are concerned.

**.A56** Whether engagement documentation is in paper, electronic, or other media, the integrity, accessibility, or retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that

- enable the determination of when and by whom engagement documentation was prepared or reviewed;
- protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means;
- prevent unauthorized changes to the engagement documentation; and
- allow access to the engagement documentation by the engagement team and other authorized parties, as necessary, to properly discharge their responsibilities.

**.A57** Controls that the firm designs and implements to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include the following:

- The use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hard copy engagement documentation

**.A58** For practical reasons, original paper documentation may be electronically scanned or otherwise copied to another media for inclusion in engagement files. In such cases, the firm's procedures designed to maintain the integrity, accessibility, and retrievability of the documentation may include requiring the engagement teams to

- generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
- integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary.
- enable the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory, or other reasons for a firm to retain original paper documentation.

*Retention of Engagement Documentation (Ref: par. .51)*

**.A59** The needs of the firm for retention of engagement documentation and the period of such retention will vary with the nature of the engagement and the firm's circumstances (for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements). The retention period may also depend on other factors, such as whether professional standards, law, or regulation prescribe specific retention periods for certain types of engagements or whether generally accepted retention periods exist in the absence of specific legal or regulatory requirements.

**.A60** In the specific case of audit engagements, the retention period would be no shorter than five years from the report release date.<sup>3</sup>

**.A61** Procedures that the firm may adopt for retention of engagement documentation include those that enable the requirements of paragraph .51 to be met during the retention period, such as, for example, procedures to

- enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time.

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<sup>3</sup> Paragraph .17 of AU-C section 230, *Audit Documentation*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

- provide, when necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.
- enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

#### *Ownership of Engagement Documentation*

**.A62** Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided that such disclosure does not undermine the validity of the work performed or, in the case of assurance engagements, the independence of the firm or its personnel.

## **Monitoring**

### ***Monitoring the Firm's Quality Control Policies and Procedures (Ref: par. .52)***

**.A63** The purpose of monitoring compliance with quality control policies and procedures is to assess, for the system of quality control as a whole, whether the firm is achieving the objective described in paragraph .12 through an evaluation of the following:

- Adherence to professional standards and applicable legal and regulatory requirements
- Whether the system of quality control has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

The evaluation may identify circumstances that necessitate changes to, or improve compliance with, the firm's policies and procedures to provide the firm with reasonable assurance that its system of quality control is effective.

**.A64** Ongoing consideration and evaluation of the system of quality control may include matters such as the following:

- Review of selected administrative and personnel records pertaining to the quality control elements
- Review of engagement documentation, reports, and clients' financial statements
- Discussions with the firm's personnel
- Determination of corrective actions to be taken and improvements to be made in the system, including providing feedback into the firm's policies and procedures relating to education and training
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with the system
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures

**.A65** Monitoring procedures also may include an assessment of the following:

- The appropriateness of the firm's guidance materials and any practice aids
- New developments in professional standards and legal and regulatory requirements and how they are reflected in the firm's policies and procedures, when appropriate
- Written confirmation of compliance with policies and procedures on independence
- The effectiveness of continuing professional development, including training
- Decisions related to acceptance and continuance of client relationships and specific engagements
- Firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof

**.A66** Some of the monitoring procedures discussed previously may be accomplished through the performance of the following:

- Engagement quality control review
- Review of engagement documentation, reports, and clients' financial statements for selected engagements after the report release date
- Inspection procedures

Reviews of the work or report when performed by engagement team members prior to the date of the report are not monitoring procedures.

**.A67** The need for, and extent of, inspection procedures depends, in part, on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

**.A68** The inspection of a selection of completed engagements may be performed on a cyclical basis. For example, engagements selected for inspection may include at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- The size of the firm
- The number and geographical location of offices
- The results of previous monitoring procedures
- The degree of authority of both personnel and office (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them)
- The nature and complexity of the firm's practice and organization
- The risks associated with the firm's clients and specific engagements

**.A69** Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals responsible for the conduct of its accounting and auditing practice.

**.A70** The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of a peer review or regulatory inspections.

### ***The Relationship of Peer Review to Monitoring***

**.A71** A peer review does not substitute for all monitoring procedures. However, because the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for the inspection of engagement documentation, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

#### *Considerations Specific to Smaller Firms*

**.A72** In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes review of engagement working papers, reports, and clients' financial statements by the engagement partner or other qualified personnel after the report release date. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

**.A73** Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a suitably qualified external person or another firm to perform engagement inspections and other monitoring procedures.

### ***Communicating Deficiencies (Ref: par. .55)***

**.A74** The reporting of identified deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partners.

### ***Complaints and Allegations***

#### *Source of Complaints and Allegations (Ref: par. .60)*

**.A75** Complaints and allegations of noncompliance with the firm's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other firm personnel.

*Investigation Policies and Procedures (Ref: par. .61)*

**.A76** Policies and procedures established for the investigation of complaints and allegations may include, for example, that the partner supervising the investigation

- has sufficient and appropriate experience,
- has authority within the firm, and
- is otherwise not involved in the engagement.

The partner supervising the investigation may involve legal counsel as necessary.

*Considerations Specific to Smaller Firms*

**.A77** In the case of firms with few partners, it may not be practicable for the partner supervising the investigation not to be involved in the engagement. These small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.

**Documentation of the System of Quality Control (Ref: par. .62)**

**.A78** The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:

- The size of the firm and the number of offices
- The nature and complexity of the firm's practice and organization

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations, and the results of monitoring inspections.

**.A79** Appropriate documentation relating to monitoring includes, for example, the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
  - Adherence to professional standards and applicable legal and regulatory requirements
  - Whether the system of quality control has been appropriately designed and effectively implemented
  - Whether the firm's quality control policies and procedures have been appropriately applied so that the reports that are issued by the firm are appropriate in the circumstances
- Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary

***Considerations Specific to Smaller Firms***

**.A80** Smaller firms may use more informal methods in the documentation of their systems of quality control, such as manual notes, checklists, and forms.

.A81

## **Exhibit—Comparison of Section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements***

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, and the rationale therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on or reviewed by the Auditing Standards Board (ASB).

### **Differences in Language**

The ASB has made various changes to the language throughout section 10, as compared with ISQC 1. Such changes have been made to use terms applicable in the United States and to make section 10 easier to read and apply. The ASB believes that such changes will not create differences between the application of ISQC 1 and the application of section 10.

### **Requirements in Section 10 Not in ISQC 1**

Section 10 requires firms to establish policies and procedures providing

- in paragraph .30, for obtaining an understanding with the client regarding the nature, scope, and limitations of the services to be performed.
- in paragraph .33, that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.
- in paragraph .44, that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed.
- in paragraph .48, that when differences of opinion exist, a member of the engagement team be able to document that member's disagreement with the conclusions reached, after appropriate consultation.

ISQC 1 does not have equivalent requirements.

## Requirements in ISQC 1 Not in Section 10

Paragraph 25 of ISQC 1 requires the firm to establish policies and procedures setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time. The ASB believes that the familiarity threat should not be singled out among other threats to independence.

Paragraph 48(a) of ISQC 1 requires including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner as a monitoring procedure. The ASB believes that this requirement is overly prescriptive and that a risk-based approach to inspections is more appropriate.

## Requirements in ISQC 1 Revised in Section 10

Paragraph .41 of section 10 requires that when an engagement quality control review is performed, the engagement quality control review be completed before the report is released. Paragraph 36 of ISQC 1 requires that the quality control review be completed before the report is dated. The ASB believes that an engagement quality control review is an independent review of the engagement team's significant judgments, including the date selected by the engagement team to date the report. As noted in the application material to section 10, when the engagement quality control review results in additional procedures having to be performed, the date of the report would be changed.

Paragraph 48(c) of ISQC 1 requires that those performing the engagement or the engagement quality control review are not involved in inspecting the engagements. Paragraph .53c of section 10, consistent with the requirement in paragraph 100 of Statement on Quality Control Standards No. 7, *A Firm's System of Quality Control*, requires that performance of monitoring of the firm's system of quality control be assigned to qualified individuals. Paragraph .A72 of section 10 notes that in small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. The ASB concluded that it was not necessary to change existing practice because in the United States, the peer review process provides a safeguard and provides evidence that the monitoring procedures are effective.

Paragraph A49 of ISQC 1 references the requirement in paragraph 40 of ISQC 1 to establish policies and procedures to maintain the objectivity of the engagement quality control reviewer and states, "Accordingly, such policies and procedures provide. . . ." The ASB believes that notwithstanding its placement as application material, the language is indicative of a requirement and, accordingly, has included a requirement for the provision of these specific policies and procedures in paragraph .44 of section 10. The ASB believes this will not create a difference in the application of ISQC 1 and the application of section 10.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

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## PR Section

# STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS

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## PR Section 100

# ***Standards for Performing and Reporting on Peer Reviews***

Effective for Peer Reviews Commencing on or After January 1, 2009.

### **NOTICE TO READERS**

In order to be admitted to or retain their membership in the AICPA, members of the AICPA who are engaged in the practice of public accounting in the United States or its territories are required to be practicing as partners or employees of firms enrolled in an approved practice-monitoring program or, if practicing in firms not eligible to enroll, are themselves enrolled in such a program if the services performed by such a firm or individual are within the scope of the AICPA's practice-monitoring standards and the firm or individual issues reports purporting to be in accordance with AICPA professional standards.

Firms have peer reviews because of the public interest in the quality of the accounting, auditing, and attestation services provided by public accounting firms. In addition, firms indicate that peer review contributes to the quality and effectiveness of their practices. Furthermore, most state boards of accountancy require its licensees to undergo peer review, which they may also call compliance assurance, to practice in their state. Other regulators require peer review in order to perform engagements and to issue reports under their standards.

A firm (or individual) enrolled in the AICPA Peer Review Program is deemed to be enrolled in an approved practice-monitoring program. See BL sections 230, *2.3 Requirements for Retention of Membership*, 220, *2.2 Requirements for Admission to Membership*, and 760, *7.6 Publication of Disciplinary Action*; AICPA Code of Professional Conduct Rule 505, *Form of Organization and Name* (ET sec. 505); and the implementing council resolutions under those sections.

These standards are applicable to firms (and individuals) enrolled in the program and to individuals and firms who perform and report on such peer reviews, to entities approved to administer the peer reviews, and to associations of CPA firms authorized by the AICPA Peer Review Board to assist its members in forming review teams. These standards are not intended for peer reviews of organizations that are not public accounting firms.

Users of these standards should be knowledgeable about the standards and their interpretations and effective dates, as well as guidance issued by the board that might affect the application of these standards. Those subject to the standards should be prepared to justify departures from these standards, and it is expected that departures will be rare.

These standards are effective for peer reviews commencing on or after January 1, 2009. Early implementation of these standards is not permitted.

## Overview

### Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews (as Referred to in a Peer Review Report)

**.01** The purpose of this document is to provide standards for administering, planning, performing, reporting on and the acceptance of peer reviews of CPA firms (and individuals) enrolled in the AICPA Peer Review Program (see interpretations). Those processes collectively are also called practice monitoring because it is the monitoring of a CPA firm's accounting and auditing practice.

**.02** The goal of practice monitoring, and the program itself, is to promote quality in the accounting and auditing services provided by the CPA firms (and individuals) subject to these standards. This goal serves the public interest and enhances the significance of AICPA membership.

**.03** Firms (and individuals) (see interpretations) enrolled in the program are required to have a peer review, once every three years, of their accounting and auditing practice related to non-Securities and Exchange Commission (SEC) issuers covering a one-year period. The peer review is conducted by an independent evaluator known as a peer reviewer. The AICPA oversees the program, and the review is administered by an entity approved by the AICPA to perform that role.

**.04** There are two types of peer reviews: System Reviews and Engagement Reviews. System Reviews focus on a firm's system of quality control, and Engagement Reviews focus on work performed on selected engagements. A further description of these peer reviews as well as a summary of the nature, objectives, scope, limitations of, and procedures performed in them is included in appendix A.

## Introduction and Scope

**.05** Firms (and individuals) (see interpretations) enrolled in the program have the responsibility to:

- a. Design and comply with a system of quality control for its accounting and auditing practice that provides the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control* (QC sec. 10), requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice.
- b. Perform accounting and auditing engagements in accordance with applicable professional standards using competent personnel<sup>1</sup> (partners<sup>2</sup> and staff<sup>3</sup>).
- c. Have independent peer reviews of their accounting and auditing practices (see interpretations). All firms that an AICPA member is

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<sup>1</sup> *Personnel* are defined per Statements on Quality Control Standards (SQCS) as partners and staff.

<sup>2</sup> *Partners* are defined per SQCS as any individual with authority to bind the firm with respect to the performance of a professional services engagement.

<sup>3</sup> *Staff* are defined per SQCS as professionals, other than partners, including any specialists that the firm employs.



associated with should undergo a peer review if the services performed and reports issued by the firm require a peer review.

- d. Engage a peer reviewer to perform the peer review in accordance with these standards, in a timely manner.
- e. Take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality any time state statutes or ethics rules promulgated by state boards of accountancy do not clearly provide an exemption from confidentiality requirements when peer reviews are undertaken.
- f. Provide written representations to describe matters significant to the peer review (see appendix B, "Considerations and Illustrations of Firm Representations").
- g. Understand the AICPA Peer Review Board's guidance on resignations from the program (see interpretations).
- h. Cooperate with the peer reviewer, administering entity, and the board in all matters related to the peer review that could impact the firm's enrollment in the program, including arranging, scheduling, and completing the review and taking remedial, corrective actions and implementing other plans as needed (see interpretations).

**.06** An *accounting and auditing practice* for the purposes of these standards is defined as all engagements covered by Statements on Auditing Standards (SASs); Statements on Standards for Accounting and Review Services (SSARS)<sup>4</sup> (see interpretations); Statements on Standards for Attestation Engagements (SSAEs); *Government Auditing Standards* (the Yellow Book) issued by the U.S. Government Accountability Office; and audits of non-SEC issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB) (see interpretations).

**.07** The objectives of the program are achieved through the performance of peer reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform engagements under the SASs or *Government Auditing Standards*, examinations of prospective financial statements or examinations of a service organization's controls likely to be relevant to user entities' internal control over financial reporting under the SSAEs, or audits of non-SEC issuers performed pursuant to the standards of the PCAOB have peer reviews called *System Reviews*. A System Review includes determining whether the firm's system of quality control for its accounting and auditing practice is designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards, including SQCS No. 8, in all material respects. Firms that only perform services under SSARS or services under the SSAEs not included in System Reviews have peer reviews called *Engagement Reviews*.<sup>5</sup> Firms that perform audits or play a substantial role in the audit of one or more SEC issuers, as defined by the PCAOB, are required to be registered with and have their accounting and auditing practice applicable to SEC issuers inspected by the PCAOB. Therefore, these standards are not intended for and exclude the review of the firm's accounting and auditing practice applicable to SEC issuers. Firms that do not provide any of the services listed in paragraph .06 are not peer reviewed.

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<sup>4</sup> Statements on Standards for Accounting and Review Services that provide an exemption from those standards in certain situations are likewise excluded from this definition of an accounting and auditing practice for peer review purposes (see interpretations).

<sup>5</sup> Although standards no longer permit the performance of Report Reviews as of January 1, 2009, a firm's last peer review could have been a Report Review.

.08 The majority of the procedures in a System Review should be performed at the reviewed firm's office (see interpretations). Engagement Reviews are normally performed at a location other than the reviewed firm's office.

.09 The program is based on the principle that a systematic monitoring and educational process is the most effective way to attain high quality performance throughout the profession. Thus, it depends on mutual trust and cooperation. On System Reviews, the reviewed firm is expected to take appropriate actions in response to findings, deficiencies, and significant deficiencies identified with their system of quality control or their compliance with the system, or both. On Engagement Reviews, the reviewed firm is expected to take appropriate actions in response to findings, deficiencies, and significant deficiencies identified in engagements. These actions will be positive and remedial. Disciplinary actions (including those that can result in the termination of a firm's enrollment in the program and the subsequent loss of membership in the AICPA and some state CPA societies by its partners<sup>6</sup> and employees) will be taken only for a failure to cooperate, failure to correct inadequacies, or when a firm is found to be so seriously deficient in its performance that education and remedial, corrective actions are not adequate.

.10 Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA's peer review requirements.

## General Considerations

### Administrative Requirements

.11 All peer reviews intended to meet the requirements of the program should be carried out in conformity with these standards under the supervision of a state CPA society, group of state CPA societies, the AICPA Peer Review Board's National Peer Review Committee (National PRC) (see interpretations), or other entity (hereinafter, administering entity) approved by the board to administer peer reviews.

.12 Peer reviews, including the reviewed firm and peer reviewers, are subject to oversight by the administering entity. In addition, peer reviews and administering entities are subject to oversight by the board and other bodies agreed upon by the board and/or the administering entity. The objectives of oversight are to ensure compliance with the standards and consistency in implementation. Reviewed firms, peer reviewers, and administering entities are expected to cooperate during the oversight process.

### Timing of Peer Reviews

.13 A firm's due date for its initial peer review is ordinarily 18 months from the date it enrolled in the program or should have enrolled, whichever date is earlier (see interpretations).

.14 A firm does not undergo a peer review if it does not perform engagements requiring it to undergo a peer review (see paragraph .07). However, when a firm performs its first engagement requiring a peer review or its first engagement requiring it to have a System Review, the firm's next due date ordinarily

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<sup>6</sup> A *partner* is a proprietor, shareholder, equity or nonequity 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. Depending on how a CPA firm is legally organized, its partner(s) could have other names, such as *shareholder*, *member*, or *proprietor*.

will be 18 months from the year-end of that engagement (18 months from the report date if it is an attestation engagement, including financial forecasts and projections) (see interpretations).

**.15** A firm's subsequent peer review ordinarily has a due date of three years and six months from the year-end of the previous peer review.

**.16** The due date for a peer review is the date by which the peer review report, and if applicable, letter of response, and the peer reviewer's materials are to be submitted to the administering entity.

**.17** Peer reviews must cover a current period of one year to be mutually agreed upon by the reviewed firm and the reviewing firm. Ordinarily, the peer review should be conducted within three to five months following the end of the year to be reviewed.

**.18** A firm is expected to maintain the same year-end on subsequent peer reviews (which is three years from the previous year-end) and the same review due date (which is three years from the previous review due date) (see interpretations).

**.19** If a firm resigns from the program and subsequently reenrolls in the program, the firm's due date is the later of the due date originally assigned or 90 days after reenrolling.

## Confidentiality

**.20** A peer review should be conducted in compliance with the confidentiality requirements set forth in the section of the AICPA Code of Professional Conduct Rule 301, *Confidential Client Information* (ET sec. 301). Except as discussed in paragraph .146, information concerning the reviewed firm or any of its clients or personnel that is obtained as a consequence of the review is confidential. Such information should not be disclosed, except as required by law, by review team members or by administering entities to anyone not involved in performing the review, or administering or carrying out the program, or used in any way not related to meeting the objectives of the program.

## Independence, Integrity, and Objectivity

**.21** Independence in fact and in appearance should be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review (see interpretations). In addition, the review team should perform all peer review responsibilities with integrity and maintain objectivity in discharging those responsibilities.

**.22** *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to the reviewed firm but also to those who may use the peer review report. The reviewing firm, the review team, and any other individuals who participate on the peer review should be free from any obligation to, or interest in, the reviewed firm or its personnel. The concepts in the AICPA Code of Professional Conduct's *Article III—Integrity* and *Article IV—Objectivity and Independence* (ET sec. 54 and 55), should be considered in making independence judgments. *Integrity* requires the review team to be honest and candid within the constraints of the reviewed firm's confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a review team's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

## Due Professional Care

.23 Due professional care, as addressed by the AICPA Code of Professional Conduct's *Article V—Due Care* (ET sec. 56), should be exercised in performing and reporting on the review. This imposes an obligation on all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner (see interpretations).

## Peer Review Documentation and Retention Policy

.24 Peer review documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. The documentation provides evidence of the work performed and is the basis for the review of the quality of the work. It should demonstrate that the peer reviewer complied with these standards and should support the basis for the peer reviewer's conclusions. Also, the documentation should be appropriately organized to provide a clear link from the working papers to the peer review report (see interpretations).

.25 Peer review documentation should not be retained for an extended period of time after the peer review's completion, with the exception of certain documents that are maintained until the subsequent peer review's acceptance and completion (see interpretations).

## Organizing the System or Engagement Review Team

.26 A System Review team comprises one or more individuals, depending upon the size and nature of the reviewed firm's practice and other factors. An Engagement Review team ordinarily comprises one individual. A review team may be formed by a firm engaged by the firm under review (a firm-on-firm review) or an association of CPA firms authorized by the board to assist its members in forming review teams (an association formed review team) (see interpretations). For Engagement Reviews, review teams may also be formed by the administering entity if it chooses to appoint such teams (hereinafter, a committee-appointed review team, also known as a CART review).

.27 A reviewing firm (including for these purposes the team captain, for an association formed review team) must determine its capability to perform a peer review. This determination includes assigning peer reviewers with appropriate levels of expertise and experience to perform the review. Before accepting a peer review engagement, the reviewing firm should obtain and consider information about the firm to be reviewed, including certain operating statistics concerning size, nature of practice, industry specializations, and levels of service.

.28 In determining its capability to perform the review, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must recognize that the performance of a peer review may demand substantial commitments of time, especially from its supervisory accounting and auditing personnel. Therefore, a reviewing firm should consider carefully the number and availability of its supervisory personnel in determining whether it can perform a peer review of another firm.

.29 One member of the System Review team is designated the team captain. The individual performing an Engagement Review is designated the review captain. The team captain or review captain is responsible for supervising and conducting the review, communicating the review team's findings to the reviewed firm and to the administering entity, preparing the report on the review, and ensuring that peer review documentation is complete and submitted to the administering entity on a timely basis. If applicable, the team captain, or review captain in unusual circumstances, should supervise and review the

work performed by other reviewers on the review team to the extent deemed necessary under the circumstances.

**.30** A System Review team, a review captain on an Engagement Review and, in unusual circumstances any additional reviewers on an Engagement Review, ordinarily should be approved by the administering entity prior to the planning and commencement of the peer review (see interpretations).

## Qualifying for Service as a Peer Reviewer

### System and Engagement Reviewers

**.31** Performing and reporting on a peer review requires the exercise of professional judgment by peers (see paragraphs .147–.153 for a discussion of a reviewer's responsibilities when performing a peer review). Accordingly, an individual serving as a reviewer on a System or Engagement Review should at a minimum:

- a. Be a member of the AICPA in good standing (that is, AICPA membership in active, nonsuspended status) licensed to practice as a CPA.
- b. Be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program (see interpretations), as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities.<sup>7, 8</sup> To be considered currently active in the accounting or auditing function, a reviewer should be presently involved in the accounting or auditing practice of a firm supervising one or more of the firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements (see interpretations).
- c. Be associated with a firm (or all firms if associated with more than one firm) that has received a report with a peer review rating of *pass*<sup>9</sup> for its most recent System or Engagement Review that was accepted timely, ordinarily within the last three years and six months.<sup>10</sup>
- d. Possess current knowledge of professional standards applicable to the kind of practice to be reviewed, including quality control and peer review standards. This includes recent experience in and knowledge about current rules and regulations appropriate to the level of service applicable to the industries of the engagements that the individual will be reviewing (see interpretations).

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<sup>7</sup> The board recognizes that practitioners often perform a number of functions, including tax and consulting work, and cannot restrict themselves to accounting and auditing work. These standards are not intended to require that reviewers be individuals who spend all their time on accounting and auditing engagements. However, CPAs who wish to serve as reviewers should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a peer review with professional expertise. For instance, in a System Review, a reviewer of auditing engagements should be currently reviewing or performing auditing engagements. In an Engagement Review, a reviewer of engagements performed under the Statements on Standards for Attestation Engagements should also be currently reviewing or performing the same type of engagements.

<sup>8</sup> A manager or person with equivalent supervisory responsibilities is a professional employee of the firm who has either a continuing responsibility for the overall planning and supervision of engagements for specified clients or authority to determine that an engagement is complete subject to final partner approval if required.

<sup>9</sup> A peer review report with a rating of *pass* was previously referred to as an unmodified report (with or without a letter of comments). If a firm's most recent peer review rating was a *pass with deficiencies or fail*, the firm's members are not eligible to perform peer reviews.

<sup>10</sup> If a firm's most recent review was a report review, then the firm's members are not eligible to perform peer reviews.

- e. Have at least five years of recent experience in the practice of public accounting in the accounting or auditing function.<sup>11</sup>
- f. Have provided the administering entity with information that accurately reflects the qualifications of the reviewer including recent industry experience, which is updated on a timely basis (see interpretations).
- g. If the reviewer is from a firm that is a provider of quality control materials (QCM) or is affiliated with a provider of quality control materials and is required to have a QCM review under these standards, be associated with a provider firm or affiliated entity that has received a QCM report with a review rating of pass for its most recent QCM review that was submitted timely, ordinarily within six months of the provider's year-end.

### Team Captain or Review Captain

**.32** In addition to adhering to the general requirements in paragraph .31 to be a peer reviewer, a System Review team captain must be a partner.<sup>12</sup> For an Engagement Review, the review captain is not required to be a partner. The team captain, or the review captain in limited circumstances, is required to ensure that all team members possess the necessary capabilities and competencies to perform assigned responsibilities and that team members are adequately supervised. The team captain or review captain has the ultimate responsibility for the review, including the work performed by team members (see interpretations).

**.33** Also, team captains and review captains should have completed peer review training that meets the requirements established by the board (see interpretations). For additional team captain qualification requirements, see the interpretations.

### Other Peer Reviewer or Reviewing Firm Qualification Considerations

**.34** Communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of a peer reviewer or reviewing firm's accounting and auditing practice, and notifications of limitations or restrictions on a peer reviewer or reviewing firm to practice, may impact the peer reviewer or reviewing firm's ability to perform the peer review. The peer reviewer or reviewing firm has a responsibility to inform the administering entity of such communications or notifications (see interpretations).

**.35** If required by the nature of the reviewed firm's practice, individuals with expertise in specialized areas may assist the review team in a consulting capacity. For example, computer specialists, statistical sampling specialists, actuaries, or experts in continuing professional education (CPE) may participate in certain segments of the review.

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<sup>11</sup> For this purpose, *recent* means having experience within the last five years in the industries and related levels of service for which engagements are reviewed. However, a reviewer should be cautious of those high-risk engagements or industries in which new standards have been issued. For example, in those cases in which new industry standards or practices have occurred in the most recent year, it may be necessary to have *current* practice experience in that industry in order to have *recent* experience.

<sup>12</sup> If the peer reviewer's firm's (see paragraph .31c) most recent peer review was an Engagement or Report Review, then the peer reviewer is not eligible to be a System Review team captain.

## Performing System Reviews

### Objectives

**.36** A System Review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether, during the year under review:

- a.* The reviewed firm's system of quality control for its accounting and auditing practice has been designed in accordance with quality control standards established by the AICPA (see SQCS No. 8).
- b.* The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

**.37** A System Review is designed to test a reasonable cross section of the firm's engagements with a focus on high-risk engagements, in addition to significant risk areas where the possibility exists of engagements not being performed and/or reported on in conformity with applicable professional standards in all material respects. A System Review is not designed to test every engagement or compliance with every professional standard and every detailed component of the firm's system of quality control.

### Basic Requirements

**.38** A System Review should include, but not be limited to, the following procedures:

- a.* Planning the review, as follows:
  1. Obtain the results of the prior peer review (see paragraph .39).
  2. Inquire of the firm about the areas to be addressed in the written representations (see paragraph .40).
  3. Obtain a sufficient understanding of the nature and extent of the firm's accounting and auditing practice to plan the review (see paragraphs .41–.45).
  4. Obtain a sufficient understanding of the design of the firm's system of quality control, including an understanding of the monitoring procedures performed since the prior review, to plan the review (see paragraphs .41–.45).
  5. Assess peer review risk (see paragraphs .46–.52).
  6. Use the knowledge obtained from the foregoing to select the offices and the engagements to be reviewed and to determine the nature and extent of the tests to be applied in the functional areas (see paragraphs .53–.63).
- b.* Performing the review, as follows:
  1. Review the firm's design and compliance with its system of quality control. The review should cover all organizational or functional levels within the firm (see paragraphs .53–.54).
  2. Review significant risk areas on selected engagements, including the relevant accounting, audit, and attestation documentation and reporting (see paragraphs .64–.65).
  3. Conclude on the review of engagements (see paragraphs .66–.67).

4. Reassess the adequacy of the scope of the review based on the results obtained to determine whether additional procedures are necessary (see paragraph .68).
5. Determine the relative importance of matters (see paragraphs .69–.72).
6. Prepare the Matter for Further Consideration (MFC) forms, Disposition of MFC (DMFC) forms, and any related Finding for Further Consideration (FFC) forms (see paragraphs .73–.74).
7. Aggregate and systemically evaluate the matters (see paragraphs .75–.86).
8. Form conclusions on the type of report to issue (see paragraphs .87–.90).
9. Obtain the written representations from the reviewed firm (see paragraph .05(f) and appendix B).
10. Conduct an exit conference with senior members of the reviewed firm to discuss the review team's comments; matters, findings, deficiencies, and significant deficiencies identified; recommendations; MFCs and related FFCs; and the type of report to be issued and the deficiencies or significant deficiencies to be included in such report and to resolve any disagreements (see paragraphs .91–.92).
11. Prepare a written report on the results of the review (see paragraphs .94–.96).
12. Review and provide comments to the reviewed firm on its response to the report, if applicable (see paragraphs .97–.101).

## Planning Considerations

**.39** To assist the review team in the planning of the review, the team captain should obtain the prior peer review report,<sup>13</sup> the letter of response, if applicable, and the letter of acceptance, all from the reviewed firm. The team captain should also obtain the prior FFC forms, if applicable (from the administering entity if the team captain's firm did not perform the prior peer review). The team captain should consider whether the issues discussed in those documents require additional emphasis in the current review and, in the course of the review, should evaluate the actions of the firm in response to the prior report.

**.40** The reviewer should inquire of the firm regarding the areas to be addressed in the written representation (see paragraph .05(f) and appendix B) and consider whether the areas discussed require additional emphasis in the course of the review (see interpretations).

## Understanding the Firm's Accounting and Auditing Practice and System of Quality Control

**.41** The review team should obtain a sufficient understanding of the nature and extent of the reviewed firm's accounting and auditing practice to plan the review. This understanding should include knowledge about the reviewed firm's organization and philosophy, as well as the composition of its accounting and auditing practice.

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<sup>13</sup> And the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.



.42 The review team should also obtain a sufficient understanding of the reviewed firm's system of quality control with respect to each of the quality control elements in SQCS No. 8 to plan the review (see interpretations). SQCS No. 8 requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It states that the quality control policies and procedures applicable to a professional service provided by the firm should encompass the following elements: leadership responsibilities for quality within the firm (the "tone at the top"); relevant ethical requirements (such as independence, integrity, and objectivity); acceptance and continuance of client relationships and specific engagements; human resources; engagement performance; and monitoring. It also states that the nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of operating autonomy allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

.43 The understanding obtained by the review team should include knowledge about the design of the reviewed firm's quality control policies and procedures in accordance with quality control standards established by the AICPA and how the policies and procedures identify and mitigate risk of material non-compliance with applicable professional standards.

.44 The understanding of the firm's accounting and auditing practice and system of quality control is ordinarily obtained through such procedures as inquiries of appropriate management and other personnel, reviewing the firm's internal policies and procedures, and reviewing the firm's responses to questionnaires developed by the board.

.45 The review team should obtain a sufficient understanding of the reviewed firm's monitoring policies and procedures since its last peer review and their potential effectiveness. In doing so, the review team may determine that the firm's current year's internal monitoring procedures could enable the review team to reduce, in a cost-beneficial manner, the number of offices and engagements selected for review or the extent of the other testing (see interpretations).

## Understanding and Assessing Peer Review Risk Factors

.46 Just as the performance of an audit involves audit risk, the performance of a System Review involves peer review risk. Peer review risk is the risk that the review team:

- a. Fails to identify significant weaknesses in the reviewed firm's system of quality control for its accounting and auditing practice, its lack of compliance with that system, or a combination thereof.
- b. Issues an inappropriate opinion on the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system, or a combination thereof.
- c. Reaches an inappropriate decision about the matters to be included in, or excluded from, the report.

.47 Peer review risk consists of the following two parts:

- a. The risk (consisting of *inherent risk* and *control risk*) that an engagement will not be performed and/or reported on in conformity with applicable professional standards in all materials respects, that the

reviewed firm's system of quality control will not prevent such failure, or both.<sup>14, 15</sup>

- b. The risk (*detection risk*) that the review team will fail to detect and report on the design and/or compliance deficiencies or significant deficiencies in the reviewed firm's system of quality control.

.48 Inherent risk and control risk relate to the reviewed firm's accounting and auditing practice and its system of quality control. These risks may be affected by circumstances arising within the firm (for example, individual partners have engagements in numerous specialized industries or the firm has a few engagements constituting a significant portion of the firm's accounting and auditing practice) or outside the firm (for example, new professional standards being applied for the first time or adverse economic developments in an industry).

### **Assessing Peer Review Risk**

.49 In planning the review, the review team should use the understanding it has obtained of the reviewed firm's accounting and auditing practice and its system of quality control to assess the inherent and control risks. The assessment of risks is qualitative and not quantitative. The lower the inherent and control risk, the higher the detection risk that can be tolerated and vice versa. Based on its assessment of inherent and control risk, the review team determines the acceptable level of detection risk.

.50 When assessing risk, the review team should evaluate the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the requirements contained in SQCS No. 8. This evaluation provides a basis for the review team to determine whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

### **Relationship of Risk to Scope**

.51 The review team should consider the combined assessed levels of inherent and control risk when selecting offices and engagements to be reviewed. The higher the combined assessed levels of inherent and control risk, the higher the peer review risk. To reduce the peer review risk to an acceptable low level, the detection risk needs to be low, and thus the greater the scope (that is, the greater the number of offices that should be visited or the greater the number of engagements that should be reviewed, or both). Conversely, the lower the combined assessed levels of inherent and control risk, the smaller the scope that needs to be considered for review. The combined assessed levels of inherent and control risk may vary among offices and engagements so that the scope may be greater for some types of offices and engagements than for others.

.52 However, even when the combined assessed levels are low, the peer review team must review some engagements to obtain reasonable assurance that the reviewed firm is complying with its quality control policies and procedures and applicable professional standards. For the review team to obtain

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<sup>14</sup> *Inherent risk* is the likelihood that an accounting or auditing engagement will fail to conform to professional standards, assuming the firm does not have a system of quality control.

<sup>15</sup> *Control risk* is the risk that a firm's system of quality control will not prevent the performance of an engagement that does not conform to professional standards. It consists of two parts: the firm's control environment and its quality control policies and procedures. The control environment represents the collective effort of various factors on establishing, enhancing, or mitigating the effectiveness of specific quality control policies and procedures. The control environment reflects the overall attitude, awareness, and actions of firm management concerning the importance of quality work and its emphasis in the firm.

such assurance, a reasonable cross section of the reviewed firm's accounting and auditing engagements must be reviewed or inspected, with greater emphasis on those portions of the practice with higher combined assessed levels of inherent and control risk (see interpretations).

## Planning and Performing Compliance Tests

**.53** After performing the aforementioned planning procedures, the team captain should then develop a general plan for the nature and extent of conducting compliance tests of engagements (to directly test the "engagement performance" element in SQCS No. 8) and the other elements described in SQCS No. 8 (collectively referred to as the *functional areas*). The compliance tests should be tailored to the practice of the reviewed firm and, taken as a whole, should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's system of quality control was complied with to provide the firm with reasonable (not absolute) assurance of performing and reporting in conformity with applicable professional standards in the conduct of its accounting and auditing practice in all material respects.

**.54** Such tests should be performed at the practice office(s) visited and should relate to individual engagements and the functional areas. The tests should include the following:

- a. Review significant risk areas (see paragraph .65) on selected engagements, including accounting and auditing documentation, and reports, to evaluate whether the engagements were performed and reported on in conformity with applicable professional standards and in compliance with relevant firm quality control policies and procedures.
- b. Interview firm personnel at various levels and, if applicable, other persons responsible for a function or activity to assess their understanding of, and compliance with, the firm's quality control policies and procedures.
- c. Review evidential material to determine whether the firm has complied with its policies and procedures for monitoring its system of quality control.
- d. Review other evidential material as appropriate. Examples include selected administrative or personnel files, correspondence files documenting consultations on technical or ethical questions, files evidencing compliance with human resource requirements, and the firm's technical reference sources (see interpretations).

### Scope Limitations

**.55** There is a presumption that all engagements and all aspects of functional areas otherwise subject to the peer review will be included in the scope of the review. However, in the rare situations when exclusions or other limitations on the scope of the review are being contemplated, a team captain should carefully consider the implications of such exclusion. This includes communicating to the firm and the administering entity the effect on the review and on the ability of the team captain to issue a peer review report (see interpretations).

### Selection of Offices

**.56** Visits to practice offices should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's quality control policies and procedures are adequately communicated throughout the firm and whether its system of quality control was complied with during the year under review based on a reasonable cross section of the

reviewed firm's accounting and auditing practice, with greater emphasis on those offices with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the office level include the following (see interpretations):

- a. The number, size, and geographic distribution of offices
- b. The degree of centralization of accounting and auditing practice control and supervision
- c. The review team's evaluation, if applicable, of the firm's monitoring procedures
- d. Recently merged or recently opened offices
- e. The significance of industry concentrations and of specialty practice areas, such as governmental compliance audits or regulated industries, to the firm and to individual offices
- f. Extent of nonaudit services to audit clients
- g. Significant clients' fees to practice office(s) and partner(s)

**.57** For a multioffice firm, the review should include, in addition to any offices selected using the risk-based criteria, a visit to the firm's executive office if one is designated as such.

### ***Selection of Engagements***

**.58** Engagements subject to selection for review ordinarily should be those with periods ending during the year under review (see interpretations). For attestation engagements, including financial forecasts or projections, the selection for review ordinarily should be those with report dates during the year under review. If the current year's engagement has not been completed and issued, and if a comparable engagement within the peer review year is not available, the prior year's engagement may be reviewed. If the subsequent year's engagement has been completed and issued, the review team should consider, based on its assessment of peer review risk, whether the more recently completed and issued engagement should be reviewed instead (see interpretations). Review team members should not have contact with or access to any client of the reviewed firm in connection with the peer review.

**.59** Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include size; industry area; level of service; personnel (including turnover, use of merged-in personnel, or personnel not routinely assigned to accounting and auditing engagements); communications from regulatory, monitoring, or enforcement bodies; extent of nonaudit services to audit clients; significant clients' fees to practice office(s) and partner(s); and initial engagements (see interpretations).

**.60** The review of engagements should usually be directed toward the accounting and auditing work performed by the practice office visited, including the work performed on those engagements by other practice offices of the reviewed firm or other public accounting firms. For those situations in which the practice office being visited performed accounting and auditing work for another practice office, the review team may limit its review to portions of the engagements performed by the practice office being visited but should evaluate the appropriateness of the instructions issued by the other practice office and the adequacy of the procedures followed in performing and reporting in conformity with applicable professional standards. When combined with other

procedures performed, the number and type of accounting and auditing engagements selected by the review team for review should be sufficient to provide the review team with a reasonable basis for its conclusions regarding the reviewed firm's system of quality control.

**.61** The initial selection of engagements to be reviewed should ordinarily be provided to the reviewed firm no earlier than three weeks prior to the commencement of the peer review procedures at the related practice office or location. This should provide ample time to enable the firm (or office) to assemble the required client information and engagement documentation before the review team commences the review. However, at least one engagement from the initial selection to be reviewed should be provided to the firm once the review commences and not provided to the firm in advance. Ordinarily, based on the nature of the firm's practice and assuming that the engagement would not be automatically anticipated for selection by the reviewed firm, the engagement should be an audit. Otherwise, the engagement should be the firm's next highest level of service where the same criteria can be met. This should not increase the scope of the review (see interpretations).

**.62** The process of engagement selection, except as noted in paragraph .63, like office selection, is not subject to definitive criteria. Nevertheless, if the team captain finds that meeting all of the preceding criteria results in the selection of an inappropriate scope of the firm's accounting and auditing practice, the team captain should consult with the administering entity about the selection of engagements for review (see interpretations).

**.63** Specific types and/or number of engagements must be selected in a System Review (see interpretations).

### ***Extent of the Review of Engagements***

**.64** The review of engagements should include the review of financial statements, accountants' reports, accounting and audit documentation, and correspondence, as well as discussions with professional personnel of the reviewed firm.

**.65** Audit engagements have areas in which risk may be inherently significant, such as, but not limited to, fraud considerations, use of estimates, emerging issues, and assertions that are difficult to audit. The review team's procedures should include determining whether the reviewed firm has appropriately:

- a. Identified the significant risk areas on each audit engagement selected for the peer review,
- b. Performed the necessary audit procedures related to the identified significant risk areas, and
- c. Documented the auditing procedures performed in these significant risk areas.

### ***Concluding on the Review of an Engagement***

**.66** For each engagement reviewed, the review team should conclude on its review by documenting whether anything came to its attention that caused it to believe that the engagement was not performed and/or reported on in conformity with applicable professional standards in all material respects (see interpretations).

**.67** The team captain should promptly inform the firm when an engagement is not performed and/or reported on in conformity with applicable

professional standards and remind the firm of its obligation under professional standards to take appropriate actions (see interpretations).

### **Expansion of Scope**

.68 If, during the peer review, the review team concludes that there was a failure to reach an appropriate conclusion on the application of professional standards in all material respects on one or more of the reviewed engagements, the review team should consider whether the application of additional peer review procedures is necessary. This consideration should be documented in the peer review working papers. The objective of the application of additional procedures would be to determine whether the failure is indicative of a pattern of such failures, whether it is a significant deficiency in the design of the reviewed firm's system of quality control or in its compliance with the system, or whether it is both. In some circumstances, the reviewer may conclude that, because of compensating controls or for other reasons, further procedures are unnecessary. If, however, additional procedures are deemed necessary, they may include an expansion of scope to review all or relevant portions of one or more additional engagements or aspects of functional areas. Additional engagements may be in the same industry, supervised by the same individual in the reviewed firm, or otherwise have characteristics associated with the failure to perform and/or report in conformity with professional standards.

### **Identifying Matters, Findings, Deficiencies, and Significant Deficiencies**

.69 In understanding the firm's system of quality control, the team captain may note that the system is not designed appropriately. Similarly, the performance of compliance tests may uncover that the system is not being complied with appropriately or may identify a design weakness that was not identified during the planning of the peer review. With any of these items, the team captain has available a set of definitions to assist in classifying the condition noted.

.70 Determining the relative importance of matters noted during the peer review, individually or combined with others, requires professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow, used in conjunction with practice aids (MFC, DMFC, and FFC forms) to document these items when applicable, are intended to assist in aggregating and evaluating the peer review results, concluding on them, and determining the nature of the peer review report to issue:

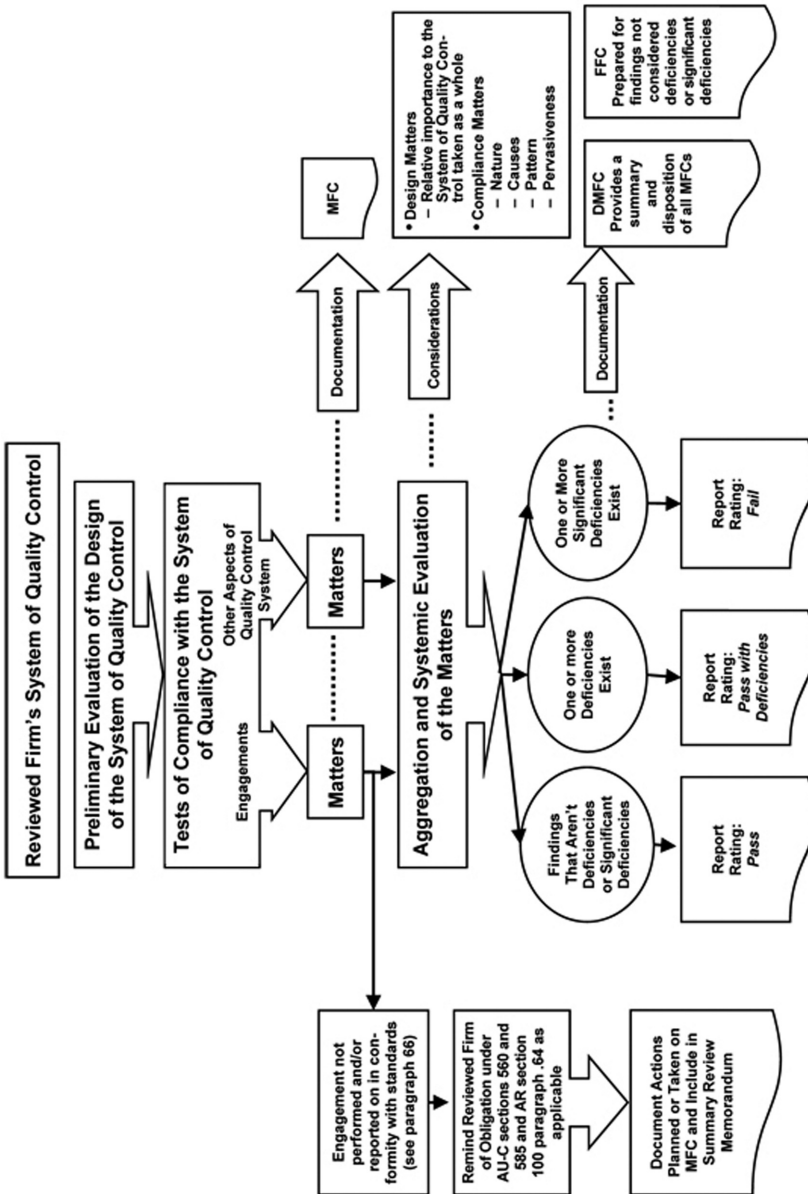
- a. A peer reviewer notes a *matter* as a result of his or her evaluation of the design of the reviewed firm's system of quality control and/or tests of compliance with it. Tests of compliance include inspection, inquiry, and observation performed by reviewing engagements and testing other aspects of the reviewed firm's system of quality control. Matters are typically one or more "No" answers to questions in peer review questionnaire(s) that a reviewer concludes warrants further consideration in the evaluation of a firm's system of quality control. A matter is documented on a Matter for Further Consideration (MFC) form.
- b. A *finding* is one or more related matters that result from a condition in the reviewed firm's system of quality control or compliance with it such that there is more than a remote possibility that the reviewed firm would not perform and/or report in conformity with applicable professional standards. A peer reviewer will conclude whether one or more findings are a deficiency or significant deficiency. If the peer reviewer

concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on a Finding for Further Consideration (FFC) form.

- c. A *deficiency* is one or more findings that the peer reviewer has concluded, due to the nature, causes, pattern, or pervasiveness, including the relative importance of the finding to the reviewed firm's system of quality control taken as a whole, could create a situation in which the firm would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects. It is not a significant deficiency if the peer reviewer has concluded that except for the deficiency or deficiencies, the reviewed firm has reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Such deficiencies are communicated in a report with a peer review rating of *pass with deficiencies*.
- d. A *significant deficiency* is one or more deficiencies that the peer reviewer has concluded results from a condition in the reviewed firm's system of quality control or compliance with it such that the reviewed firm's system of quality control taken as a whole does not provide the reviewed firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects. Such deficiencies are communicated in a report with a peer rating of *fail*.

**.71** A broad understanding of the peer review process, from the preliminary evaluation of the design of the system of quality control, to the tests of compliance, to the decision making process of determining whether an item noted during a System Review is a matter, finding, deficiency, or significant deficiency, is shown in exhibit A. The exhibit also illustrates the aggregation of these items, where those items are documented in the practice aids and how they might affect the type of report issued.

Exhibit A





.72 As described by exhibit A in paragraph .71, depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated and, after considering the nature, causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole, may not get elevated to a deficiency. A matter may develop into a finding and get elevated to a deficiency. That deficiency may or may not be further elevated to a significant deficiency.

.73 A matter is documented on an MFC form. If the matter, after further evaluation, gets elevated to a finding but not a deficiency or significant deficiency, it is documented on an FFC form. The FFC form is a standalone document that includes the reviewer's recommendation and the reviewed firm's response regarding actions planned or taken and the timing of those actions by the firm. MFC and FFC forms are subject to review and oversight by the administering entity, who will evaluate the reviewed firm's FFC form responses for appropriateness and responsiveness (see paragraphs .141–.145 and determine whether any further action is necessary. If the matter documented on the MFC form is instead elevated to a deficiency or significant deficiency, then it is communicated in the report itself, along with the reviewer's recommendation. The firm submits a letter of response regarding actions planned or taken and the timing of those actions by the firm, which is also evaluated for appropriateness and responsiveness (see paragraphs .139–.140).

.74 In order to document the disposition of all the MFCs, the team captain completes a DMFC form. The DMFC form is part of the working papers and provides a trail of the disposition of the MFCs for the peer reviewer, administering entity, and individuals conducting technical reviews or oversight. All of the MFCs are identified on the DMFC form with an indication after each as to whether it was cleared, discussed with the firm during the exit conference, included on a specific FFC form (individually or combined with other MFCs), or included as a deficiency in a report with a peer review rating of *pass with deficiencies* or as a significant deficiency in a report with a peer review rating of *fail*.

## Aggregating and Systemically Evaluating Matters

.75 To conclude on the results of a peer review, the review team must aggregate the matters noted during the peer review and determine whether the matters were the result of the design of the reviewed firm's system of quality control or the failure of its personnel to comply with the firm's quality control policies and procedures. The review team should consider their relative importance to the firm's system of quality control as a whole and their nature, causes, pattern, and pervasiveness.

.76 Use of professional judgment is essential in determining whether the aggregation of the matters noted during the review are findings and whether one or more findings is a deficiency or significant deficiency for purposes of reporting on the results of the peer review.

### Design Matters

.77 A design matter exists when the reviewed firm's system of quality control is missing a quality control policy or procedure or the reviewed firm's existing quality control policies and procedures, even if fully complied with, would not result in engagements performed and/or reported on in accordance with professional standards in some respect. To be effective, a system of quality control must be designed properly, and all of the quality control policies and procedures necessary to provide the reviewed firm with reasonable assurance of

performing and reporting in conformity with applicable professional standards in all material respects should be in place. Therefore, the review team will need to determine whether the quality control policies and procedures would be effective if they were complied with. To make this determination, the review team should consider the implications of the evidence obtained during its evaluation of the system of quality control and its tests of compliance, including its reviews of engagements. For example, a pattern of engagement failures to perform and/or report in conformity with applicable professional standards in all material respects (that is, failures requiring the application of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, or AU-C section 585, *Consideration of Omitted Procedures After the Report Release Date*) likely is indicative of a finding pertaining to the design of the reviewed firm's quality control policies and procedures.

**.78** As noted in SQCS No. 8, "The nature of the policies and procedures developed by individual firms to comply with this Statement will depend on various factors such as the size and operating characteristics of the firm." Likewise, the relative importance of design matters noted in the reviewed firm's quality control policies and procedures, individually and in the aggregate, need to be evaluated in the context of the firm's size, organizational structure, and the nature of its practice. For example, a matter noted during the review of a quality control policy or procedures may be particularly or wholly offset by another policy or procedure. In this circumstance, the review team should consider the interrelationships among the elements of quality and weigh the matters noted against compensating policies and procedures to determine whether a finding exists and its relative importance.

**.79** There may be circumstances in which the reviewer finds few findings in the work performed by the firm and yet may conclude that the design of the firm's system of quality control needs to be improved. For example, a firm that is growing rapidly and adding personnel and clients may not be giving appropriate attention to the policies and procedures necessary in areas such as human resources (hiring, assigning personnel to engagements, and advancement) and acceptance and continuance of clients and engagements. A reviewer might conclude that these conditions could create a situation in which the firm would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects. However, in the absence of findings in the engagements reviewed, the reviewer would ordinarily conclude that the matter should be addressed in an FFC as a finding rather than result in a report with a peer review rating of *pass with deficiencies or fail*.

### **Compliance Matters**

**.80** A compliance matter exists when a properly designed quality control policy or procedure does not operate as designed because of the failure of the personnel of the reviewed firm to comply with it. Since a variance in individual performance and professional interpretation will affect the degree of compliance, adherence to all policies and procedures in every case generally is not possible. However, the degree of compliance by the personnel of the reviewed firm with its prescribed quality control policies and procedures should be adequate to provide the reviewed firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

**.81** In assessing whether the degree of compliance was adequate to provide the required assurance, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted and their

relative importance to the firm's system of quality control as a whole, not merely their importance in the specific circumstances in which they were observed. As with the evaluation of design matters, compliance matters also need to be evaluated in the context of the firm's size, organizational structure, and the nature of its practice.

**.82** To determine the degree of noncompliance, the review team should evaluate the matters of noncompliance, both individually and in the aggregate, recognizing that adherence to certain policies and procedures of the reviewed firm is more critical to the firm obtaining reasonable assurance of performing and reporting in conformity with applicable professional standards than adherence to others. In this context, the review team should consider the likelihood that noncompliance with a given quality control policy or procedure could have resulted in engagements not being performed and/or reported on in conformity with applicable professional standards in all material respects. The more direct the relationship between a specific quality control policy or procedure and the application of professional standards, the lower the degree of noncompliance necessary to determine whether a matter (or matters) is a finding and whether a finding is a deficiency or significant deficiency.

### ***Determining the Cause for a Finding***

**.83** When the review team is faced with an indication that a matter(s) could be a finding, and/or the firm failed to perform and/or report in conformity with applicable professional standards in all material respects, the review team's first task in such circumstances is to determine the cause of the finding or failure (see interpretations). Causes that might be systemic and might affect the type of peer review report issued include, but are not limited to, the following:

- a. The failure related to a specialized industry practice, and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.
- b. The failure related to an issue covered by a recent professional pronouncement, and the firm had failed to identify, through professional development programs or appropriate supervision, the relevance of that pronouncement to its practice.
- c. The failure should have been detected if the firm's quality control policies and procedures had been followed.
- d. The failure should have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the administering entity before reaching such a conclusion.

**.84** The finding or failure to perform and/or report in conformity with applicable professional standards in all material respects may be the result of an isolated human error and, therefore, would not necessarily mean that a peer review report with a peer review rating of *pass with deficiencies* or *fail* should be issued (see interpretations). However, if the reviewer believes that the probable cause (for example, a failure to provide or follow appropriate policies for supervision of the work of assistants) of a finding or failure to perform and/or report in conformity with applicable professional standards in all material respects on an engagement or a finding within a functional area also exists in other engagements or in other functional areas, the reviewer needs to consider carefully the need to issue a peer review report with a peer review rating of *pass with deficiencies* or *fail*.

.85 Although an isolated matter or an instance of noncompliance with the firm's quality control policies and procedures ordinarily would not be included in the report, its nature, cause (if determinable), and relative importance for the firm's system of quality control as a whole should be evaluated in conjunction with the review team's other findings before making a final determination (see interpretations).

### **The Pattern and Pervasiveness of Matters**

.86 The review team must consider the pattern and pervasiveness of matters and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed. As noted in the preceding paragraphs, the review team's first task is to try to determine why the matters occurred. In some cases, the design of the firm's system of quality control may be deficient (for example, when it does not provide for timely involvement in the planning process by a partner of the firm or there is inadequate supervision of engagement planning). In other cases, there may be a pattern of noncompliance with a quality control policy or procedure such as when firm policy requires the completion of a financial statement disclosure checklist but such checklists often were not used or relevant questions or points were incorrectly considered. That increases the possibility that the firm might not perform and/or report in conformity with applicable professional standards in all material respects, which also means that the reviewer must consider carefully whether the matter(s) individually or in the aggregate is (are) a deficiency or a significant deficiency and whether there is the need to issue a peer review report with a peer review rating of *pass with deficiencies* or *fail*. On the other hand, the types of matters noted may be individually different, not individually significant, and not directly traceable to the design of or compliance with a particular quality control policy or procedure. This may lead the reviewer to the conclusion that the matters were isolated cases of human error that should not result in a peer review report with a peer review rating of *pass with deficiencies* or *fail*.

### **Forming Conclusions on the Type of Report to Issue in a System Review**

.87 The team captain must use professional judgment in determining the type of peer review report to issue. This judgment requires the consideration of several factors, including an understanding of the firm's system of quality control and the nature, causes, pattern, and pervasiveness of matters and their relative importance to the firm's system of quality control taken as a whole, including limitations on the scope of the review.

### **System Review Report With a Peer Review Rating of Pass**

.88 A report with a peer review rating of *pass* should be issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. There are no deficiencies or significant deficiencies that affect the nature of the report and, therefore, the report does not contain any deficiencies, significant deficiencies, or recommendations. In the event of a scope limitation, a report with a peer review rating of *pass (with a scope limitation)* is issued.

**System Review Report With a Peer Review Rating of Pass With Deficiencies**

.89 A report with a peer review rating of *pass with deficiencies* should be issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects with the exception of a certain deficiency or deficiencies that are described in the report. These deficiencies are conditions related to the firm's design of and compliance with its system of quality control that could create a situation in which the firm would have less than reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects due to the nature, causes, pattern, or pervasiveness, including the relative importance of the deficiencies to the quality control system taken as a whole. In the event of a scope limitation, a report with a peer review rating of *pass with deficiencies (with a scope limitation)* is issued.

**System Review Report With a Peer Review Rating of Fail**

.90 A report with a peer review rating of *fail* should be issued when the team captain has identified significant deficiencies and concludes that the firm's system of quality control is not suitably designed to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects or the firm has not complied with its system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. In the event of a scope limitation, a report with a peer review rating of *fail (with a scope limitation)* is issued.

**Communicating Conclusions at the Exit Conference**

.91 A firm that has a System Review should respond promptly to questions raised in the review in order to assist the review team in reaching its conclusions. Prior to issuing its report or finalizing FFC form(s), if applicable, the review team should communicate its conclusions to senior members of the reviewed firm at an exit conference (see interpretations). Ordinarily, the team captain should be physically present at the exit conference, unless the System Review is performed at a location other than the reviewed firm's office. The exit conference may also be attended by representatives of the administering entity, the board, AICPA staff, or other board authorized organizations with oversight responsibilities.

.92 The reviewed firm is entitled to be informed at the exit conference about any matters documented on the MFC form(s), findings documented on the FFC form(s), deficiencies or significant deficiencies to be included in the peer review report, and the type of report to be issued. Accordingly, except in rare circumstances that should be explained to the reviewed firm, the exit conference should be postponed if there is any uncertainty about the report to be issued or the deficiencies or significant deficiencies to be included in the report. The review team should also communicate, if applicable, that the firm will be required to respond to the findings documented on the FFC form(s), and/or the deficiency(ies) or significant deficiencies included in the peer review report. The review team should also communicate that the firm may be required, if applicable, to (1) take certain actions to correct the deficiencies or significant deficiencies noted in the report and/or (2) complete an implementation plan to address the findings noted in the FFC form(s). The review team should also

discuss with the reviewed firm the implications of these steps on the acceptance and completion of the peer review and the reviewed firm's enrollment in the program. The exit conference is also the appropriate vehicle for providing suggestions to the firm that are not included in the report, FFC form(s), or MFC form(s).

## Addressing Disagreements Between the Reviewer and the Reviewed Firm

**.93** Disagreements may arise on the resolution of various issues, for instance, related to the review of particular engagements, the systemic cause for a deficiency, or issues related to a design deficiency. In addition, there could be a disagreement on the appropriate approach to be taken in performing and/or reporting in conformity with applicable professional standards, or the review team might not believe that the actions planned or taken by the firm, if any, are appropriate (for example, if the reviewed firm believes that it can continue to support a previously issued report and the review team continues to believe that there may be a failure to reach appropriate conclusions in the application of professional standards). Reviewers and reviewed firms should understand that professional judgment often becomes a part of the process and that each party has the right to challenge each other on an issue. Nevertheless, a disagreement on the resolution of an issue may persist in some circumstances. The reviewed firm or reviewer should be aware that they may consult with their administering entity and, if necessary, request that the administering entity's peer review committee resolve the disagreement. If the administering entity's full peer review committee is unable to resolve the disagreement, the administering entity may refer unresolved issues to the board for a final determination. Only the administering entity's peer review committee will be responsible for determining whether a disagreement still exists, or whether the reviewed firm or review team is not cooperating, in order for the administering entity to refer the issue to the board.

## Reporting on System Reviews

### General

**.94** The team captain should furnish the reviewed firm with a written report within 30 days of the exit conference date or by the firm's peer review due date, whichever is earlier. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the team captain performing the review. The report in a System Review ordinarily should be dated as of the date of the exit conference. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### Preparing the Report in a System Review

**.95** The standard form for a report with a peer review rating of *pass* is illustrated in appendix C, "Illustration of a Report With a Peer Review Rating of *Pass* in a System Review." Illustrations of reports with a peer review rating of *pass with deficiencies* and *fail* are presented in appendixes E, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review" and I, "Illustration of a Report With a Peer Review Rating of *Fail* in a System Review," respectively. Illustrations of reports with a peer review rating

of *pass* (with a scope limitation), *pass with deficiencies* (with a scope limitation), and *fail* (with a scope limitation) are presented in appendixes D, "Illustration of a Report With a Peer Review Rating of *Pass* (With a Scope Limitation) in a System Review;" G, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* (With a Scope Limitation) in a System Review;" and K, "Illustration of a Report With a Peer Review Rating of *Fail* (With a Scope Limitation) in a System Review," respectively.

**.96** The written report in a System Review should:

- a. State at the top of the report the title "System Review Report."
- b. State that the system of quality control for the accounting and auditing practice of the firm was reviewed and include the year-end covered by the peer review.
- c. State that the peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants.
- d. State that the firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
- e. State that the reviewer's responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on the review.
- f. State that the nature, objectives, scope, limitations of, and procedures performed in a System Review are described in the standards.
- g. Include a URL reference to the AICPA website where the standards are located.
- h. Identify engagement types required to be selected by the board in the interpretations, when applicable.
- i. Identify the different peer review ratings that the firm could receive.
- j. In a report with a peer review rating of *pass*:
  - Express an opinion that the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
  - State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *pass*.
  - In the event of a scope limitation, include an additional paragraph before the opinion paragraph that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review.
  - Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.

- k. In a report with a peer review rating of *pass with deficiencies*:<sup>16</sup>
- Express an opinion that, except for the deficiencies described above, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
  - State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *pass with deficiencies*.
  - In the event of a scope limitation, include an additional paragraph before the deficiencies that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review.
- l. In a report with a peer review rating of *fail*:
- Express an opinion that as a result of the significant deficiencies described above, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended was not suitably designed or complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
  - State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *fail*.
  - In the event of a scope limitation, include an additional paragraph before the significant deficiencies that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the affect of the exclusion on the scope and results of the peer review.
- m. Include, for reports with a peer review rating of *pass with deficiencies* or *fail*, systemically written descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered) (see interpretations).
- n. Identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also made in the report<sup>17</sup> issued on the firm's previous peer review (see interpretations). This should be determined based on the underlying systemic cause of the deficiencies or significant deficiencies.
- o. Identify the level of service for any deficiencies or significant deficiencies. If the deficiency or significant deficiency included in the report with a peer review rating of *pass with deficiencies* or *fail* is industry specific, also identify the industry.

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<sup>16</sup> Reference to plural could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

<sup>17</sup> And/or the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.



## Firm Responses in a System Review

**.97** If the reviewed firm receives a report with a peer review rating of *pass with deficiencies* or *fail*, the reviewed firm should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report. The letter of response should be addressed to the administering entity's peer review committee and should describe the actions planned (including timing) or taken by the reviewed firm with respect to each deficiency in the report. The reviewed firm should submit a copy of the report, and its letter of response, to the administering entity within 30 days of the date it received the report from the team captain or by the firm's peer review due date, whichever date is earlier. Prior to submitting the response to the administering entity, the reviewed firm should submit the response to the team captain for review, evaluation, and comment (see interpretations).

**.98** If the reviewed firm receives a report with a peer review rating of *pass* or *pass (with a scope limitation)*, a letter of response is not applicable, and the reviewed firm does not submit a copy of the report to the administering entity.

**.99** The reviewed firm should respond to all findings and related recommendations not rising to the level of a deficiency or significant deficiency on the related FFC forms. These responses should describe the plan the reviewed firm has implemented or will implement (including timing) with respect to each finding. The team captain should review and evaluate the responses on the FFC forms before they are submitted to the administering entity (see interpretations).

**.100** If, after a discussion with the team captain, the reviewed firm disagrees with one or more of the findings, deficiencies, or significant deficiencies, the reviewed firm should contact the administering entity for assistance in the matter (see paragraph .93). If the reviewed firm still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for the disagreement.

**.101** Illustrations of letters of response by a reviewed firm to reports in a System Review with a peer review rating of *pass with deficiencies* and *fail* are included in appendix F, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review;" H, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review;" J, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in a System Review;" and L, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review."

## Performing Engagement Reviews

### Objectives

**.102** The objective of an Engagement Review is to evaluate whether engagements submitted for review are performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations and the applicable documentation required by professional standards.

**.103** Engagement Reviews are available only to firms that do not perform engagements under the SASs, *Government Auditing Standards*, examinations of prospective financial statements or examinations of a service organization's controls likely to be relevant to user entities' internal control over financial reporting under the SSAEs, or audits of non-SEC issuers performed pursuant to the standards of the PCAOB. However, firms eligible to have an Engagement Review may elect to have a System Review (see interpretations).

## Basic Requirements

**.104** The criteria for selecting the peer review year-end and the period to be covered by an Engagement Review are the same as those for a System Review (see paragraphs .13–.19). Engagements subject to review ordinarily should be those with periods ending during the year under review. For attestation engagements, including financial forecasts or projections, the selection for review ordinarily should be those engagements with report dates during the year under review. The reviewed firm should provide summarized information showing the number of its compilation and review engagements performed under SSARS and engagements performed under the SSAEs, classified into industry categories. That information should be provided for each partner, or individual if not a partner, of the firm who is responsible for the issuance of reports on such engagements. On the basis of that information, the review captain or the administering entity ordinarily should select the types of engagements to be submitted for review, in accordance with the following guidelines:

- a. One engagement should be selected from each of the following areas of service performed by the firm:
  1. Review of historical financial statements (performed under SSARS)
  2. Compilation of historical financial statements, with disclosures (performed under SSARS)
  3. Compilation of historical financial statements that omits substantially all disclosures (performed under SSARS)
  4. Engagements performed under the SSAEs other than examinations of prospective financial statements or examinations of a service organization's controls likely to be relevant to user entities' internal control over financial reporting.
- b. One engagement should be selected from each partner, or individual of the firm if not a partner, responsible for the issuance of reports listed in item (a).
- c. Ordinarily, at least two engagements should be selected for review.

**.105** The preceding criteria are not mutually exclusive. The objective is to ensure that one engagement is selected for each partner and one engagement is selected from each of the areas of service performed by the firm listed in item (a) in the previous list. Therefore, one of every type of engagement that a partner, or individual if not a partner, responsible for the issuance of the reports listed in item (a) in the previous list performs does not have to be reviewed as long as, for the firm taken as a whole, all types of engagements noted in item (a) in the previous list performed by the firm are covered.

**.106** The review captain should obtain the required representations submitted by the firm (see paragraph .05(f)) and should obtain the firm's prior peer review report,<sup>18</sup> the letter response, if applicable, and the letter accepting those

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<sup>18</sup> And the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

documents, all from the reviewed firm. The review captain should also obtain the prior FFC forms (from the administering entity if the review captain's firm did not perform the prior review).

**.107** For each engagement selected for review, the reviewed firm should submit the appropriate financial statements or information and the accountant's report, masking client identity if it desires, along with specified background information, representations about each engagement and the firm's documentation required by applicable professional standards for each of these engagements. There is a presumption that all engagements otherwise subject to the peer review will be included in the scope of the review. However, in the rare situations when exclusions or other limitations on the scope of the review are being contemplated, a review captain should carefully consider the implications of such exclusion. This includes communicating with the firm and the administering entity the effect on the review and on the ability of the review captain to issue a peer review report.

**.108** The evaluation of each engagement submitted for review includes:

- a. Consideration of the financial statements or information and the related accountant's report on the compilation and review engagements performed under SSARS and engagements performed under SSAEs.
- b. Consideration of the documentation on the engagements performed via reviewing background and engagement profile information, representations made by the firm, and inquiries.
- c. Review of all other documentation required by applicable professional standards on the engagements.

**.109** An Engagement Review does not include a review of other documentation prepared on the engagements submitted for review (other than the documentation referred to in paragraphs .107–.108), tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a System Review (see interpretations). Accordingly, an Engagement Review does not provide the review captain with a basis for expressing any form of assurance on the firm's system of quality control for its accounting practice. The review captain's report does indicate, however, whether anything came to the review captain's attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects (see interpretations). The review captain should promptly inform the firm when an engagement is not performed and/or reported on in conformity with applicable professional standards and remind the firm of its obligation under professional standards to take appropriate actions (see interpretations).

## Identifying Matters, Findings, Deficiencies, and Significant Deficiencies

**.110** Determining the relative importance of matters noted during the peer review, individually or combined with others, is a matter of professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow, used in conjunction with practice aids (MFC, DMFC, and FFC forms) described below to document these items, are intended to assist in determining the nature of the peer review report to issue:

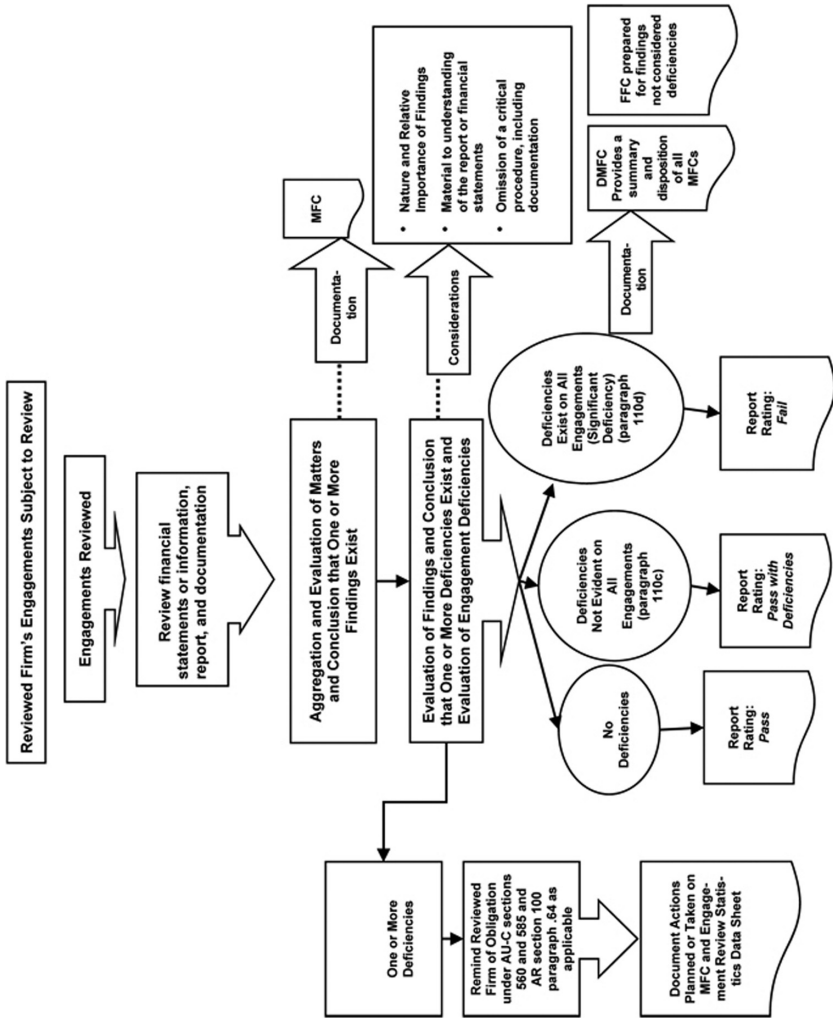
- a. A *matter* is noted as a result of evaluating whether an engagement submitted for review was performed and/or reported on in conformity with applicable professional standards. The evaluation includes reviewing the financial statements or information, the related accountant's

reports, and the adequacy of procedures performed, including related documentation. Matters are typically one or more "No" answers to questions in peer review questionnaire(s). A matter is documented on a Matter for Further Consideration (MFC) form.

- b. A *finding* is one or more matters that the review captain has concluded result in financial statements or information, the related accountant's reports submitted for review, or the procedures performed, including related documentation, not being performed and/or reported on in conformity with the requirements of applicable professional standards. A review captain will conclude whether one or more findings are a deficiency or significant deficiency. If the review captain concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on a Finding for Further Consideration (FFC) form.
- c. A *deficiency* is one or more findings that the review captain concludes are material to the understanding of the financial statements or information and/or related accountant's reports or that represent omission of a critical procedure, including documentation, required by applicable professional standards. When the review captain concludes that deficiencies are not evident on all of the engagements submitted for review, or when the exact same deficiency occurs on each of the engagements submitted for review and there are no other deficiencies, such deficiencies are communicated in a report with a peer review rating of *pass with deficiencies*.
- d. A *significant deficiency* exists when the review captain concludes that deficiencies are evident on all of the engagements submitted for review (with the exception of when more than one engagement has been submitted for review, the exact same deficiency occurs on each of those engagements, and there are no other deficiencies, which ordinarily would result in a report with a peer review rating of *pass with deficiencies*). When a significant deficiency is noted, the review captain concludes that all engagements submitted for review were not performed and/or reported on in conformity with applicable professional standards in all material respects. Such significant deficiencies are communicated in a report with a peer review rating of *fail*.

.111 A broad understanding of the peer review process, from the review of submitted engagements to the decision making process of determining whether an item noted during an Engagement Review is a matter, finding, deficiency, or significant deficiency, is shown in exhibit B. The exhibit also illustrates the aggregation of these items, where those items are documented in the practice aids, and how they might affect the type of report issued.

Exhibit B



.112 As described by exhibit B in paragraph .111, depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated, and after considering their nature and relative importance, including whether they are material to the understanding of the report or financial statements and/or represent the omission of a critical procedure including documentation, may not get elevated to a deficiency. Alternatively, a matter may develop into a finding and get elevated to a deficiency. That deficiency may or may not be further elevated to a significant deficiency.

.113 A matter is documented on an MFC form. If the matter, after further evaluation, gets elevated to a finding, but not a deficiency or significant deficiency, it is documented on an FFC form. The FFC form is a standalone document that includes the reviewer's recommendation and the reviewed firm's response regarding actions planned or taken and the timing of those actions by the firm. MFC and FFC forms are subject to review and oversight by the administering entity, who will evaluate the reviewed firm's FFC form responses for appropriateness and responsiveness (see paragraphs .141–.145). If the matter documented on the MFC form is instead elevated to a deficiency or significant deficiency, then it is communicated in the report itself, along with the reviewer's recommendation. The firm submits a letter of response regarding actions planned or taken and the timing of those actions by the firm, which is also evaluated for appropriateness and responsiveness (see paragraphs .139–.140).

.114 In order to document the disposition of all the MFCs, the review captain completes a DMFC form. The DMFC form is part of the working papers and provides a trail of the disposition of the MFCs for the peer reviewer, administering entity, and individuals conducting technical reviews or oversight. All of the MFCs are identified on the DMFC form with an indication after each as to whether it was cleared, discussed with the firm, included on a specific FFC form (individually or combined with other MFCs), or included as a deficiency in a report with a peer review rating of *pass with deficiencies* or as a significant deficiency in a report with a peer review rating of *fail*.

.115 A firm that has an Engagement Review should respond promptly to questions raised in the review, whether those questions are raised orally or in writing. The review captain will contact the firm, before issuing the final peer review report, to resolve questions raised during the peer review and to complete the MFC, DMFC, and FFC forms as applicable. In addition to discussing deficiencies or significant deficiencies and recommendations to be included in a report with a peer review rating of *pass with deficiencies* or *fail*, ordinarily, these should be discussed, along with the content of the letter of response, and agreed upon with the firm prior to the issuance of the final written report. The review captain should also communicate, if applicable, that the firm may be required to (1) take certain actions to correct the deficiencies or significant deficiencies noted in the report and/or (2) complete an implementation plan to address the findings noted on the FFC form(s). The review team should also discuss with the reviewed firm the implications of these steps on the acceptance and completion of the peer review and the reviewed firm's enrollment in the program. This is also the appropriate opportunity for providing suggestions to the firm that are not included in the report, FFC form(s), or MFC form(s).

## Addressing Disagreements Between the Reviewer and the Reviewed Firm

.116 Disagreements may arise on the resolution of various issues. For instance, there could be a disagreement on the appropriate approach to performing and/or reporting in conformity with applicable professional standards, or the review team might not believe that the actions planned or taken by the firm, if any, are appropriate (for example, if the reviewed firm believes that it can continue to support a previously issued report and the review team continues to believe that there may be a failure to reach appropriate conclusions in the application of professional standards). Reviewers and reviewed firms should understand that professional judgment often becomes a part of the process and that each party has the right to challenge each other on an issue. Nevertheless, a disagreement on the resolution of an issue may persist in some circumstances. The reviewed firm and reviewer should be aware that they may consult with their administering entity and, if necessary, request that the administering entity's peer review committee resolve the disagreement. If the administering entity's full peer review committee is unable to resolve the disagreement, the administering entity may refer unresolved issues to the board for a final determination. Only the administering entity's peer review committee will be responsible for determining whether a disagreement still exists or whether the reviewed firm or review team is not cooperating in order to refer the issue to the board.

## Reporting on Engagement Reviews

### Forming Conclusions on the Type of Report to Issue in an Engagement Review

#### ***Engagement Review Report With a Peer Review Rating of Pass***

.117 A report with a peer review rating of *pass* is issued when the reviewer concludes that nothing came to his or her attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects. There are no deficiencies or significant deficiencies that affect the nature of the report and, therefore, the report does not contain any deficiencies, significant deficiencies, or recommendations. In the event of a scope limitation, a report with a peer review rating of *pass (with a scope limitation)* is issued.

#### ***Engagement Review Report With a Peer Review Rating of Pass With Deficiencies***

.118 A report with a peer review rating of *pass with deficiencies* is issued when the review captain concludes that nothing came to his or her attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects except for the deficiencies that are described in the report. The deficiencies are one or more findings that the peer reviewer concludes are material to the understanding of the report or financial statements or represents omission of a critical procedure, including documentation, required by applicable professional standards. A report with a peer review rating of *pass with deficiencies* is issued when at least one but not all of the engagements submitted for review contain a deficiency. However, when more than one engagement has been submitted for review, and the exact same deficiency

occurs on each of the engagements, and there are no other deficiencies, a report with a peer review rating of *pass with deficiency* should be issued rather than with a peer review rating of *fail*. In the event of a scope limitation, a report with a peer review rating of *pass with deficiencies (with a scope limitation)* is issued.

### **Engagement Review Report With a Peer Review Rating of Fail**

.119 A report with a peer review rating of *fail* is issued when the review captain concludes that, as a result of the deficiencies described in the report, the engagements submitted for review were not performed and/or reported on in conformity with applicable professional standards in all material respects. A report with a peer review rating of *fail* is issued when deficiencies are evident on all of the engagements submitted for review. However, a report with a peer review rating of *pass with deficiency* should be issued when more than one engagement has been submitted for review, and the exact same deficiency occurs on each of the engagements, and there are no other deficiencies. The review captain should not expand scope beyond the original selection of engagements in an effort to change the conclusion from a peer review rating of *fail* in these circumstances. In the event of a scope limitation, a report with a peer review rating of *fail (with a scope limitation)* is issued.

### **General**

.120 In an Engagement Review, the review captain should furnish the reviewed firm with a written report within 30 days of the review of engagements or by the firm's peer review due date, whichever is earlier. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the review captain performing the review. Other reports are issued on the letterhead of the administering entity. The report in an Engagement Review ordinarily should be dated as of the date of the completion of the peer review procedures. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### **Illustrations of Reports in an Engagement Review**

.121 The standard form for a report with a peer review rating of *pass* is illustrated in appendix M, "Illustration of a Report with a Peer Review Rating of *Pass* in an Engagement Review." Illustrations of reports with a peer review rating of *pass with deficiencies* and *fail* are presented in appendixes N, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review," and P, "Illustration of a Report With a Peer Review Rating of *Fail* in an Engagement Review," respectively. Additional paragraphs included for scope limitations follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

.122 The written report in an Engagement Review should:

- a. State at the top of the report the title "Engagement Review Report."
- b. State that the review captain reviewed selected accounting engagements of the firm and include the year-end covered by the peer review.
- c. State that the peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants.



- d. State that the firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects (even though this is an Engagement Review, the statement reflects the responsibility of the firm).
- e. State that the reviewer's responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects.
- f. State that an Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, the reviewers express no opinion or any form of assurance on that system.
- g. State that the nature, objectives, scope, limitations of, and procedures performed in an Engagement Review are described in the standards.
- h. Include a URL to the AICPA website where the standards are located.
- i. Identify the different peer review ratings that the firm could receive.
- j. In a report with a peer review rating of *pass*, state:
  - That nothing came to the review captain's attention that caused the review captain to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.
  - At the end of the second paragraph, that therefore the firm has received a peer review rating of *pass*.
  - In the event of a scope limitation, include an additional paragraph before the last paragraph that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the affect of the exclusion on the scope and results of the peer review.
  - Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.
- k. In a report with a peer review rating of *pass with deficiencies*,<sup>19</sup> state:
  - That except for the deficiencies described above, nothing came to the review captain's attention that caused the review captain to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.
  - At the end of the last paragraph, that therefore the firm has received a peer review rating of *pass with deficiencies*.
  - In the event of a scope limitation, include an additional paragraph before the deficiencies that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the affect of the exclusion on the scope and results of the peer review.

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<sup>19</sup> Reference to plural could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

- l. In a report with a peer review rating of *fail*, state:
  - That as a result of the deficiencies described above, the review captain believes that the engagements submitted for review were not performed and/or reported on in conformity with applicable professional standards in all material respects.
  - At the end of the last paragraph, that therefore the firm has received a peer review rating of *fail*.
  - In the event of a scope limitation, include an additional paragraph before the significant deficiencies that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the affect of the exclusion on the scope and results of the peer review.
- m. Include, for reports with a peer review rating of *pass with deficiencies* or *fail*, descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered) (see interpretations).
- n. Identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also made in the report<sup>20</sup> in the firm's previous peer review. However, if the specific types of reporting, presentation, disclosure, or documentation deficiencies or significant deficiencies are not substantially the same on the current review as on the prior review, the deficiencies or significant deficiencies would not be considered a repeat (see interpretations).
- o. Identify the level of service for any deficiencies or significant deficiencies. If the deficiency or significant deficiency included in the report with a peer review rating of *pass with deficiencies* or *fail* is industry specific, also identify the industry.

## Firm Responses in an Engagement Review

**.123** In an Engagement Review, if the firm receives a report with a peer review rating of *pass with deficiencies* or *fail*, the reviewed firm should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report. The letter of response should be addressed to the administering entity's peer review committee and should describe the actions planned (including timing) or taken by the reviewed firm with respect to each deficiency in the report. The reviewed firm should submit a copy of the report, and its letter of response, to the administering entity within 30 days of the date it received the report from the review captain or by the firm's peer review due date, whichever date is earlier. Prior to submitting the letter of response to the administering entity, the reviewed firm should submit the response to the review captain for review, evaluation, and comment (see interpretations).

**.124** If the firm receives a report with a peer review rating of *pass* or *pass (with a scope limitation)*, a letter of response is not applicable, and the reviewed firm does not submit a copy of the report to the administering entity.

**.125** The reviewed firm should respond to all findings and related recommendations not rising to the level of a deficiency or significant deficiency on the related FFC forms. These responses should describe the plan the reviewed

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<sup>20</sup> And/or the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

firm has implemented or will implement (including timing) with respect to each finding. The review captain should review and evaluate the responses on the FFC forms before they are submitted to the administering entity (see interpretations).

**.126** If, after a discussion with the review captain, the reviewed firm disagrees with one or more of the findings, deficiencies, or significant deficiencies, the reviewed firm should contact the administering entity for assistance in the matter (see paragraph .116). If the reviewed firm still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for such disagreement.

**.127** Illustrations of letters of responses by a reviewed firm to reports with a peer review rating of *pass with deficiencies* and *fail* are included in appendixes O, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review," and Q, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in an Engagement Review."

## Administering Peer Reviews

**.128** All peer reviews intended to meet the requirements of the program should be carried out in conformity with these standards under the supervision of a state CPA society, group of state CPA societies, the AICPA Peer Review Board's National PRC (see interpretations), or other entity (hereinafter, administering entity) approved by the board to administer peer reviews. This imposes an obligation on reviewed firms to facilitate completion of their peer reviews in compliance with the procedures established by the board, and to cooperate with the peer reviewer, administering entity, and the board in all matters related to the review that could impact the firm's enrollment in the program.

**.129** Entities requesting to administer the program are required to complete and sign a Plan of Administration annually whereby the entity agrees to administer the program in compliance with these standards, interpretations, and other guidance established by the board. Upon receipt of the plans by the AICPA, including jurisdictions not requesting to administer the program for their state, the board annually approves the administering entities for all of the jurisdictions covered by the program.

**.130** This imposes an obligation on the administering entities to ensure that their staff, technical reviewers, committee members, and all others involved in the administration of the program and performance of peer reviews comply with these standards, interpretations, and other guidance established by the board. Administering entities shall also cooperate with the board in all matters related to the administration of the program. Failure to comply with these standards, interpretations, and other guidance may result in the revocation of the administering entity's plan by the board. If an administering entity refuses to cooperate or is found to be deficient in administering the program in compliance with these standards or with other guidance, the board may decide pursuant to fair procedures whether the administering entity's plan should be revoked or whether some other action should be taken.

**.131** Due to the volume of peer reviews, firms, reviewers, and other contributing factors, the board recognizes that administering entities, and in some situations firms and peer reviewers, may need the flexibility, in specific circumstances, to implement alternate methods of complying with the standards, interpretations, or guidance issued by the board. The board and/or its staff

will consider reasonable requests from administering entities' peer review committees on such matters. The comprehensiveness of the administering entity's oversight policies and procedures will be considered as well as such factors as whether the objectives of the standards, interpretations, or guidance would still be met. Administering entities must submit a request in writing to the board for approval prior to implementing alternative methods of complying with the standards, interpretations, or other guidance. This request should ordinarily be submitted in conjunction with the submission of its plan.

## Fulfilling Peer Review Committee and Report Acceptance Body Responsibilities

**.132** An administering entity appoints a peer review committee to oversee the administration, acceptance, and completion of peer reviews. The committee may decide to delegate a portion of the report acceptance function to report acceptance bodies (RABs), whose members may be, but are not required to be, members of the committee as well. Members of a committee or a RAB must meet minimum qualification requirements (see interpretations). It is ultimately the committee's responsibility to ensure that it (or a RAB on its behalf) considers the results of peer reviews it administers that are undertaken to meet the requirements of the program. The activities of the committee should be carried out in accordance with administrative procedures and guidance issued by the board. Committee members may not participate in any discussion or have any vote with respect to a reviewed firm if the member lacks independence or has a conflict of interest with the reviewing firm, the reviewer, or the reviewed firm.

**.133** The committee's report acceptance responsibilities include, but are not limited to:

- a. Ensuring that peer reviews are presented to an RAB in a timely manner, ordinarily within 120 days of the later of receipt of the working papers and peer review report from the team captain or review captain or, if applicable, the report with a peer review rating of *pass with deficiencies* or *fail* and the related letter of response from the reviewed firm, or within 60 days for Engagement Reviews meeting certain criteria (see paragraphs .137–.138).
- b. Considering whether the review has been performed in accordance with these standards, interpretations, and related guidance materials.
- c. Considering whether the report, and the response thereto, if applicable, are in accordance with these standards, interpretations, and related guidance materials, including an evaluation of the adequacy of the corrective actions the reviewed firm has represented that it has taken or will take in its letter of response.
- d. Determining whether it should require any remedial, corrective actions related to the deficiencies or significant deficiencies noted in the peer review report, in addition to those described by the reviewed firm in its letter of response. Examples of such corrective actions include, but are not limited to, requiring certain individuals to obtain specified kinds and specified amounts of CPE, requiring the firm to carry out more comprehensive monitoring procedures, or requiring it to engage another CPA to perform preissuance or postissuance reviews of financial statements, reports, and accounting and audit documentation to attempt to strengthen the performance of the firm's personnel.

e. In relation to FFCs:

1. Considering whether FFC (and associated MFC and DMFC) forms are prepared in accordance with these standards, interpretations, and related guidance materials, including whether the findings addressed on the FFC forms should have been included in a report with a peer review rating of *pass with deficiencies* or *fail*.
2. Determining the adequacy of the plan the reviewed firm has represented that it has implemented or will implement in its response on the FFC form(s).
3. Determining whether it should require an implementation plan in addition to or as an affirmation of the plan described by the reviewed firm in its response to the findings on the FFC form(s).

f. Ensuring that all corrective actions related to deficiencies or significant deficiencies in the peer review report and all implementation plans related to findings on FFC forms have been completed to the satisfaction of the committee.

g. Ensuring that all firms within its jurisdiction have timely peer reviews and keeping track of the timing of the completion of corrective actions and implementation plans by all firms that the committee has required, including those that are overdue.

**.134** In reaching its conclusions on the preceding items, the committee is authorized to make whatever inquiries or initiate whatever actions it considers necessary in the circumstances, including but not limited to requesting expansion of scope, revisions to the report, or the reviewed firm's response thereto. Such inquiries or actions by the committee should be made with the understanding that the program is intended to be positive and remedial in nature and is based on mutual trust and cooperation.

**.135** In the rare event of a disagreement between the administering entity and either the reviewer or the reviewed firm that cannot be resolved by ordinary good-faith efforts, the administering entity may request that the matter be referred to the board for final resolution. Only the approved administering entity's peer review committee will be responsible for determining whether a disagreement still exists in order to refer the matter to the board. In these circumstances, the board may consult with representatives of other AICPA committees or with appropriate AICPA staff.

## Accepting System and Engagement Reviews

**.136** Technical reviews are required to be performed by the administering entity on all peer reviews. Technical reviewers must meet minimum qualification requirements (see interpretations).

**.137** All System Reviews are required to be presented for committee consideration, but committee consideration is not always required in an Engagement Review. The technical reviewer<sup>21</sup> should be delegated the authority from the committee to accept Engagement Reviews in certain circumstances (see interpretations).

**.138** Engagement Reviews that do not require committee consideration are required to be accepted by the technical reviewer within 60 days of receipt of the

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<sup>21</sup> The responsibilities and the role of technical reviewers are included in the AICPA Peer Review Program Report Acceptance Body Handbook, which is provided to all administering entities.

working papers and report from the review captain. If the committee does not delegate the authority to the technical reviewer to accept Engagement Reviews under the specific criteria indicated previously, the review is required to be presented to the committee within 60 days of receipt of the working papers and report from the review captain.

**.139** In deciding on the need for and nature of any corrective actions, the committee should consider the nature and significance (and for System Reviews, the causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole) of the deficiencies or significant deficiencies. It should evaluate whether the recommendations of the review team appear to address those deficiencies or significant deficiencies adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible.

**.140** If the peer review committee determines that corrective actions related to the deficiencies or significant deficiencies noted in the peer review report, in addition or as an affirmation of those described by the firm in its letter of response, are appropriate, the firm will be required to evidence its agreement to perform these corrective action(s) in writing before the report is accepted and complete the action(s) as a condition of cooperation with the administering entity and the board.

## Cooperating in a Peer Review

**.141** Paragraph .05(h) of the standards noted that firms (and individuals) enrolled in the program have the responsibility to cooperate with the peer reviewer, administering entity, and the board in all matters related to the peer review that could impact the firm's enrollment in the program, including taking remedial, corrective actions or implementing FFC plans as needed.

**.142** In deciding on the need for and nature of any implementation plan in addition to that described by the firm in its response on the FFC form, the committee should consider the nature and significance (and for System Reviews, the causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole) of the findings. It should evaluate whether the recommendations of the review team appear to address those findings adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible.

**.143** If the peer review committee determines, as part of its deliberations regarding the peer review, that an implementation plan in addition to or as an affirmation of those described by the firm in its responses on the FFC form are warranted, the firm will be required to evidence its agreement to perform this FFC implementation plan in writing and complete the plan as a condition of cooperation with the administering entity and the board (see interpretations). Although agreeing to and completing such a plan is not tied to the acceptance of the peer review, if a firm fails to cooperate, the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations). The resulting MFC, DMFC, and FFC forms, as well as any correspondence relating to the implementation plan to be followed by the firm related to these documents, are outside of the reporting and acceptance process.

**.144** If a reviewed firm refuses to cooperate, fails to correct deficiencies or significant deficiencies, or is found to be so seriously deficient in its performance that education and remedial, corrective actions or implementation plans are not adequate, the board may decide, pursuant to fair procedures that

it has established, to appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated or whether some other action should be taken. A firm that receives peer reviews with recurring deficiencies or significant deficiencies that are not corrected may be deemed as a firm refusing to cooperate. In addition, a firm that fails to correct deficiencies or significant deficiencies after consecutive corrective actions requested by the committee may also be deemed as a firm refusing to cooperate.

**.145** If a decision is made by the hearing panel to terminate a firm's enrollment in the program, the firm will have the right to appeal to the AICPA Joint Trial Board for a review of the hearing panel's findings. The fact that a firm's enrollment in the program has been terminated shall be published in such form and manner as the AICPA Council may prescribe.

## Publicizing Peer Review Information

**.146** The reviewed firm should not publicize the results of the review or distribute copies of the peer review report to its personnel, clients, or others until it has been advised that the report has been accepted (see interpretations) by the administering entity as meeting the requirements of the program. Neither the administering entity nor the AICPA shall make the results of the review available to the public, except as authorized or permitted by the firm under certain circumstances (see interpretations). The administering entity and the AICPA may disclose the following information:

- a. The firm's name and address
- b. The firm's enrollment in the program
- c. The date of acceptance and the period covered by the firm's most recently accepted peer review
- d. If applicable, whether the firm's enrollment in the program has been dropped or terminated

## Peer Reviewers' Performance and Cooperation

**.147** A team captain, review captain, or reviewer (hereinafter, reviewer) has a responsibility to perform a review in a timely, professional manner. This relates not only to the initial submission of the report and materials on the review, but also to the timely completion of any additional actions necessary to complete the review, such as completing any omitted documentation of the work performed on the review and resolving questions raised by the committee or technical reviewer accepting the review as well as the board and AICPA staff.

**.148** In considering peer review documents for acceptance, the committee evaluates the reviewer's performance on the peer review. In addition to the committee's evaluation, the board and AICPA staff also evaluate and track reviewers' performance on peer reviews. If serious weaknesses in the reviewer's performance are noted on a particular review, or if a pattern of poor performance by a particular reviewer is noted, then the board or committee, depending on the particular circumstances, will consider the need to impose corrective actions on the service of the reviewer.

**.149** In situations in which one or more of such actions is imposed, the administering entity will inform the board and may request that the board ratify the action(s) to be recognized by other administering entities.

**.150** Any condition imposed on a reviewer will generally apply to the individual's service as a team captain, review captain, team member, or QCM

reviewer unless the condition is specific to the individual's service as only a team captain, review captain, team member, or QCM reviewer.

**.151** If a reviewer refuses to cooperate with the committee or board, fails to revise peer review documents as requested by the committee or board, fails to correct the poor performance, or is found to be deficient in his or her performance, and education or other corrective or monitoring actions are not considered adequate to correct the poor performance, the committee may recommend to the board that the reviewer be prohibited from performing peer reviews in the future. In such situations imposed by a committee, the board shall appoint a hearing panel to consider ratifying the action(s) taken by the committee for the reviewer's name to be removed from the list of qualified reviewers, or if some other action should be taken. The board may decide, with or without committee recommendation pursuant to fair procedures that it has established, to consider whether the reviewer should be prohibited from performing peer reviews or whether some other action should be taken.

**.152** Corrective or other action(s) can only initially be appealed to the committee that imposed the action(s). For actions previously appealed to the committee or imposed or ratified by the board, if the reviewer disagrees with the corrective action(s), he or she may appeal the decision by writing the board and explaining why he or she believes that the action(s) are unwarranted. The board will review and consider the request upon its receipt.

**.153** If a reviewer has a corrective or other action(s) imposed on him or her by the committee or board, and the reviewer had previously been approved to perform a peer review that has either begun or has yet to begin, then the committee or board will need to consider whether the review should be performed by another reviewer, or if the review should be overseen by a member of the committee at the reviewer's expense, or other actions, if any (whether or not the reviewer has filed an appeal with the committee or board). If the reviewer has completed the fieldwork on one or more peer reviews prior to the imposition of the corrective action, then the committee or board will consider what action, if any, to take regarding those peer reviews based on the facts and circumstances.

## Performing and Reporting on Reviews of Quality Control Materials (QCM)

### Introduction

**.154** Quality control materials (QCM) are materials that are suitable for adoption by a firm as an integral part of that firm's system of quality control. Such materials provide guidance to assist firms in performing and reporting in conformity with professional standards and may include, but are not limited to, such items as engagement aids, including accounting and auditing manuals, checklists, questionnaires, work programs, computer-aided accounting and auditing tools, and similar materials intended for use by accounting and auditing engagement teams.

**.155** Organizations (hereinafter referred to as *providers*) may sell or otherwise distribute to CPA firms (hereinafter referred to as *user firms*) QCM that they have developed.

**.156** Providers may elect voluntarily or be required to have an independent review of their system of quality control for the development and maintenance



of the QCM they have developed, and of the resultant materials (see paragraph .159). The reasons for having such a review are:

- a. Providing reasonable assurance to user firms that the provider's system of quality control to develop and maintain QCM is appropriately designed and complied with, and that the resultant materials are reliable aids to assist them in conforming with all those components which are integral to the professional standards the materials purport to encompass.
- b. Providing more cost-effective peer reviews for firms that use such materials by allowing the peer reviewers of user firms to place reliance on the results of the QCM review in evaluating the design of the user firm's system of quality control.
- c. Ensuring that independence and objectivity on peer reviews of user firms is maintained when such peer reviews are performed by providers.

.157 A summary of the nature, objectives, scope, limitations of, and procedures performed on QCM reviews is included in appendix A.

### Objectives of a QCM Review

.158 The objectives of a review of QCM developed by a provider are determining:

- a. Whether the provider's system for the development and maintenance of the QCM was suitably designed and was being complied with during the period under review to provide user firms with reasonable assurance that the materials are reliable aids.
- b. Whether the resultant materials are reliable aids to assist user firms in conforming with all those components which are integral to the professional standards the materials purport to encompass.

### Applicability

.159 Generally, there are two categories of providers:

- a. A CPA firm or its affiliate or related entity (see interpretations) that develops and maintains QCM (collectively, a provider firm). A provider firm is ordinarily permitted to perform the peer review of a user firm if an independent review of both the provider firm's system of quality control for the development and maintenance of the QCM and the provider firm's resultant materials (the QCM review) is performed as a safeguard of independence.
- b. Any other type of organization that does not fall under the description of a provider firm (voluntary provider), including an association of CPA firms providing QCM or a third party organization that provides QCM as a primary function of its business.

All QCM reviews are administered by the National PRC and performed in accordance with these standards.

.160 With respect to a provider firm, the initial QCM review is due within six months of the elected year-end date. The initial QCM review is required to be completed before the provider firm can be scheduled to perform the peer review of a user firm. A provider firm's subsequent QCM review has a due date of three years and six months from the year-end of the previous QCM review. The due date for a QCM review is the date by which the QCM review report, letter of response (if applicable), and the QCM reviewer's working papers are

to be submitted to the National PRC. If the QCM review working papers are not submitted by the due date, the provider firm will no longer be independent to perform peer reviews of user firms after that date (that is, the necessary independence safeguard was not implemented timely, which is considered non-cooperation).

**.161** Subsequent to the QCM review, if there are substantial changes in either the system for the development and maintenance of the materials or in the resultant materials themselves, the provider firm should consult with the National PRC to determine whether an accelerated QCM review is required.

**.162** In addition, a provider firm that will perform the peer review of a user firm is required to have its own firm's subsequent peer reviews administered by the National PRC (from the point of scheduling the QCM review onward) (see interpretations).

**.163** Voluntary providers of QCM that elect (but are not required) to have a QCM review should consult with the National PRC. Reviews of providers that voluntarily elect to have a QCM review under these standards must comply with the standards in all respects.

**.164** Materials relating to audits of SEC issuers performed pursuant to the standards of the PCAOB are not within the scope of these standards.

**.165** The National PRC will administer reviews of QCM based on the standards and the RAB Handbook. When not otherwise addressed in this section, QCM reviewers and providers should refer to the other sections of the Standards for Performing and Reporting on Peer Reviews for additional guidance on performing, reporting on, and accepting QCM reviews.

## Qualifications for Serving as a QCM Reviewer

**.166** The National PRC establishes minimum requirements to qualify as a QCM reviewer. In addition to the peer reviewer qualifications set forth in the paragraphs under "Organizing the System or Engagement Review Team" and "Qualifying for Service as a Peer Reviewer" (see paragraphs .26-.35) and in the interpretations, the National PRC will consider other factors in determining whether a potential QCM reviewer is qualified (see interpretations). Members of the QCM review team must be approved by the National PRC prior to the commencement of the review. Final approval of QCM review teams is at the National PRC's discretion.

## Procedures for Planning and Performing QCM Reviews

**.167** A QCM review should include procedures to plan and perform the review. The provider should identify the specific materials subject to the QCM review that will be opined upon in the report. Procedures to test the provider's system of quality control should be determined based on the specific materials included in the scope of the review.

**.168** Once materials are identified for review purposes, they cannot be subsequently excluded from the scope of the review without resulting in a scope limitation. If the QCM review is required because the provider firm plans to peer review user firms, ordinarily all of the provider firm's materials should be included in the scope of the QCM review. If specific materials are excluded from the scope of the QCM review, then the provider firm will not be independent of firms that use those specific materials excluded from the scope of the QCM review.

### ***Planning Considerations***

**.169** The QCM reviewer should obtain the prior QCM report, the letter of response (if applicable), and the acceptance letter from the provider. The QCM reviewer should also obtain the prior FFC forms (if applicable) from the National PRC. The QCM reviewer should consider whether the issues discussed in those documents require additional emphasis in the current review, and evaluate the provider's actions in response to the prior report.

**.170** In addition, the QCM review team should assess the risk associated with QCM reviews. This is the risk that the QCM review team:

- a. Fails to identify significant weaknesses in the provider's system of quality control for the development and maintenance of its quality control materials, its lack of compliance with that system, or a combination thereof.
- b. Fails to identify significant weaknesses in the materials.
- c. Issues an inappropriate opinion on the provider's system of quality control for the development and maintenance of its quality control materials, its compliance with that system, or a combination thereof.
- d. Issues an inappropriate opinion on the materials.
- e. Reaches an inappropriate decision about the matters to be included in, or excluded from, the report.

**.171** QCM review risk consists of:

- a. The risk (consisting of inherent risk and control risk) that the quality control materials are not reliable aids, that the provider's system of quality control will not prevent such failure, or both.
- b. The risk (detection risk) that the review team will fail to detect and report on design or compliance deficiencies or significant deficiencies in the provider's system of quality control or in the resultant materials.

**.172** In planning the review, the QCM review team should assess and document the relevant inherent and control risk factors, and how the combined risks affect detection risk and, therefore, the scope of review procedures. This assessment should include but is not limited to consideration of the nature and environment of the provider (including economic and competitive pressures); experience with developing and maintaining QCM; the level of risk; complexity and change inherent in the industries and professional standards covered by the QCM; prior findings on previously-issued materials and the disposition of those findings; and any investigations, allegations, or restrictions on authors and technical reviewers (including outside and guest authors or technical reviewers).

### ***Understanding the Provider's System of Quality Control***

**.173** A provider's system of quality control for the development and maintenance of the materials normally should include:

- a. A requirement that the provider's system of quality control be documented.
- b. A requirement that the provider perform on-going monitoring of its system of quality control.
- c. A requirement that the materials be developed and maintained by individuals qualified in the subject matter.
- d. A requirement that the materials be reviewed for technical accuracy by a qualified person(s) other than the developer(s).

- e. Procedures to ensure that the individuals who develop, maintain, or review the materials for technical accuracy are appropriately qualified in the subject matter.
- f. Procedures to ensure that the materials are current and address the relevant professional standards and industry guidance.
- g. Procedures for soliciting and evaluating feedback from users of the materials.
- h. Procedures for communicating the period and, where appropriate, the professional standards encompassed by the materials.
- i. Procedures (if any) regarding the issuance of updates to the materials and, if a policy exists, the method of updating. If the provider's policy is not to provide updates to the materials between versions, then include the procedures for communicating this policy to users.
- j. Procedures for ensuring that the materials are updated in accordance with the provider's policy when it has undertaken to update them.
- k. Procedures for ensuring that the system of quality control as designed is operating effectively.

**.174** A study and evaluation of the system for the development and maintenance of the materials normally should include the following procedures:

- a. Reviewing and evaluating the procedures established for monitoring the system of quality control, and assessing how any findings or issues were resolved.
- b. Reviewing and evaluating the procedures established for developing and maintaining the materials.
- c. Reviewing and evaluating the procedures established for updating (including distributing) the materials to ensure that the materials remain current and relevant when the provider has undertaken the responsibility for updating the materials.
- d. Reviewing the technical competence of the developers and updaters (if applicable) of the materials.
- e. Obtaining evidence that the materials were reviewed for technical accuracy by qualified person(s) other than the developers or updaters.
- f. Determining whether the provider has appropriately communicated its policy regarding the period covered by the materials, the professional standards the materials purport to encompass, and the provider's policy regarding updating the materials.
- g. Reviewing the system developed for soliciting and evaluating feedback from users of the materials.

### ***Performing Tests of the Materials***

**.175** The scope of the QCM review includes all of the materials identified by the provider and covered in the opinion (see paragraph .167). The extent to which individual manuals, guides, checklists, practice aids, and so on are reviewed is subject to the QCM review team's judgment and should be documented in the risk assessment (see interpretations). For QCM reviews of provider firms, all materials should be within the scope of the review. A QCM review team should review the resultant materials, to the extent deemed necessary, to evaluate whether the materials are reliable aids to assist firms in conforming to those professional standards the materials purport to encompass.

**.176** For all of the materials tested, the QCM review team should assess whether or not the materials are reliable aids. This includes evaluating whether

the materials can assist users in conforming with all those components which are integral to the professional standards that the materials purport to encompass. The QCM review team performs this evaluation by assessing the level of instructions and explanatory guidance in the materials, and determining whether the methodology inherent in the materials is appropriate (see interpretations).

## Identifying Matters, Findings, Deficiencies, and Significant Deficiencies

.177 In evaluating the provider's system of quality control, the QCM review team may note that the system is not appropriately designed or complied with. Similarly, the tests of the provider's materials may uncover that design weaknesses or lack of compliance with the system resulted in one or more materials that do not reach the threshold of reliable aids. With any of these items, the QCM review team has available a set of definitions to assist in classifying the condition noted.

.178 Determining the relative importance of matters noted during the QCM review, individually or combined with others, requires professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow are intended to assist in aggregating and evaluating the QCM review results, concluding on them, and determining the nature of the QCM review report to issue:

a. A *matter* is noted as a result of

- i. the QCM reviewer's evaluation of the design of and compliance with the provider's system of quality control. Matters can be one or more "no" answers to questions in QCM review questionnaire(s) that a QCM reviewer concludes warrants further consideration in the evaluation of a provider's system of quality control.
- ii. the QCM reviewer's evaluation of whether the materials submitted for review are reliable aids. Matters can arise from either the QCM reviewer's comments based on tests of the materials, or one or more "no" answers to questions in QCM review questionnaire(s) that the QCM reviewer concludes warrants further consideration by the provider in the evaluation of the materials.

A matter is documented on a MFC form.

b. A *finding* is one or more matters that result from

- i. a condition in the provider's system of quality control or compliance with it such that there is more than a remote possibility that the provider would not develop or maintain reliable aids, or
- ii. the QCM reviewer's conclusion that one or more of the materials tested do not encompass some portion of the components of the professional standards that the materials purport to encompass.

A QCM reviewer will conclude whether one or more findings are a deficiency or significant deficiency. If the QCM reviewer concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on a FFC form.

c. A *deficiency* is one or more findings that

- i. the QCM reviewer has concluded, due to the nature, causes, pattern, or pervasiveness, could create a situation in which the

provider would not have reasonable assurance of developing or maintaining reliable aids, or

- ii. affects the reliability of one or more of the materials tested, such that one or more of the materials do not encompass the components which are integral to the professional standards that the materials purport to encompass.

This includes the relative importance of the deficiency to either the provider's system of quality control taken as a whole, or any of the materials tested (individually or collectively). It is not a significant deficiency if the QCM reviewer has concluded that except for the deficiency or deficiencies the provider has reasonable assurance of developing and maintaining reliable aids or that the nature of the deficiency or deficiencies is limited to a small number of the total materials reviewed. Such deficiencies are communicated in a report with a QCM review rating of *pass with deficiencies*.

d. A *significant deficiency* is one or more deficiencies that the QCM reviewer has concluded results from a condition in the provider's system of quality control when the system taken as a whole does not provide reasonable assurance of developing or maintaining reliable aids, and it has affected the reliability of one or more of the materials reviewed.

Such deficiencies are communicated in a report with a QCM rating of *fail*.

## **Aggregating and Evaluating Matters in the Provider's System**

.179 The QCM review team must aggregate matters noted during the review of the provider's system of quality control to develop and maintain the materials in order to conclude on the opinion of the provider's system. This entails determining whether any matters noted were the result of the design of the provider's system of quality control or the failure of its personnel to comply with the provider's quality control policies and procedures. The QCM review team should consider their relative importance to both the provider's system of quality control as a whole and the impact on the materials (individually and collectively), and their nature, causes, pattern, and pervasiveness.

.180 The use of professional judgment is essential in determining whether matters should be aggregated as findings, and whether one or more findings is a deficiency or significant deficiency.

### ***Design Matters***

.181 A design matter in a QCM review exists when the provider's system of quality control is missing a quality control policy or procedure or when the provider's existing quality control policies and procedures (even if fully complied with) would not result in the development or maintenance of reliable aids in one or more respects. To be effective, a system of quality control must be designed properly, and all of the quality control policies and procedures necessary to provide the provider with reasonable assurance of developing and maintaining reliable aids should be in place. Therefore, the QCM review team will need to determine whether the quality control policies and procedures would be effective if they were complied with. To make this determination, the QCM review team should consider the implications of the evidence obtained during its evaluation of the system of quality control and its tests of compliance, including its review of the materials.

.182 The relative importance of design matters noted in the provider's quality control policies and procedures, individually and in the aggregate, need to be evaluated in the context of the provider's organizational structure, the nature of its practice, the number of users, and so on. For example, a matter

noted during the review of a quality control policy or procedure may be partially or wholly offset by another policy or procedure. In this circumstance, the QCM review team should consider the interrelationships among the elements of quality control and weigh the matters noted against compensating policies and procedures to determine whether a finding exists and its relative importance.

**.183** There may be circumstances in which the QCM reviewer finds few findings in the materials developed and maintained by the provider, yet he or she still concludes that the design of the provider's system of quality control needs to be improved. For example, a provider that has a rapidly growing customer base may not have appropriately revised its policies and procedures to solicit user feedback. However, this type of finding may not result in less than reasonable assurance of developing or maintaining reliable aids. The QCM reviewer should exercise judgment in determining whether this matter should be addressed in an FFC as a finding rather than result in a report with a QCM review rating of pass with deficiencies or fail.

### ***Compliance Matters***

**.184** A compliance matter exists when a properly designed quality control policy or procedure does not operate as designed because of the failure of the personnel of the provider to comply with it. Because a variance in individual performance will affect the degree of compliance, adherence to all policies and procedures in every case generally is not possible. However, the degree of compliance by the personnel of the provider with its prescribed quality control policies and procedures should be adequate to give the provider reasonable assurance of developing and maintaining reliable aids.

**.185** In assessing whether the degree of compliance was adequate to provide the required assurance, the QCM review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted and their relative importance to the provider's system of quality control as a whole, as well as their importance in the specific circumstances in which they were observed. As with the evaluation of design matters, compliance matters also need to be evaluated in the context of the provider's organizational structure, the nature of its practice, the number of users, and so on.

**.186** To determine the degree of noncompliance, the QCM review team should evaluate the matters of noncompliance, both individually and in the aggregate, recognizing that adherence to certain policies and procedures of the provider is more critical to the provider obtaining reasonable assurance of developing and maintaining reliable aids. In this context, the QCM review team should consider the likelihood that noncompliance with a given quality control policy or procedure could have resulted in materials that are not reliable aids. The more direct the relationship between a specific quality control policy or procedure and the reliability of the aids, the lower the degree of noncompliance necessary to determine whether a matter (or matters) is a finding and whether a finding is a deficiency or significant deficiency.

### **Aggregating and Evaluating Matters in the Provider's Materials**

**.187** The QCM review team must also aggregate matters noted during the QCM review in order to conclude on the separate opinion on the reliability of the materials. Any design or compliance matters will usually be addressed in the consideration of the provider's system. However, all matters that impact the system also have to be evaluated for their impact and relative importance on the individual materials reviewed and opined upon in the report. The use of professional judgment is essential in determining whether matters should be

aggregated as findings, and whether one or more findings is a deficiency. One or more deficiencies in the materials is indicative of a deficiency or significant deficiency in the provider's system of quality control.

**.188** The QCM review team should consider whether design matters noted in the review of the provider's quality control system, individually and in the aggregate, impact the reliability of the materials. For example, a provider may not specify in its policies and procedures that authors must have a certain level of professional experience or expertise. In this circumstance, the QCM review team should consider whether this design matter resulted in a potentially inexperienced or otherwise unqualified author writing portions of the materials, and whether those portions of the materials are technically accurate, to determine the impact on the reliability of the materials, and whether a finding or deficiency exists with respect to the materials.

**.189** Similarly, the QCM review team should consider whether compliance matters noted in either the review of the provider's quality control system or in the tests of the materials impact the reliability of the aids. For example, personnel that performed technical review on a particular industry manual may not have obtained the appropriate type or amount of CPE for that industry in compliance with the provider's policies and procedures. In this circumstance, the QCM review team should consider if this compliance matter resulted in a failure to include new or recent changes in professional standards or industry guidance, or other omissions, to determine whether a finding or deficiency exists with respect to the materials.

## Reporting on QCM Reviews

### *General*

**.190** The QCM review team should furnish the provider with a written report and the final FFC forms within 30 days of the date of the exit conference or by the provider's review due date, whichever is earlier. A report on a QCM review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a QCM review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the team captain performing the review. The report in a QCM review ordinarily should be dated as of the date of the exit conference. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### *Forming Conclusions on the Type of Report to Issue in a QCM Review*

**.191** The following circumstances ordinarily would be considered deficiencies or significant deficiencies:

- a. The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary (that is, a scope limitation).
- b. The provider's system of quality control for the development and maintenance of QCM, as designed, did not provide reasonable assurance that reliable aids had been developed or maintained.
- c. The degree of compliance with the provider's system of quality control for the development and maintenance of QCM was not sufficient to provide user firms with reasonable assurance that reliable aids had been developed or maintained.
- d. The resultant QCM are not reliable aids to assist user firms in conforming with the components integral to the professional standards the



materials purport to encompass (generally resulting from the condition described in b. or c).

**.192** In those instances in which the QCM review team determines that a report with a review rating of *pass with deficiencies* or *fail* is required, all the reasons should be disclosed, and the QCM review team should consult with the National PRC prior to the issuance of the report.

### **Preparing the Report in a QCM Review**

**.193** The standard forms for a QCM review report with a review rating of *pass*, *pass with deficiencies*, and *fail* are included in appendixes R, "Illustration of a Report With a Review Rating of *Pass* in a Review of Quality Control Materials;" S, "Illustration of a Report With a Review Rating of *Pass With Deficiencies* in a Review of Quality Control Materials;" and T, "Illustration of a Report With a Review Rating of *Fail* in a Review of Quality Control Materials," respectively.

**.194** A QCM report with a rating of *pass*, *pass with deficiencies*, or *fail* contains elements similar to those in a System Review report. As such, the written report in a QCM System Review should:

- a. State at the top of the page the title "Quality Control Materials Review Report."
- b. State that the system of quality control for the development and maintenance of the materials and the resultant materials in effect at the year-end covered by the QCM review were reviewed.
- c. State that the review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants.
- d. State that the provider is responsible for designing a system of quality control and complying with it to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in performing and reporting in conformity with the components which are integral to the professional standards that the materials purport to encompass.
- e. State that the reviewer's responsibility is to express an opinion on the design of the system of quality control, the provider's compliance with that system, and the reliability of the resultant materials based on the review.
- f. State that the nature, objectives, scope, limitations of, and procedures performed in a Quality Control Materials review are described in the standards.
- g. Include a URL reference to the AICPA website where the standards are located.
- h. State that the users of the materials are responsible for implementing, tailoring, and augmenting the materials as appropriate.
- i. State that there may be important elements of a quality control system in accordance with Statements on Quality Control Standards that are not part of the materials that have been subject to this QCM review.
- j. Identify the different peer review ratings that the provider could receive.
- k. In a report with a peer review rating of *pass*:
  - Express an opinion that the system of quality control for the development and maintenance of the quality control materials was suitably designed and was being complied with during the year

ended to provide reasonable assurance that the materials are reliable aids.

- Express an opinion that the quality control materials were reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at year-end.
  - State at the end of the opinion paragraph that therefore the report reflects a peer review rating of *pass*.
  - Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.
- l.* In a report with a review rating of *pass with deficiencies*:<sup>22</sup>
- Express an opinion that, except for the deficiencies described previously, the system of quality control for the development and maintenance of the quality control materials was suitably designed and was being complied with during the year ended to provide reasonable assurance that the materials are reliable aids or
  - Express an opinion that, except for the deficiencies described previously, the quality control materials were reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at year-end.
  - State at the end of the opinion paragraph that therefore the report reflects a review rating of *pass with deficiencies*.
- m.* In a report with a peer review rating of *fail*:
- Express an opinion that as a result of the significant deficiencies described previously, the system of quality control for the development and maintenance of the quality control materials was not suitably designed and being complied with during the year ended and, therefore, cannot provide reasonable assurance that the materials are reliable aids.
  - Express an opinion that also, as a result of the significant deficiencies described previously, the quality control materials are not reliable aids and do not assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at year-end.
  - State at the end of the opinion paragraph that therefore the provider has received a peer review rating of *fail*.
- n.* Include, for reports with a review rating of *pass with deficiencies* or *fail*, written descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered).
- o.* Identify, for any deficiencies or significant deficiencies included in the report with a review rating of *pass with deficiencies* or *fail* any that were also made in the report<sup>23</sup> issued on the provider's previous QCM review. This should be determined based on the underlying systemic cause of the deficiencies or significant deficiencies.

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<sup>22</sup> Reference to plural could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

<sup>23</sup> And/or the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

## Provider Responses on QCM Reviews

**.195** If the provider receives a report with a review rating of *pass with deficiencies* or *fail*, then the provider should respond in writing to the deficiencies and significant deficiencies and related recommendations identified in the report, if applicable. The letter of response should be addressed to the National PRC and should describe the action(s) planned (including timing) or taken by the provider with respect to each deficiency in the report. If the provider disagrees with one or more of the deficiencies or significant deficiencies, its response should describe the reasons for such disagreement. In the event that a material error or omission in the materials is uncovered by the QCM review team, the response also should describe the provider's plan for notifying known users of that error or omission. The provider should submit the letter of response for review and comment to the QCM reviewer prior to submitting the response to the National PRC.

**.196** The provider should submit a copy of the report and its letter of response to the National PRC within 30 days of the date it received the report or by the provider's review due date, whichever date is earlier. Prior to submitting the response to the National PRC, the provider should submit the response to the QCM reviewer for review, evaluation, and comment. If the provider receives a report with a review rating of *pass*, a letter of response is not applicable, and the provider does not submit a copy of the report to the National PRC.

**.197** The provider should also respond on the FFC forms, if any are developed, to findings and related recommendations. These responses should describe the plan (including timing) the provider has implemented or will implement with respect to each finding. They should be submitted to the QCM reviewer no later than two weeks after the exit conference or by the review's due date, whichever is earlier. FFC forms are submitted by the QCM reviewer with the applicable working papers to the National PRC.

**.198** If, after a discussion with the QCM reviewer, the provider disagrees with one or more of the findings, deficiencies, or significant deficiencies, the provider should contact the National PRC for assistance in the matter (see paragraph .93). If the provider still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for such disagreement.

## Cooperating in a QCM Review

**.199** Providers that undertake to have a QCM review under these standards have a responsibility to cooperate with the QCM review team, the National PRC, and the board in all matters related to the QCM review.

**.200** If a provider firm fails to cooperate during the course of a QCM review, the provider firm's independence with respect to user firms may be impaired (see interpretations).

## QCM Reviewers' Performance and Cooperation

**.201** A QCM reviewer has a responsibility to perform a QCM review in a timely, professional manner. This relates not only to the initial submission of the report and materials on the review, but also to the timely completion of any additional actions necessary to complete the review, such as resolving questions raised by the National PRC, as well as the board and AICPA staff.

**.202** In considering QCM review documents for acceptance, the National PRC evaluates the QCM reviewer's performance on the QCM review. In addition to the National PRC's evaluation, the board and AICPA staff also evaluate and track reviewers' performance on both peer reviews and QCM reviews.

**.203** If weaknesses in a QCM reviewer's performance are noted on a particular QCM review (for example, submitting incomplete review documentation, not performing sufficient review procedures, a failure to resolve questions raised by the committee or technical reviewer, and so on), or if the QCM reviewer refuses to cooperate with the National PRC at any time during the review process, the QCM reviewer will be required to comply with the actions described in paragraphs .148–.153. In addition, the National PRC has the discretion to no longer approve that individual to perform future QCM reviews or other peer reviews.

### **Publicizing QCM Review Information**

**.204** The provider should not publicize the results of the review or distribute copies of the QCM report to its personnel, users, or others until it has been advised that the report has been accepted by the National PRC.

**.205** Providers that elect or are required to have a QCM review under these standards agree that the National PRC and the AICPA may disclose the following information to allow peer reviewers of user firms to easily obtain this information for consideration during the user firm's peer review:

- a. The provider's name
- b. The results of the QCM review (that is, report, letter of response (LOR) (if applicable), and so on)
- c. The date of acceptance and the year covered by the provider's most recently accepted QCM review

### **Effective Date**

**.206** The effective date for these standards is for peer reviews commencing on or after January 1, 2009, and QCM reviews commencing on or after January 1, 2011. Early implementation is permitted for QCM reviews, but not for peer reviews.

## Appendix A

### Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews and Quality Control Materials Reviews (as Referred to in a Peer Review Report)

(Effective for Peer Reviews Commencing on or After January 1, 2009)

1. Firms (and individuals) enrolled in the AICPA Peer Review Program are required to have a peer review, once every three years, of their accounting and auditing practice related to non-Security and Exchange Commission (SEC) issuers covering a one-year period. The peer review is conducted by an independent evaluator, known as a peer reviewer. The AICPA oversees the program, and the review is administered by an entity approved by the AICPA to perform that role.
2. The peer review helps to monitor a CPA firm's accounting and auditing practice (*practice monitoring*). The goal of the practice monitoring, and the program itself, is to promote quality in the accounting and auditing services provided by the AICPA members and their CPA firms. This goal serves the public interest and enhances the significance of AICPA membership.
3. There are two types of peer reviews: System Reviews and Engagement Reviews. System Reviews focus on a firm's system of quality control, while Engagement Reviews focus on work performed on particular selected engagements. As noted in paragraphs .04 and .157, a further description of System and Engagement Reviews, and Quality Control Materials (QCM) Reviews, as well as a summary of the nature, objectives, scope, limitations of, and procedures performed on them, is provided in the following sections.

#### System Reviews

4. A System Review is a type of peer review that is a study and appraisal by an independent evaluator(s), known as a peer reviewer, of a CPA firm's system of quality control to perform accounting and auditing work. The system represents the policies and procedures that the CPA firm has designed, and is expected to follow, when performing its work. The peer reviewer's objective is to determine whether the system is designed to ensure conformity with professional standards and whether the firm is complying with its system appropriately.
5. Professional standards are literature, issued by various organizations, that contain the framework and rules that a CPA firm is expected to comply with when designing its system and when performing its work. Professional standards include but are not limited to the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (AICPA) that pertain to leadership responsibilities for quality within the firm (the "tone at the top"); relevant ethical requirements (such as independence, integrity, and objectivity); acceptance and continuance of client relationships and specific engagements; human resources; engagement performance; and monitoring.

6. To plan a System Review, a peer reviewer obtains an understanding of (1) the firm's accounting and auditing practice, such as the industries of its clients, and (2) the design of the firm's system, including its policies and procedures and how the firm checks itself that it is complying with them. The reviewer assesses the risk levels implicit within different aspects of the firm's practice and its system. The reviewer obtains this understanding through inquiry of firm personnel and review of documentation on the system, such as firm manuals.
7. Based on the types of engagements firms perform, they may also have their practices reviewed or inspected on a periodic basis by regulatory or governmental entities, including but not limited to the Department of Health and Human Service, the Department of Labor, and the Public Company Accounting Oversight Board. The team captain obtains an understanding of those reviews or inspections, and he or she considers their impact on the nature and extent of the peer review procedures performed.
8. Based on the peer reviewer's planning procedures, the reviewer looks at a sample of the CPA firm's work, individually called engagements. The reviewer selects engagements for the period covered by the review from a cross section of the firm's practice with emphasis on higher risk engagements. The engagements selected include those performed under *Government Auditing Standards*, audits of employee benefit plans, audits of depository institutions (with assets of \$500 million or greater), and audits of carrying broker-dealers when applicable. The scope of a peer review only covers accounting and auditing engagements performed under U.S. professional standards; it does not include the firm's SEC issuer practice, nor does it include tax or consulting services. The reviewer will also look at administrative elements of the firm's practice to test the elements listed previously from the Statements on Quality Control Standards.
9. The reviewer examines engagement working paper files and reports, interviews selected firm personnel, reviews representations from the firm, and examines selected administrative and personnel files. The objectives of obtaining an understanding of the system and then testing the system forms the basis for the reviewer's conclusions in the peer review report.
10. When a CPA firm receives a report from the peer reviewer with a peer review rating of *pass*, the report means that the system is appropriately designed and being complied with by the CPA firm in all material respects. If a CPA firm receives a report with a peer review rating of *pass with deficiencies*, this means the system is designed and being complied with appropriately by the CPA firm in all material respects, except in certain situations that are explained in detail in the peer review report. When a firm receives a report with a peer review rating of *fail*, the peer reviewer has determined that the firm's system is not suitably designed or being complied with, and the reasons why are explained in detail in the report.
11. There are inherent limitations in the effectiveness of any system and, therefore, noncompliance with the system may occur and not be detected. A peer review is based on selective tests. It is directed at assessing whether the design of and compliance with the firm's system provides the firm with reasonable, not absolute, assurance of conforming to applicable professional standards. Consequently, it would not

necessarily detect all weaknesses in the system or all instances of non-compliance with it. It does not provide assurance with respect to any individual engagement conducted by the firm or that none of the financial statements audited by the firm should be restated. Projection of any evaluation of a system to future periods is subject to the risk that the system may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

### Engagement Reviews

12. An Engagement Review is a type of peer review that is a study and appraisal by an independent evaluator(s), known as a peer reviewer, of a sample of a CPA firm's actual accounting work, including accounting reports issued and documentation prepared by the CPA firm, as well as other procedures that the firm performed.
13. By definition, CPA firms undergoing Engagement Reviews do not perform audits or other similar engagements but do perform other accounting work including reviews and compilations, which are a lower level of service than audits. The peer reviewer's objective is to evaluate whether the CPA firm's reports are issued and procedures performed appropriately in accordance with applicable professional standards. Therefore, the objective of an Engagement Review is different from the objectives of a System Review, which is more system oriented and involves determining whether the system is designed in conformity with applicable professional standards and whether the firm is complying with its system appropriately.
14. Professional standards represent literature, issued by various organizations, that contain the framework and rules that a CPA firm is expected to follow when performing accounting work.
15. The reviewer looks at a sample of the CPA firm's work, individually called engagements. The scope of an Engagement Review only covers accounting engagements; it does not include tax or consulting services. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations from the firm and, except for certain compilation engagements, the documentation required by applicable professional standards.
16. When the CPA firm receives a report with a peer review rating of *pass*, the peer reviewer has concluded that nothing came to his or her attention that the CPA firm's work was not performed and reported on in conformity with applicable professional standards in all material respects. A report with a peer review rating of *pass with deficiencies* is issued when the reviewer concludes that nothing came to his or her attention that the work was not performed and reported on in conformity with applicable professional standards in all material respects, except in certain situations that are explained in detail in the report. A report with a peer review rating of *fail* is issued when the reviewer concludes that as a result of the situations described in the report, the work was not performed and/or reported on in conformity with applicable professional standards in all material respects.
17. An Engagement Review does not provide the reviewer with a basis for expressing any assurance as to the firm's system of quality control for

its accounting practice, and no opinion or any form of assurance is expressed on that system.

### Quality Control Materials Reviews

18. An organization (hereinafter referred to as provider) may sell or otherwise distribute quality control materials (QCM or materials) that it has developed to CPA firms (hereinafter referred to as user firms). QCM may be all or part of a user firm's documentation of its system of quality control, and it may include manuals, guides, programs, checklists, practice aids (forms and questionnaires) and similar materials intended for use in conjunction with a user firm's accounting and auditing practice. User firms rely on QCM to assist them in performing and reporting in conformity with the professional standards covered by the materials (as described in the preceding paragraphs).
19. A QCM review is a study and appraisal by an independent evaluator (known as a QCM reviewer) of a provider's materials, as well as the provider's system of quality control to develop and maintain the materials (hereinafter referred to as provider's system). The QCM reviewer's objective is to determine whether the provider's system is designed and complied with and whether the materials produced by the provider are appropriate so that user firms can rely on the materials. The scope of a QCM review only covers materials related to accounting and auditing engagements under U.S. professional standards. The scope does not include SEC or PCAOB guidance, nor does it cover materials for tax or consulting services.
20. To plan a QCM review, a QCM reviewer obtains an understanding of (1) the provider's QCM, including the industries and professional standards that they cover, and (2) the design of the provider's system, including the provider's policies and procedures and how it ensures that they are being complied with. The QCM reviewer assesses the risk levels implicit within different aspects of the provider's system and materials. The QCM reviewer obtains this understanding through inquiry of provider personnel, review of documentation on the provider's system, and review of the materials.
21. Based on the planning procedures, the QCM reviewer looks at the provider's QCM, including the instructions, guidance, and methodology therein. The scope of a QCM review encompasses those materials which the provider elects to include in the QCM review report; QCM designed to aid user firms with tax or other non-attest services are outside of the scope of this type of review. The QCM reviewer will also look at the provider's system and will test elements including, but not limited to, requirements regarding the qualifications of authors and developers, procedures for ensuring that the QCM are current, procedures for reviewing the technical accuracy of the materials, and procedures for soliciting feedback from users. The extent of a provider's policies and procedures and the manner in which they are implemented will depend upon a variety of factors, such as the size and organizational structure of the provider and the nature of the materials provided to users. Variance in individual performance and professional interpretation affects the degree of compliance with prescribed quality control policies and procedures. Therefore, adherence to all policies and procedures in every case may not be possible. The objectives of obtaining an understanding of the provider's system and the materials forms the basis for the QCM reviewer's conclusions in the QCM review report.



22. When a provider receives a QCM review report from an approved QCM reviewer with a review rating of *pass*, this means the provider's system is designed and being complied with and the materials produced by the provider are appropriate so that user firms can rely on the QCM to assist them in performing and reporting in conformity with the professional standards covered by the materials. If a provider receives a QCM review report with a review rating of *pass with deficiencies*, this means the provider's system is designed and being complied with and the materials produced by the provider are appropriate so that user firms can rely on the QCM to assist them in performing and reporting in conformity with the professional standards covered by the materials, except in certain situations that are explained in detail in the review report. When a provider receives a report with a review rating of *fail*, the QCM reviewer has determined that the provider's system is not suitably designed or being complied and the materials produced by the provider are not appropriate, and the reasons why are explained in detail in the report.
23. There are inherent limitations in the effectiveness of any system and, therefore, noncompliance with the system may occur and not be detected. A QCM review is based on the review of the provider's system and its materials. It is directed at assessing whether the provider's system is designed and complied with and whether the QCM produced by the provider are appropriate so that user firms have reasonable, not absolute, assurance that they can rely on the materials to assist them in performing and reporting in conformity with the professional standards covered by the materials. Consequently, a QCM review would not necessarily detect all weaknesses in the provider's system, all instances of noncompliance with it, or all aspects of the materials that should not be relied upon. Projection of any evaluation of a system or the materials to future periods is subject to the risk that the system or materials may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

## Appendix B

### Considerations and Illustrations of Firm Representations

1. The team captain or review captain obtains written representations from management of the reviewed firm to describe matters significant to the peer review in order to assist in the planning and performance of and the reporting on the peer review. In connection with System and Engagement Reviews, specific representations should relate to the following matters, although the firm is not prohibited from making additional representations, and the firm may tailor the representation letter as it deems appropriate, as long as the minimum applicable representations are made to the team captain or review captain (see interpretations):
  - a. Situations or a summary of situations where management is aware that the firm or its personnel has not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies (including applicable firm and individual licensing requirements in each state in which it practices for the year under review) and, if applicable, how the firm has or is addressing and rectifying situations of noncompliance (see interpretations).
  - b. Communications or summary of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within the three years preceding the firm's current peer review year-end and through the date of the exit conference. The information should be obtained in sufficient detail to consider its effect on the scope of the peer review (see interpretations). In addition, the reviewer may inquire if there are any other issues that may affect the firm's practice.
  - c. Restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.
  - d. Completeness and availability of the engagements with periods ending during the year under review. For engagements performed under the Statements on Standards for Attestation Engagements, including financial forecasts and projections, this includes those with report dates during the year under review.
  - e. Discussions of significant issues from reports or communications, or both (see interpretations), from other practice monitoring or external inspection programs, such as the Public Company Accounting Oversight Board's (PCAOB's) (see interpretations), with the team captain.
  - f. Accepting responsibility for understanding, tailoring, and augmenting the quality control materials that the firm develops or adopts for use in its accounting and auditing practice.

- g. Other representations obtained by the team captain or review captain will depend on the circumstances and nature of the peer review.
2. The written representations should be obtained for the entire firm and not for each individual engagement the firm performs. Firm management's refusal to furnish written representations to the team captain or review captain constitutes a failure to cooperate with the reviewer and thus the administering entity and with the AICPA Peer Review Board, and the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations).
3. On System Reviews, the written representations should be addressed to the team captain. Since the team captain is concerned with events occurring during the peer review period and through the date of his or her peer review report that may require an adjustment to the report or other peer review documents, the representations should be dated the same date as the peer review report. The written representations should be signed by those members of management whom the team captain believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control. Such members of management normally include the managing partner and partner or manager in charge of the firm's system of quality control. If a representation made by management is contradicted by other information obtained, the team captain should investigate the circumstances and consider the reliability of the representations made and any effect on the report.
4. On Engagement Reviews, the representations should be addressed to the review captain (for example, "To John Smith, CPA" or on committee-appointed review team reviews where appropriate, it may be addressed "To the Review Captain") and dated the same date that the firm submits the list of engagements to the reviewer or the administering entity. The written representations should be signed by those members of management whom the reviewer or the administering entity believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control (even though an Engagement Review). Such members of management normally include the managing partner and partner or manager in charge of the firm's system of quality control. If a representation made by management is contradicted by other information obtained, the reviewer should investigate the circumstances and consider the reliability of the representations made and any effect on the report.

**Illustration of a Representation Letter That has No Significant Matters to Report to the Team Captain or Review Captain**

(The firm may tailor the language in this illustration and may refer to attachments to the letter as long as adequate representations pertaining to the matters discussed above, as applicable, are included to the satisfaction of the team captain or review captain.)

October 31, 20XX

To the Team Captain or Review Captain

We are providing this letter in connection with the peer review of [*name of firm*] as of the date of this letter and for the year ended June 30, 20XX.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. We confirm, to the

best of our knowledge and belief, that there are no known situations in which [name of firm] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review. We have also provided a list of all engagements to the [team captain, review captain, or administering entity] with periods ending during the year under review. For attestation engagements, including financial forecasts or projections, the list included those engagements with report dates during the year under review. We have also provided the [team captain or review captain] with any other information requested, including communications by regulatory, monitoring, or enforcement bodies relating to allegations or investigations in the conduct of its accounting, audit, or attestation engagements performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. In addition, there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end. We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance which is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting and auditing practice in all material respects. We have also discussed the content of our PCAOB inspection report with the [team captain or review captain] (if applicable).

Sincerely,

[Signature(s)\*]

**Illustration of a Representation Letter That Has Been Tailored to Report to the Team Captain a Matter of Noncompliance With a Regulatory Requirement**

(The firm may tailor the language in this illustration and may refer to attachments to the letter as long as adequate representations pertaining to the matters discussed above, as applicable, are included to the satisfaction of the team captain or review captain.)

October 31, 20XX

To the Team Captain or Review Captain

We are providing this letter in connection with the peer review of [name of firm] as of the date of this letter and for the year ended June 30, 20XX.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. Other than the firm not having a practice unit license during the year under review in one state where the firm practices (which has been subsequently obtained), we confirm, to the best of our knowledge and belief, that there are no known situations in which [name of firm] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review. We have also provided a list of all engagements to the [team captain, review captain, or administering entity] with periods ending during the year under review. For attestation engagements, including financial forecasts or projections, the list included those engagements

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\* Members of management as noted in section 3 of appendix B, "Considerations and Illustrations of Firm Representations."

with report dates during the year under review. We have also provided the [team captain] with any other information requested, including communications by regulatory, monitoring, or enforcement bodies relating to allegations or investigations in the conduct of its accounting, audit, or attestation engagements performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. In addition, there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting within three years preceding the current peer review year-end. We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance which is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting and auditing practice in all material respects. We have also discussed the content of our Public Company Accounting Oversight Board inspection report with the team captain (if applicable).

Sincerely,

[Signature(s)\*]

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\* See footnote \* in this paragraph.

## Appendix C

### Illustration of a Report With a Peer Review Rating of *Pass* in a System Review

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.*]

#### System Review Report

October 31, 20XX

To the Partners of [*or other appropriate terminology*]

XYZ & Co.

and the Peer Review Committee of the [*insert the name of the applicable administering entity*]\*

We\*\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)## in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers.)†

In our opinion, the system of quality control for the accounting and auditing practice of XYZ & Co.## in effect for the year ended June 30, 20XX, has been

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\* The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the Partners of [*or appropriate terminology*] XYZ & Co. and the National Peer Review Committee.

\*\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

## The report of a firm who is required to be registered and inspected by the PCAOB and thus whose review is administered by the National Peer Review Committee should be tailored here to add "applicable to non-SEC issuers."

† If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal year, audits of carrying broker-dealers, or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency (ies)* or *fail*. XYZ & Co. has received a peer review rating of *pass*.

Smith, Jones and Associates

[*Name of team captain's firm*]

## Appendix D

### Illustration of a Report With a Peer Review Rating of *Pass* (With a Scope Limitation) in a System Review

#### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards) that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies)* or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *pass*.

*[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]*

#### System Review Report

October 31, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable administering entity]*\*

We\*\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)## in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

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\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.



As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers).<sup>†</sup>

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of its former partners who left the firm during the peer review year. Accordingly, we were unable to include in our engagement selection any of the divested engagements. That partner's responsibility was concentrated in the construction industry. The engagements excluded from our engagement selection process included audit engagements and comprised approximately 15 percent of the firm's audit and accounting practice during the peer review year.

In our opinion, except for any deficiencies or significant deficiencies that might have come to our attention had we been able to review divested engagements, as described above, the system of quality control for the accounting and auditing practice of XYZ & Co.<sup>##</sup> in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. XYZ & Co. has received a peer review rating of *pass (with a scope limitation)*.

Smith, Jones and Associates

[Name of team captain's firm]

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<sup>†</sup> See footnote <sup>†</sup> in paragraph .209.

<sup>##</sup> See footnote <sup>##</sup> in paragraph .209.

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## Appendix E

### Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.*]

#### System Review Report

August 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]\*

We\*\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)### in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers).†

We noted the following deficiencies during our review:

1. **Deficiency**—The firm's quality control policies and procedures do not provide its staff with a means of ensuring that all necessary procedures are performed on review and compilation engagements. As a result, the firm's review and compilation working papers did not include documentation of all procedures required by professional standards, in particular relating to accounts and notes payable. We were able to satisfy ourselves that, in each case, sufficient procedures had been performed, and the firm subsequently prepared the appropriate documentation.

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\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.

† See footnote † in paragraph .209.

Recommendation—The firm's quality control policies and procedures should be revised to ensure documentation of all procedures performed as required by professional standards. Although not required by professional standards, the firm should consider using the practice aids in the reference manuals available in the firm's library in order to accomplish this step.

2. Deficiency—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but the standards emphasize the importance of proper planning to the conduct of the engagement. We found several audits performed in which, as a result of a lack of involvement including timely supervision by the engagement partner in planning the audit, the work performed on contracts, contract provisions, and related receivables did not support the firm's opinion on the financial statements. The firm has subsequently performed the necessary additional procedures to provide a satisfactory basis for its opinion.

Recommendation—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit partner review of the preliminary audit plan and the audit program. The firm should ensure that this is addressed as part of its ongoing monitoring procedures.

3. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists appropriate to the industry of the engagement being performed be completed. Our review noted that these checklists were not being used on all audit engagements. As a result, on certain audit engagements in the construction industry, the financial statements were missing several significant disclosures specific to the industry as required by generally accepted accounting principles. The subject reports have been recalled, and the financial statements are being revised.

Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists that are appropriate to the industry of an engagement. The engagement partner should carefully review these checklists at the completion of an engagement to ensure that the appropriate checklists are utilized and to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, except for the deficiencies described above, the system of quality control for the accounting and auditing practice of XYZ & Co.## in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *pass with deficiencies*.

Smith, Jones and Associates

[Name of team captain's firm]

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## See footnote ## in paragraph .209.

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## Appendix F

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

*[Reviewed firm's letterhead]*

September 21, 20XX

*[Addressed to the peer review committee of the administering entity]*<sup>†††</sup>

Ladies and Gentlemen:

This letter represents our<sup>‡</sup> response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. The corrective actions discussed in this letter will be monitored to ensure that they are effectively implemented as part of our system of quality control.

- 1<sup>||</sup> The firm modified its quality control policies and procedures to require the use of practice aids to document procedures performed on review and compilation engagements, especially for accounts and notes payable. Partners were instructed to ensure that these aids were being utilized appropriately when reviewing engagements. This policy was discussed in a recent training session held in connection with a recent firm-wide staff meeting.
2. The firm also modified its quality control policies and procedures to place a greater emphasis on partner involvement in the planning stage of all audit engagements. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program.

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<sup>†††</sup> The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: To the National Peer Review Committee.

<sup>‡</sup> The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

<sup>||</sup> The numbering of responses, to coincide with the numbered comments in the report, is optional.

The importance of proper planning, including timely partner involvement, to quality work was emphasized in the training session referred to above.

3. In addition, at that training session, the importance of proper use of the firm's reporting and disclosure checklists appropriate to the industry of the engagement being performed was discussed. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on industry specific disclosure issues.

As mentioned above, these corrective actions will also be emphasized in our monitoring procedures and internal inspection.

We believe these actions are responsive to the findings of the review.

Sincerely,

*[Name of Firm]*<sup>#</sup>

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<sup>#</sup> Signed by an authorized partner of the firm.

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## Appendix G

### Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

#### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards) that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies)*, or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *pass with deficiencies*, where one of the deficiencies related to the circumstances of the scope limitation.

*[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]*

System Review Report

October 31, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable administering entity]*\*

We\*\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)## in effect for the year ended June 30, 20XX. Except as described below, our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in

\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.

conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers).<sup>†</sup>

In performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (Yellow Book). As a result, we were unable to review all of the types of engagements required to be selected by the standards established by the Peer Review Board of the AICPA. We noted the following deficiencies during our review:

1. **Deficiency**—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but the standards emphasize the importance of proper planning to the conduct of the engagement. We found several audits performed in which, as a result of a lack of involvement, including timely supervision by the engagement partner in planning the audit, the work performed on contracts, contract provisions, and related receivables did not support the firm's opinion on the financial statements. The firm has subsequently performed the necessary additional procedures to provide a satisfactory basis for its opinion.

**Recommendation**—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit partner review of the preliminary audit plan and the audit program. The firm should ensure that this is addressed as part of its ongoing monitoring procedures.

2. **Deficiency**—As noted above, in performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (Yellow Book). As a result, the firm was not in compliance with the Yellow Book peer review engagement selection requirements.

**Recommendation**—We recommend that the firm consider the importance of adhering to the Yellow Book requirements and the possible consequences of noncompliance.

In our opinion, except for the effects of the deficiency described above and any additional deficiencies or significant deficiencies that might have come to our attention had we been able to review the engagement as described above, the system of quality control for the accounting and auditing practice of XYZ & Co.<sup>##</sup> in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *pass with deficiencies (with a scope limitation)*.

Smith, Jones and Associates

[Name of team captain's firm]

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<sup>†</sup> See footnote † in paragraph .209.

<sup>##</sup> See footnote ## in paragraph .209.

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## Appendix H

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

[Reviewed firm's letterhead]

November 30, 20XX

[Addressed to the peer review committee of the administering entity]<sup>†††</sup>

Ladies and Gentlemen:

This letter represents our<sup>‡</sup> response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX.

- 1.<sup>||</sup> The firm also modified its quality control policies and procedures to place a greater emphasis on partner involvement in the planning stage of all audit engagements. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning, including timely partner involvement, to quality work was emphasized in a recent training session held in conjunction with a recent firm-wide staff meeting.
2. Due to circumstances that we deemed appropriate, we notified the peer reviewer that he would be unable to select our only audit subject to *Government Auditing Standards* in the peer review. This is the only governmental audit the firm has performed, so there were no previous audits for the reviewer to select. We suggested selecting an audit engagement in a different industry. We have considered the consequences of noncompliance related to this matter.

Sincerely,

[Name of Firm]<sup>#</sup>

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<sup>†††</sup> See footnote <sup>†††</sup> in paragraph .212.

<sup>‡</sup> See footnote <sup>‡</sup> in paragraph .212.

<sup>||</sup> See footnote <sup>||</sup> in paragraph .212.

<sup>#</sup> See footnote <sup>#</sup> in paragraph .212.



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## Appendix I

### Illustration of a Report With a Peer Review Rating of *Fail* in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]

#### System Review Report

October 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]<sup>\*</sup>

We<sup>\*\*</sup> have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)<sup>##</sup> in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers).<sup>†</sup>

We noted the following significant deficiencies<sup>\*\*\*</sup> during our review:

1. **Deficiency**—The firm's quality control policies and procedures do not require written audit programs as required by professional standards. As a result, we noted several instances in which audit procedures were not adequately performed and documented in the areas of investments and expenses. As a result, the audit work performed for several audits

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\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.

† See footnote † in paragraph .209.

\*\*\* When considered together, the deficiencies rise to the level of significant deficiencies.

did not support the opinion issued and was not performed in conformity with applicable professional standards. The firm has subsequently performed the omitted procedures to support the audit opinions.

Recommendation—The firm's quality control policies and procedures should require the use of audit programs on all audits. All audit programs should be retained with the engagement working papers.

2. Deficiency—The firm's quality control policies and procedures require consultation based upon the following factors: materiality, experience in a particular industry or functional area, and familiarity with the accounting principles or auditing requirements in a specialized area. We noted instances in which the firm did not consult during the year, either by use of the firm's technical reference material or by requesting assistance from outside the firm. As a result, financial statements on audits for development stage companies did not conform with applicable professional standards. The firm was not aware of the unique disclosure and statement presentations required until it was brought to its attention during the peer review. The firm intends to recall and reissue the financial statements and reports.

Recommendation—The firm should emphasize its consultation policies and procedures on those engagements that are new to the experience level of the firm's accounting and auditing personnel.

3. Deficiency—The firm's quality control policies and procedures do not provide its personnel with a means of ensuring that all necessary procedures are performed on Employee Retirement Income Security Act (ERISA) engagements. During our review, we noted that the firm failed to adequately perform, including appropriately documenting, procedures related to benefit payments on ERISA engagements. The firm has subsequently performed the testing and documented its procedures.

Recommendation—The firm should review and implement the requirements of specialized industries. This can be accomplished by the purchase and use of practice aids tailored to the industry.

4. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists be completed for all engagements. Our review noted that these checklists were not being used on all engagements. As a result, the reviewed financial statements in the construction industry were missing several significant disclosures as required by generally accepted accounting principles. The subject reports have been recalled, and the financial statements are being revised.

Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists specific to the industry of the engagement, when available. The engagement partner should carefully review these checklists at the completion of an engagement to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, as a result of the significant deficiencies described above, the system of quality control for the accounting and auditing practice of XYZ & Co.## in effect for the year ended June 30, 20XX, was not suitably designed

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## See footnote ## in paragraph .209.

or complied with to provide the firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *fail*.

Smith, Jones and Associates

[*Name of team captain's firm*]

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## Appendix J

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each of the significant deficiencies discussed in the report. If the reviewed firm disagrees with one or more of the significant deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

November 30, 20XX

*[Addressed to the peer review committee of the administering entity]*<sup>†††</sup>

Ladies and Gentlemen:

This letter represents our<sup>‡</sup> response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. All issues have been brought to the attention of personnel at a meeting held on November 22, 20XX. In addition, steps have been added to our monitoring procedures to review the deficiencies noted in the report so that they will not happen again.

- 1<sup>||</sup> Several of the deficiencies noted by the review team included missing or incomplete audit and review documentation. All individuals with responsibility for managing audit and accounting engagements have been reminded of their responsibility to ensure the applicable professional standards for performing and documenting engagements are followed. In addition, we have implemented a concurring partner review on all audit and review engagements, and the quality of audit documentation will be a focus of the concurring partner's review.
2. The firm has contacted two other accounting firms with expertise in Employee Retirement Income Security Act (ERISA) audits, development stage companies, and other industries that are similar to ours. We have implemented a plan for consultation with these firms for guidance in situations with which we are unfamiliar.
3. We have purchased practice aids that are specific to the industries of our clients and have instructed staff and partners on their use.
4. At the staff meeting mentioned above, the importance of proper use of the firm's reporting and disclosure checklist was discussed, including

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<sup>†††</sup> See footnote <sup>†††</sup> in paragraph .212.

<sup>‡</sup> See footnote <sup>‡</sup> in paragraph .212.

<sup>||</sup> See footnote <sup>||</sup> in paragraph .212.

the use of checklists for specialized industries. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on disclosure issues.

The firm is committed to strengthening its monitoring policies and procedures, especially as they relate to a timely postissuance review of engagements. We have acquired quality control materials to guide the firm, and supervision of the monitoring process has been assigned to a partner. Additionally, outside assistance (as mentioned above) has been sought, and this individual will be available for consultation and guidance.

Sincerely,

*[Name of Firm]*<sup>#</sup>

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<sup>#</sup> See footnote # in paragraph .212.

## Appendix K

### Illustration of a Report With a Peer Review Rating of *Fail* (With a Scope Limitation) in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

#### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards) that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there is not an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies)*, or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *fail*.

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]

#### System Review Report

October 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]\*

We\*\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)## in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility

\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.

is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers).<sup>†</sup>

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of the firm's four offices that divested from the firm during the peer review year. As a result, we were unable to include within our engagement selection any engagements issued by that office. The engagements excluded from our engagement selection process included audit engagements and composed approximately 20 percent of the firm's audit and accounting hours during the peer review year.

In addition, we noted the following significant deficiencies<sup>\*\*\*</sup> during our review:

1. **Deficiency**—The firm's quality control policies and procedures do not require written audit programs as required by professional standards. As a result, we noted several instances in which audit procedures were not adequately performed and documented in the areas of investments and expenses. As a result, the audit work performed for several audits did not support the opinion issued and was not performed in conformity with applicable professional standards. The firm has subsequently performed the omitted procedures to support the audit opinions.

**Recommendation**—The firm's quality control policies and procedures should require the use of audit programs on all audits. All audit programs should be retained with the engagement working papers.

2. **Deficiency**—The firm's quality control policies and procedures require consultation based upon the following factors: materiality, experience in a particular industry or functional area, and familiarity with the accounting principles or auditing requirements in a specialized area. We noted instances in which the firm did not consult during the year, either by use of the firm's technical reference material or by requesting assistance from outside the firm. As a result, financial statements on audits for development stage companies did not conform with applicable professional standards. The firm was not aware of the unique disclosure and statement presentations required until it was brought to its attention during the peer review. The firm intends to recall and reissue the financial statements and reports.

**Recommendation**—The firm should emphasize its consultation policies and procedures on those engagements that are new to the experience level of the firm's accounting and auditing personnel.

3. **Deficiency**—The firm's quality control policies and procedures do not provide its personnel with a means of ensuring that all necessary procedures are performed on Employee Retirement Income Security Act (ERISA) engagements. During our review, we noted that the firm failed to adequately perform, including appropriately documenting, procedures related to benefit payments on ERISA engagements. The firm has subsequently performed the testing and documented its procedures.

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<sup>†</sup> See footnote <sup>†</sup> in paragraph .209.

<sup>\*\*\*</sup> See footnote <sup>\*\*\*</sup> in paragraph .215.

Recommendation—The firm should review and implement the requirements of specialized industries. This can be accomplished by the purchase and use of practice aids tailored to the industry.

4. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists be completed for all engagements. Our review noted that these checklists were not being used on all engagements. As a result, the reviewed financial statements in the construction industry were missing several significant disclosures as required by generally accepted accounting principles. The subject reports have been recalled and the financial statements are being revised.

Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists specific to the industry of the engagement, when available. The engagement partner should carefully review these checklists at the completion of an engagement to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, as a result of the significant deficiencies described above, and any additional significant deficiencies that might have come to our attention had we been able to review engagements from the divested office as described above, the system of quality control for the accounting and auditing practice of XYZ & Co.## in effect for the year ended June 30, 20XX was not suitably designed or complied with to provide the firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *fail (with a scope limitation)*.

Smith, Jones and Associates

[Name of team captain's firm]

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## See footnote ## in paragraph .209.



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## Appendix L

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions, to prevent a recurrence of each of the significant deficiencies discussed in the report. If the reviewed firm disagrees with one or more of the significant deficiencies, or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

November 30, 20XX

*[Addressed to the peer review committee of the administering entity]*<sup>†††</sup>

Ladies and Gentlemen:

This letter represents our<sup>‡</sup> response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. All issues have been brought to the attention of the personnel at a meeting held on November 22, 20XX. In addition, steps have been added to our monitoring procedures to review the deficiencies noted in the report so that they will not happen again.

We notified our peer reviewer that he would be unable to review the engagements performed by one of our firm's four offices that divested from our firm during the peer review year. We have considered the consequences of this scope limitation on the results of our peer review.

- 1.<sup>||</sup> Several of the deficiencies noted by the review team included missing or incomplete audit and review documentation. All individuals with responsibility for managing audit and accounting engagements have been reminded of their responsibility to ensure the applicable professional standards for performing and documenting engagements are followed. In addition, we have implemented a concurring partner review on all audit and review engagements, and the quality of audit documentation will be a focus of the concurring partner's review.
2. The firm has contacted two other accounting firms with expertise in Employee Retirement Income Security Act (ERISA) audits, development stage companies, and other industries that are similar to ours. We have

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<sup>†††</sup> See footnote <sup>†††</sup> in paragraph .212.

<sup>‡</sup> See footnote <sup>‡</sup> in paragraph .212.

<sup>||</sup> See footnote <sup>||</sup> in paragraph .212.

implemented a plan for consultation with these firms for guidance in situations with which we are unfamiliar.

3. We have purchased practice aids that are specific to the industries of our clients and have instructed staff and partners on their use.
4. At the staff meeting mentioned above, the importance of proper use of the firm's reporting and disclosure checklist was discussed, including the use of checklists for specialized industries. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on disclosure issues.

The firm is committed to strengthening its monitoring policies and procedures, especially as they relate to a timely postissuance review of engagements. We have acquired quality control materials to guide the firm, and supervision of the monitoring process has been assigned to a partner. Additionally, outside assistance (as mentioned above) has been sought, and this individual will be available for consultation and guidance.

Sincerely,

[Name of Firm]<sup>#</sup>

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<sup>#</sup> See footnote # in paragraph .212.

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## Appendix M

### Illustration of a Report With a Peer Review Rating of *Pass* in an Engagement Review

In the event of a scope limitation, include an additional paragraph (as described in paragraph .122j of the standards), and follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

*[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team]*

#### Engagement Review Report

September 30, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable administering entity]*\*

We\*\* have reviewed selected accounting engagements of XYZ & Co. (the firm)## issued with periods ending during the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

Based on our review, nothing came to our attention that caused us to believe that the engagements submitted for review by XYZ & Co.## issued with periods ending during the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *pass*.

Smith, Jones and Associates

*[Name of review captain's firm on firm-on-firm review or association formed review team]*

*[or]*

John Brown, Review Captain

*[Committee-appointed review team review]*

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\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.

## Appendix N

### Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review

This illustration assumes either the review captain concludes that deficiencies are not evident on all of the engagements submitted for review or that the exact same deficiency occurs on each of the engagements submitted for review and no other deficiencies exist. Otherwise, this firm would have received a peer review rating of *fail*.

In the event of a scope limitation, include an additional paragraph (as described in paragraph .122j of the standards), and follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

*[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team]*

Engagement Review Report

September 30, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable administering entity]*\*

We\*\* have reviewed selected accounting engagements of XYZ & Co. (the firm)## issued with periods ending during the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following deficiencies†† during our review:

1. Deficiency—On one review engagement of a manufacturing client, we noted that the accompanying accountant's report was not appropriately modified. The financial statements did not appropriately present or disclose matters in accordance with industry standards. The firm discussed

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\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.

†† The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

the departure with the client and decided to recall its report and restate the accompanying financial statements in order to report in conformity with applicable professional standards in all material respects.

Recommendation—We recommend that the firm establish a means of ensuring that financial statements present or disclose matters in accordance with industry standards. Such means might include continuing professional education in the industries of the firm's engagements and, although not required by professional standards, use of a comprehensive reporting and disclosure checklist on accounting engagements that is tailored for specialized industries, where applicable, or a cold review of reports and financial statements prior to issuance.

2. Deficiency—On a review engagement we reviewed, we noted that the firm failed to obtain a management representation letter, and its working papers failed to document the matters covered in the accountant's inquiry and analytical procedures. These deficiencies were identified on the firm's previous review.

Recommendation—The firm should review and implement the requirements for obtaining management representation letters and the content of the accountant's working papers on review engagements.

Based on our review, except for the deficiencies described above, nothing came to our attention that caused us to believe that the engagements submitted for review by XYZ & Co.<sup>##</sup> issued with periods ending during the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass with deficiencies*.

Smith, Jones and Associates

*[Name of review captain's firm on firm-on-firm review or association formed review team]*

*[or]*

John Brown, Review Captain

*[Committee-appointed review team review]*

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<sup>##</sup> See footnote ## in paragraph .209.

## Appendix O

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions to prevent the recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance in the matter. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For additional guidance on disagreements, see .116 of standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the reviewer for review and comment prior to the firm submitting the response to the administering entity.

October 31, 20XX

*[Addressed to the peer review committee of the administering entity]*<sup>†††</sup>

Ladies and Gentlemen:

This letter represents our<sup>‡</sup> response to the report on the Engagement Review of our firm's accounting practice for engagements submitted for review with periods ending during the year ended June 30, 20XX.

- 1.<sup>||</sup> As recommended by the reviewer, the entire staff has participated in continuing professional education related to reporting and disclosures, with a particular focus on areas specific to the industries that we are engaged in. We will be performing a preissuance review by a partner not associated with the engagement to make sure that the accountant's report is appropriately modified when the financial statements depart from applicable professional standards.
2. Management representation letters will be obtained for all future review engagements issued by the firm. The firm has required that a manager review each engagement to ensure that the management representation letter is obtained and that all the required documentation, including the matters covered in the accountant's inquiry and analytical procedures, is included in the working papers.

We believe these actions address the matters noted by the reviewer.

Sincerely,

*[Name of firm]*<sup>#</sup>

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<sup>†††</sup> See footnote <sup>†††</sup> in paragraph .212.

<sup>‡</sup> See footnote <sup>‡</sup> in paragraph .212.

<sup>||</sup> See footnote <sup>||</sup> in paragraph .212.

<sup>#</sup> See footnote <sup>#</sup> in paragraph .212.

.222

## Appendix P

### Illustration of a Report With a Peer Review Rating of *Fail* in an Engagement Review

The deficiencies in this illustration represent various examples and are not intended to suggest that the peer review would include this many engagements in the scope or require this number of deficiencies to warrant a report with a peer review rating of *fail*. However, each of the engagements reviewed would have one or more deficiencies in a report with a peer review rating of *fail*.

In the event of a scope limitation, include an additional paragraph (as described in paragraph .122j of the standards), and follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

*[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team]*

#### Engagement Review Report

September 30, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable Administering Entity]*\*

We\*\* have reviewed selected accounting engagements of XYZ & Co. (the firm)## issued with periods ending during the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following significant deficiencies†† during our review:

1. **Deficiency**—Our review disclosed several failures to adhere to applicable professional standards in reporting on material departures from generally accepted accounting principles (GAAP) and in conforming to standards for accounting and review services. Specifically, the firm did

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\* See footnote \* in paragraph .209.

\*\* See footnote \*\* in paragraph .209.

## See footnote ## in paragraph .209.

†† See footnote †† in paragraph .220.

not disclose in certain compilation and review reports failures to conform with GAAP in accounting for leases, in accounting for revenue from construction contracts, and in disclosures made in the financial statements or the notes thereto concerning various matters important to an understanding of those statements. The compilation and review engagements were in the construction and manufacturing industries, respectively. In addition, the firm did not obtain management representation letters on review engagements.

Recommendation—We recommend the firm establish a means of ensuring its conformity with applicable professional standards. In addition, we recommend the firm review and implement the requirements for obtaining management representation letters on review engagements. The firm should either participate in continuing professional education in financial statement disclosures, use a reporting and disclosure checklist on accounting engagements (tailored if the financial statements are in a specialized industry), or conduct a preissuance review of the engagement by an individual not associated with the engagement prior to issuance.

2. Deficiency—During our review, we noted the firm did not modify its compilation reports on financial statements when neither the financial statements nor the footnotes noted that the statements were presented on a comprehensive basis of accounting other than generally accepted accounting principles. This deficiency was noted in the firm's previous peer reviews.

Recommendation—We recommend that the firm review the reports issued during the last year and identify those reports that should have been modified to reflect a comprehensive basis of accounting other than generally accepted accounting principles. A memorandum should then be prepared highlighting the changes to be made in the current year and placed in the files of the client for whom a report must be changed.

3. Deficiency—In the construction industry compilation engagements that we reviewed, disclosures of material lease obligations as required by generally accepted accounting principles were not included in the financial statements, and the omissions were not disclosed in the accountant's reports.

Recommendation—We recommend the firm review and disseminate information regarding the disclosure requirements on specialized industries to all staff involved in reviewing or compiling financial statements. In addition, we recommend that the firm establish appropriate policies to ensure that all lease obligations are disclosed in financial statements reported on by the firm. For example, a step might be added to compilation and review work programs requiring that special attention be given to these areas.

4. Deficiency—During our review of the financial statements for a compilation engagement prepared under Statement on Standards for Accounting and Review Services No. 8, for management use only, we noted that the engagement letter did not include all of the information required by applicable professional standards.

Recommendation—The firm should review the professional standards governing the information to be included in engagement letters for financial statements prepared for management use only and make sure it conforms to those standards.



As a result of the deficiencies described above, we believe that the engagements submitted for review by XYZ & Co.## issued with periods ending during the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *fail*.

Smith, Jones and Associates

*[Name of review captain's firm on firm-on-firm review or association formed review team]*

*[or]*

John Brown, Review Captain

*[Committee-appointed review team review]*

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## See footnote ## in paragraph .209.

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## Appendix Q

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in an Engagement Review

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions to prevent the recurrence of each of the significant deficiencies. If the reviewed firm disagrees with one or more of the significant deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For additional guidance on disagreements, see paragraph .116 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the reviewer for review and comment prior to the firm submitting the response to the administering entity.

October 31, 20XX

*[Addressed to the peer review committee of the administering entity]*<sup>†††</sup>

Ladies and Gentlemen:

This letter represents our<sup>‡</sup> response to the report on the Engagement Review of our firm's accounting practice for engagements submitted for review with periods ending during the year ended June 30, 20XX.

|| To prevent the recurrence of the deficiencies noted by the reviewer and to prevent other such deficiencies from occurring, we will review the professional standards related to the deficiencies and ensure that the professional standards will be complied with on all future engagements.

Specifically, we have strengthened the engagement review to ensure that management representation letters are obtained for all review engagements performed by the firm.

All personnel who work on accounting engagements will be participating in continuing professional education in disclosures and reporting by December 31, 20XX, to address the disclosure and reporting deficiencies noted by the reviewer. In addition, we have started using a third-party reporting and disclosure checklist to ensure all reporting and disclosure matters are appropriately addressed. The reporting and disclosure checklist is tailored to specialized industries, where applicable.

The firm is now using third-party practice aids for guidance in compilations of financial statements for management use only, and this includes engagement letters that conform to professional standards to document the client's

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<sup>†††</sup> See footnote <sup>†††</sup> in paragraph .212.

<sup>‡</sup> See footnote <sup>‡</sup> in paragraph .212.

|| See footnote || in paragraph .212.

understanding with respect to these engagements. We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

*[Name of firm]*<sup>#</sup>

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<sup>#</sup> See footnote # in paragraph .212.

## Appendix R

### Illustration of a Report With a Review Rating of *Pass* in a Review of Quality Control Materials

Quality Control Materials Review Report

April 30, 20XX

Executive Board

XYZ Organization

and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the provider) and the resultant materials in effect at December 31, 20XX. Our quality control materials review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The provider is responsible for designing and complying with a system of quality control that provides reasonable assurance that the materials are reliable aids to assist users in conforming with the components which are integral to the professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system, the provider's compliance with that system, and the reliability of the resultant materials, based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

Users of the materials are responsible for implementing, tailoring, and augmenting the materials as appropriate. There may be important elements of a quality control system in accordance with the Statements on Quality Control Standards that are not included in the materials that have been subject to this review.

In our opinion, the system of quality control for the development and maintenance of the quality control materials of the XYZ Organization was suitably designed and was being complied with during the year ended December 31, 20XX, to provide users of the materials with reasonable assurance that the materials are reliable aids. Also, in our opinion, the quality control materials referred to above are reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at December 31, 20XX. Providers can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a review rating of *pass*.

ABC & Co. <sup>||||</sup>

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<sup>||||</sup> The report should be signed in the name of the team captain's firm for firm-on-firm reviews or association formed review teams.

## Appendix S

### Illustration of a Report With a Review Rating of *Pass With Deficiencies* in a Review of Quality Control Materials

Quality Control Materials Review Report

April 30, 20XX

Executive Board  
XYZ Organization  
and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the provider) and the resultant materials in effect at December 31, 20XX. Our quality control materials review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The provider is responsible for designing and complying with a system of quality control that provides reasonable assurance that the materials are reliable aids to assist users in conforming with the components which are integral to the professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system, the provider's compliance with that system, and the reliability of the resultant materials, based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following deficiencies<sup>††</sup> during our review:

1. **Deficiency**—The provider's policies and procedures for the development and maintenance of quality control materials state that feedback on the materials is obtained by means of a questionnaire provided with the materials. The provider's policies and procedures do not specify the procedures to be followed for reviewing and analyzing returned questionnaires. As a result, our review of the questionnaires received by the provider during the review period indicated that several questionnaires that had significant feedback as to the accuracy of the information of certain materials were not being read, summarized, or analyzed to determine whether the quality control materials require change. During our review we noted an error in the provider's interpretation of a recently issued professional standard in the *How To Perform Employee Benefit Plan Audits* manual. This error was also noted on several of the feedback questionnaires. However, the error was not of such significance that it affected the reliability of the aid. Our review did not note any similar issues in the other materials.

**Recommendation**—The provider should revise its policies and procedures to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials in order to determine whether the materials require change(s) to provide reasonable assurance that the materials are reliable aids. In addition, the provider

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<sup>††</sup> See footnote <sup>††</sup> in paragraph .220.

may wish to consider using external technical reviewers to confirm its understanding of new professional standards.

2. Deficiency—The organization's policies and procedures require that a technical review of all quality control materials be performed by a qualified person other than the developer to ensure that the materials are reliable aids to assist users in conforming to those professional standards the materials purport to encompass. During our review, we noted that such a technical review was performed on all of the materials we reviewed except for the current edition of the General Financial Statement Disclosure and Reporting checklist, Construction Contractor Disclosure checklist, and the Personal Financial Statements checklist, which had cold reviews performed by the developer. However, we were satisfied that the checklists are reliable aids.

Recommendation—The organization should remind its personnel of the importance of complying with its technical review policy. In addition, the organization may wish to implement other controls to ensure compliance with this policy.

In our opinion, except for the deficiencies described above, the system of quality control for the development and maintenance of the quality control materials of the XYZ Organization was suitably designed and was being complied with during the year ended December 31, 20XX, to provide users of the materials with reasonable assurance that the materials are reliable aids. Also, in our opinion, the quality control materials referred to above are reliable aids to assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at December 31, 20XX. Providers can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a review rating of *pass with deficiencies*.

ABC & Co.<sup>|||</sup>

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<sup>|||</sup> See footnote |||| in paragraph .224.

.226

## Appendix T

### Illustration of a Report With a Review Rating of *Fail* in a Review of Quality Control Materials

The deficiencies and related recommendations provided are examples for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *fail*.

Quality Control Materials Review Report

October 31, 20XX

Executive Board

XYZ Organization

and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the provider) and the resultant materials in effect at December 31, 20XX. Our quality control materials review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The provider is responsible for designing and complying with a system of quality control that provides reasonable assurance that the materials are reliable aids to assist users in conforming with the components which are integral to the professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system, the provider's compliance with that system, and the reliability of the resultant materials, based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following significant deficiencies<sup>\*\*\*</sup> during our review:

1. **Deficiency**—The organization's policies and procedures for the development and maintenance of quality control materials state that feedback on the materials is obtained by means of a questionnaire provided with the materials. The organization's policies and procedures do not specify the procedures to be followed for reviewing and analyzing returned questionnaires. As a result, our review of the questionnaires received by the organization during the review period indicated that several questionnaires that had significant feedback as to the accuracy of the information of certain materials were not being read, summarized, or analyzed to determine whether the quality control materials require change. During our review we noted errors in the provider's interpretation of recently issued professional standards in the *How To Perform Employee Benefit Plan Audits*, *How To Perform Audits of Small Businesses*, and *How To Perform Construction Contractor Reviews* manuals. The errors were identified on several of the feedback questionnaires. As a result, these specific materials were inaccurate and, thus, were not reliable aids.

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<sup>\*\*\*</sup> See footnote \*\*\* in paragraph .215.

Recommendation—The organization should revise its policies and procedures to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials in order to determine whether the materials require change(s) to provide reasonable assurance that the materials are reliable aids. In addition, the provider may wish to consider using external technical reviewers to confirm its understanding of new professional standards.

2. Deficiency—The organization's policies and procedures require that a technical review of all quality control materials be performed by a qualified person other than the developer to ensure that the materials are reliable aids to assist users in conforming to the professional standards the materials purport to encompass. During our review, we noted that such a technical review was not performed on the *How To Perform Single Audits* and *How To Perform HUD Audits* manuals. As a result, these materials were not up-to-date or were inaccurate, and thus were not reliable aids.

Recommendation—The organization should remind its personnel of the importance of complying with its technical review policy. In addition, the organization may wish to implement other controls to ensure compliance with this policy.

In our opinion, as a result of the deficiencies described above, the system of quality control for the development and maintenance of the quality control materials of XYZ Organization was not suitably designed and/or complied with during the year ended December 31, 20XX, to provide the users of the materials with reasonable assurance that the materials are reliable aids. Also, in our opinion, the quality control materials referred to above are not reliable aids and do not assist users in conforming with the components which are integral to the professional standards the materials purport to encompass at December 31, 20XX. Providers can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a review rating of *fail*.

ABC & Co.<sup>|||</sup>

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<sup>|||</sup> See footnote <sup>|||</sup> in paragraph .224.



## AICPA Peer Review Board (2010)

Daniel J. Hevia, <i>Chair</i> **	Clayton Lynn Hold
Tracey C. Golden, <i>Vice Chair</i> *	James N. Kennedy
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Scott W. Frew	Robert Rohweder
G. William Graham**	Michael Solakian**
Jerry W. Hensley	Randy Watson

\* *Chair of Standards Task Force*

\*\* *Member of Standards Task Force*

## Joint Peer Review Task Force (JPRTF) and Subtaskforces 2004–2006

Edward F. Rockman, <i>Chair</i>	G. Alan Long
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## Additional JPRTF Subtaskforce Members 2005–2006

John Compton	John Gribble
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## PR Section 9100

# ***Standards for Performing and Reporting on Peer Reviews: Interpretations of Section 100***

[Originally issued March 2008; revised December 2008, revised December 2009; revised December 2011; revised January 2013.]

### **NOTICE TO READERS**

Interpretations of the AICPA *Standards for Performing and Reporting on Peer Reviews* (section 100) are developed in open meetings by the AICPA Peer Review Board for peer reviews of firms enrolled in the AICPA Peer Review Program. Interpretations need not be exposed for comment and are not the subject of public hearings. These interpretations are applicable to firms (and individuals) enrolled in the program; individuals and firms who perform and report on peer reviews; entities approved to administer the peer reviews; associations of CPA firms, whose members are also AICPA members, authorized by the board to assist its members in forming review teams; and AICPA program staff. Interpretations are effective upon issuance unless otherwise indicated.

The prefix of each interpretation refers first to the paragraph number in the standards and second to the number of the interpretation relating to that paragraph. For example, Interpretation No. 5-3 would be the third interpretation of paragraph .05 of the standards. Not every paragraph of the standards has an interpretation, and thus there could be gaps in the numbering sequence of the interpretations. If more than one paragraph of the standards refers to a particular interpretation, then the interpretation's prefix will refer to the first instance in the standards, and the interpretation would note what other paragraphs refer to the interpretation. Interpretations have been grouped by topic for reference purposes. For example, there are paragraph Interpretation Nos. 3-1 and 3-2 under the interpretation related to "Individual Enrollment in the Program."

To the extent that new interpretations are added before the next version of the standards is issued, an interpretation may not be referred to in the standards with the phrase (see interpretations).

**(Issued Through October 31, 2009)**

## **Use of the Standards**

**1-1 Question**—Paragraph .01 of the standards discusses that the standards are provided for those enrolled in the program. Who else may use these standards and who determines who enrolls in the program?

**Interpretation**—Although the standards are currently intended for AICPA members and their firms, state CPA societies, or other organizations that are approved by the AICPA Peer Review Board (board) to administer the program,

AICPA members may also use these standards, as applicable,<sup>1</sup> in administering peer reviews of non-AICPA firms (and individuals).

The board determines who is eligible for enrollment in the program.

There are professional organizations with peer review programs to assist government audit organizations in meeting their *Government Auditing Standards* peer review requirements. For example, the President's Council on Integrity and Efficiency (PCIE) peer review program arranges reviews for the Federal Inspector General; the National Association of State Auditors, Comptrollers and Treasurers (NASACT) program arranges reviews for state auditors; and the Association of Local Government Auditors (ALGA) program arranges reviews for local government auditors. Each of these programs have established their own set of standards for conducting peer reviews and should be contacted for additional information when a peer reviewer is considering performing a peer review for one of their members because these standards are not intended for those purposes.

**1-2 Question**—Who is currently eligible to enroll in the program?

*Interpretation*—CPA firms in which at least one partner is a member of the AICPA and, in certain circumstances, individual AICPA members may enroll.

**1-3 Question**—What other guidance is available to those who use the standards?

*Interpretation*—Users of the standards have a number of other sources of guidance they can refer to, depending on their role in the program. The standards are principles based and form the foundation for more detailed guidance, encompassed in these interpretations, other guidance in the *AICPA Peer Review Program Manual* (including Supplemental Guidance and the Report Acceptance Manual), the Oversight Handbook, Administrative Manual, and Peer Review Alerts. There is no hierarchical structure to the standards, interpretations, and other guidance; guidance in each is equally significant. However, in the event of a conflict in interpreting and implementing these sources of guidance, the standards and interpretations take precedence.

Peer review course manuals, conference materials, and other miscellaneous items are also available for reference purposes.

**1-4 Question**—As discussed in Interpretation No. 1-1, although the standards are currently intended for AICPA members and their firms, state CPA societies or other organizations that are approved by the board to administer the program may also use the standards, as applicable, to administer peer reviews of non-AICPA firms. Does this include firms that are required to be registered with and inspected by the PCAOB, and/or firms that perform audits of non-SEC issuers pursuant to the standards of the PCAOB?

*Interpretation*—No, this does not include firms that are required to be registered with and inspected by the PCAOB, and/or firms that perform audits of non-Securities and Exchange Commission (SEC) issuers pursuant to the standards of the PCAOB. Under the standards, those firms are required to be administered by the board's National Peer Review Committee (National PRC), an administering entity of the program.

Although it is conceivable that a "peer review" for a non-AICPA firm with SEC clients could be administered by a state CPA society, the peer review report,

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<sup>1</sup> Although peer reviews performed under these circumstances are permissible, they are not currently considered as being performed under the auspices of the program, and such firms are not enrolled in the program because they are not subject to certain AICPA directed activities, including oversight and "fair procedures."

acceptance letter, and other related documents would have to clearly indicate that the peer review was not intended to meet the minimum requirements of or be in compliance with the standards. Since there is a public expectation that the peer review would comply with the minimum requirements and be in compliance, it would not be appropriate to issue peer review documents that imply that they do (when they do not).

Therefore, any firm undergoing a peer review intended to be in compliance with the standards must be enrolled in the program and its review must be administered by the National PRC if it is required to be registered with and inspected by the PCAOB, and/or performs audits of non-SEC issuers pursuant to the standards of the PCAOB. This would also require that at least one owner of the firm be a member of the AICPA.

## Individual Enrollment in the Program

**3-1 Question**—AICPA bylaws require individual CPAs (not the firm) to enroll in the program if they perform compilation services in firms or organizations not eligible to enroll in such a program. To reflect this requirement, paragraphs .03 and .05 of the standards refer to "firms and individuals in the program." What is meant by "firms or organizations not eligible to enroll," and can any AICPA member enroll in the program as an individual?

*Interpretation*—Under the AICPA Code of Professional Conduct ET appendix B, *Council Resolution Concerning Rule 505—Form of Organization and Name*, when the majority of the ownership of a firm, in terms of financial interests and voting rights, belongs to CPAs, it must enroll in the program. A firm or organization without CPA majority ownership (a non-CPA owned entity) would not be eligible to enroll in the program. The characteristics of such a firm are discussed in ET appendix B. Where the firm or organization is not eligible to enroll, such as due to a lack of majority ownership by CPAs, and where the individual AICPA member performs compilation services in the firm or organization, the AICPA member is required to enroll individually in the program. Only AICPA members meeting these criteria are able to enroll individually. Individual AICPA members who are only practicing with a firm that is eligible to enroll in the program may not enroll in the program individually.

**3-2 Question**—The standards, interpretations, and guidance materials for the program use the term *firm* throughout the materials. When an individual is appropriately enrolled in the program, how does the term *firm* apply to the enrolled individual, and are there any situations in which the standards, interpretations, or guidance materials are intended to be directed at the actual firm or organization that was not eligible to enroll?

*Interpretation*—As an alternative to rewriting all of the standards to reflect individual enrollment, the term *firm* as it appears in the standards should be applied to the enrolled individual and not the firm or organization in which the individual is practicing public accounting that was not eligible to enroll. Under the characteristics of a firm not eligible to enroll in the program, there must be a CPA who has ultimate responsibility for any financial statement compilation services; non-CPA owners cannot assume ultimate responsibility for any such services. In addition, any compilation report must be signed individually by a CPA and may not be signed in the name of the firm or organization.

**3-3 Question**—When performing the peer review of an enrolled individual in the program, what type of peer review would be required, what peer review materials would be used, and what changes would be necessary to the peer review report?

*Interpretation*—As with any peer review, the types of engagements performed dictate the type of peer review required. Because the enrolled individual could only be performing compilation services, this would only require an Engagement Review, although the individual could undergo a System Review. The current peer review materials can still be used as long as the peer reviewer indicates that the peer review was that of an enrolled individual and not of a firm or organization. Similarly, the report and, if applicable, the letter of response, as well as other peer review documents and correspondences, should be tailored so that it is very clear that only the individual is being peer reviewed and not the firm or organization.

**3-4 Question**—If an individual enrolled in the program receives a report with a peer review rating of *pass* (previously referred to as an unmodified report) on his or her Engagement Review and meets all other individual qualifications for service as a peer reviewer including independence considerations, can that individual perform peer reviews?

*Interpretation*—Yes. However, the individual alone would be the peer reviewer and not the firm or organization that was not eligible to enroll in the program. The peer reviewer should make this fact evident.

**3-5 Question**—As discussed in paragraph .144 of the standards, can a hearing panel decide to terminate an individual's enrollment in the program?

*Interpretation*—Yes. The fair procedures related to hearings and appeals to the AICPA Joint Trial Board for individuals enrolled in the program would parallel the process for enrolled firms, including publication of termination in such form and manner as the AICPA Council may prescribe. If a hearing panel decides to terminate an individual's enrollment in the program, that individual can appeal to the AICPA Joint Trial Board. When the fact that an individual's enrollment has been terminated is published, the name of the firm or organization that was not eligible to enroll in the program with which the individual was practicing is not published.

## Acquisitions and Divestitures and Their Effect on Peer Review Scope

**5c-1 Question**—Paragraph .05(c) of the standards requires that enrolled firms have independent peer reviews of their accounting and auditing practices. What is the effect on the scope of a firm's peer review when there has been an acquisition of another practice or portion thereof, or a divestiture of a significant portion of the firm's practice, during or subsequent to the firm's peer review year?

*Interpretation*—When a reviewed firm has had an acquisition of another practice or a portion thereof or a divestiture of a significant portion of its practice during or subsequent to its peer review year, the reviewer, the reviewed firm, or both, should consult with AICPA staff prior to the commencement of the review to consider the appropriate scope of the review or other actions that should be taken.

A divestiture of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance with the system of quality control for reports issued under the firm's name during that year. If the review team is able to review engagements of the divested portion of the reviewed firm's practice, then the review team should review such engagements considered necessary to obtain an appropriate scope for the peer review. In such circumstances, an appropriate scope is one where a reasonable cross section of the firm's practice

is covered and the review covers all partners and significant industry areas that existed before the divestiture. The review team should carefully assess the effects the divestiture has on the scope of the peer review. A team captain or review captain who is considering whether a peer review report should be issued with an additional paragraph for a scope limitation due to a divestiture should consult with the administering entity.

Illustrations of System Review reports with a peer review rating of *pass (with a scope limitation)*, *pass with deficiencies (with a scope limitation)*, and *fail (with a scope limitation)* are presented in appendix D, "Illustration of a Report With a Peer Review Rating of *Pass (With a Scope Limitation)* in a System Review"; appendix G, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review"; and appendix K, "Illustration of a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review." Additional paragraphs included for scope limitations for Engagement Review reports follow the illustrations for System Reviews with scope limitations.

## Resignations From and Reenrollment in the Program

**5g-1 Question**—Paragraph .05(g) of the standards discusses an enrolled firm's responsibility to understand the board's guidance on resignations from the program. Under what conditions may a firm resign from the program?

**Interpretation**—A firm whose peer review has not commenced may resign from the program by submitting a letter of resignation to the board. However, once a peer review commences, and until its completion (see Interpretation No. 25-2), a firm will not be able to resign from the program except as stated in the following paragraph. A peer review commences when the review team begins field work, ordinarily at the reviewed firm's office in a System Review, or begins the review of engagements in an Engagement Review. The submission by the firm of a request to resign from the program once its peer review has commenced but has not been completed is considered a failure to cooperate with the administering entity and may lead to the termination of the firm's enrollment in the program by a hearing panel of the board.

A firm will be permitted to resign once its peer review has commenced but has not been completed when the firm submits a letter pleading guilty, acknowledging its noncooperation with the program, waiving its right to a hearing, and agreeing to allow the AICPA to publish, in such form and manner as the AICPA Council may prescribe, the fact that the firm has resigned from the program before completion of its peer review, evidencing noncooperation with the program. In addition, if (a) the firm has been notified of the reviewer's or administering entity's intent to issue or require a report with a peer review rating of *pass with deficiencies* or *fail* (previously referred to as modified or adverse reports) or (b) the reviewer or administering entity has knowledge of the discovery of an engagement that was not conducted in accordance with professional standards on which the firm must take, or would likely be required to take, action in accordance with professional standards, then the fact that the situation in items (a) or (b) of the preceding existed would also be published.

If the firm does not sign the letter pleading guilty and waiving its right to a hearing, the firm will be referred to a Peer Review Board hearing panel. The panel will consider terminating the firm's enrollment due to noncooperation.

A firm that has been terminated from the program may reenroll in the program once it completes the delinquent action that caused the firm to be terminated. Similarly, a firm that has resigned by pleading guilty, or after the completion of its peer review but before the completion of its implementation plan, may

reenroll in the program once it completes the delinquent action. The administering entity and the board make the determination of whether the action is satisfactorily completed. If the firm is past its next peer review due date, the firm will be required to complete its subsequent peer review within 90 days of reenrolling.

## Cooperating in a Peer Review

**5h-1 Question**—Paragraph .05(h) of the standards notes that firms (and individuals) enrolled in the program have the responsibility to cooperate with the peer reviewer, administering entity, and the board in all matters related to the peer review that could impact the firm's enrollment in the program, including arranging, scheduling, and completing the review and taking remedial, corrective actions as needed (paragraph .143 of the standards). Under what circumstances will a firm (or individual) be not cooperating, and what actions can be taken by the board for noncooperation?

*Interpretation*—The board has issued a resolution regarding dropping a firm's enrollment from the program that is as follows:

### AICPA Peer Review Board Resolution

**(Adopted April 29, 1996 with amendments through January 1, 2009, and May 3, 2011)**

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required to have a peer review once every three years performed in conformity with the *AICPA Standards for Performing and Reporting on Peer Reviews*; and

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required under the *AICPA Standards for Performing and Reporting on Peer Reviews* to cooperate with the peer reviewer, administering entity and the AICPA Peer Review Board in all matters related to the review that could impact the firm's enrollment in the program;

NOW, THEREFORE, BE IT RESOLVED: A firm's enrollment in the AICPA Peer Review Program will be dropped by the AICPA Peer Review Board, without a hearing, thirty days after the AICPA Peer Review Program notifies the firm by certified mail that the firm has failed to:

- (1) Timely file requested information with the entity administering the firm's peer review concerning the arrangement or scheduling of that peer review, prior to the commencement of the peer review,
- (2) Timely submit requested information to the reviewer necessary to plan or perform the firm's peer review, prior to the commencement of the peer review,
- (3) Have a peer review by the required date,
- (4) Timely pay in full the fees and expenses of the review team formed by an administering entity, or
- (5) Timely pay fees related to the administration of the program that have been authorized by the governing body of an administering entity.

The AICPA Peer Review Board may at its discretion decide to hold a hearing. Whether a hearing is held or not, a firm enrolled in the AICPA Peer Review Program has the right to appeal to the AICPA Joint Trial Board within 30 calendar days of being notified that the firm's enrollment has been dropped.

*Interpretation*—The AICPA Peer Review Board has issued a resolution regarding terminating a firm's enrollment from the AICPA Peer Review Program that is as follows:



**AICPA Peer Review Board Resolution**

**(Adopted April 29, 1996 with amendments through January 1, 2009, May 3, 2011, and August 8, 2012)**

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required to have a peer review once every three years performed in conformity with the AICPA *Standards for Performing and Reporting on Peer Reviews*; and

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required under the AICPA *Standards for Performing and Reporting on Peer Reviews* to cooperate with the peer reviewer, administering entity and the AICPA Peer Review Board in all matters related to the review that could impact the firm's enrollment in the program;

NOW, THEREFORE, BE IT RESOLVED: A firm is deemed as failing to cooperate once the review has commenced by actions including but not limited to:

- Not responding to inquiries,
- Withholding information significant to the peer review, for instance but not limited to failing to discuss communications received by the reviewed firm relating to allegations or investigations in the conduct of accounting, auditing or attestation engagements from regulatory, monitoring or enforcement bodies,
- Not providing documentation including but not limited to the representation letter, quality control documents, engagement working papers, all aspects of functional areas,
- Not responding to MFCs or FFCs timely,
- Limiting access to offices, personnel or other,
- Not facilitating the arrangement for the exit conference on a timely basis,
- Failing to timely file the report and the response thereto related to its peer review, if applicable,
- Failing to cooperate during oversight, or
- Failing to timely acknowledge and complete required corrective actions or implementation plans.

The firm will be advised by certified mail that the AICPA Peer Review Board will appoint a hearing panel to consider whether the firm's enrollment in the AICPA Peer Review Program should be terminated. A firm enrolled in the AICPA Peer Review Program that has been notified that it is the subject of such a hearing may not resign until the matter causing the hearing has been resolved. After a hearing is held, a firm whose enrollment in the AICPA Peer Review Program has been terminated has the right to appeal the panel's decision to the AICPA Joint Trial Board within 30 calendar days of the hearing; and

BE IT FURTHER RESOLVED: That a firm's failure to cooperate with the administering entity would also include failing to receive a report with a rating of pass after (1) receiving at least two consecutive peer reviews prior to the third that had a report with a peer review rating of *pass with deficiencies* and/or *fail* (previously referred to as modified or adverse reports) AND (2) receiving notification via certified mail after the second consecutive report with a peer review rating of *pass with deficiencies* and/or *fail* (previously referred to as modified or adverse reports), that a third consecutive failure to receive a report with a peer review rating of pass (previously referred to as an unmodified report) may be considered a failure to cooperate with the administering entity. Report

Reviews<sup>2</sup> containing significant comments are considered equivalent to failing to receive a report with a peer review rating of pass (previously referred to as an unmodified report) for the purposes of this resolution.

**BE IT FURTHER RESOLVED:** The administering entity has the authority to determine if a firm's response is substantive. If the administering entity determines that a response is not substantive, and the firm does not revise its response or submits additional responses that are not substantive as determined by the administering entity, this would also be deemed as a firm's failure to cooperate.

**BE IT FURTHER RESOLVED:** The administering entity has the authority to determine if erroneously provided or omitted information by a firm discovered after acceptance of the firm's review that results in a significant change in the planning, performance, evaluation of results, or peer review report is a matter of non-cooperation. The firm's failure to provide substantive responses during the process of resolving such a matter may also be deemed as a firm's failure to cooperate.

**BE IT FURTHER RESOLVED:** That a firm's failure to cooperate with the administering entity would also include failing to timely notify the administering entity that it is performing a type of engagement(s) or engagement(s) in an industry in which the firm had previously represented by written communication to the administering entity that it was no longer performing and had no plans to perform, in response to a related corrective action or implementation plan wherein the corrective action or implementation plan was eliminated by the administering entity based on the representation.

**BE IT FURTHER RESOLVED:** A firm's enrollment in the AICPA Peer Review Program will be terminated for failure to cooperate in any of the preceding situations, without a hearing, upon receipt of a plea of guilty from the firm; and **BE IT FURTHER RESOLVED:** That pursuant to the AICPA *Standards for Performing and Reporting on Peer Reviews*, the fact that a firm's enrollment in the AICPA Peer Review Program has been terminated, whether with or without a hearing, will be published in such form and manner as the AICPA Council may prescribe.

## **Compilations Performed When the Compiled Financial Statements Are Not Expected to Be Used by a Third Party (Management Use Only), Where No Compilation Report Is Issued**

**6-1 Question**—Statement on Standards for Accounting and Review Services (SSARS) No. 19, *Compilation and Review Engagements*, includes compilations of financial statements where in very specific situations the accountant may document his or her understanding with the entity through the use of an engagement letter instead of issuing a compilation report. This approach is only available when the accountant submits unaudited financial statements to his or her client that are not expected to be used by a third party (in other words, compilation for management's use only). AICPA bylaws state that firms (or individuals in certain situations) are only required to enroll in the program if they perform services that are within the scope of the AICPA's practice-monitoring standards and issue reports purporting to be in accordance with AICPA *Professional Standards*. Therefore, for purposes of individual AICPA membership

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<sup>2</sup> Although standards no longer permit the performance of Report Reviews as of January 1, 2009, a firm's last peer review could have been a Report Review.

admission and retention, firms (or individuals) that only perform these types of compilations, where no report is issued and no other engagements within the scope of peer review as discussed in paragraph .06 of the standards, would not be required to enroll in the program. Would the compilations for management's use only be subject to peer review when the firm is already enrolled in the program because, for example, it performs services and issues reports on other engagements that are within the scope of the standards?

*Interpretation*—Yes. For firms enrolled in the program, compilations for management's use only would fall within the scope of peer review. The standards (and Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control* [QC sec. 10]) include, within the definition of an accounting and auditing practice, all engagements covered by SSARs except where SSARs provide an exemption from those standards.

**6-2 Question**—The current standards and guidance materials are written referring to *reports* throughout and do not consider an engagement performed when the compiled financial statements are not expected to be used by a third party (management use only) where a compilation report is not issued. What general guidance should be followed by peer reviewers?

*Interpretation*—For purposes of the program only, the required documentation of the understanding in the engagement letter should be treated as though it was a *report* (as reports are discussed and referred to in the standards). This documentation would not be considered a *report* for bylaw purposes.

**6-3 Question**—If a firm elects to enroll in the peer review program and its only level of service is performing compilations when the financial statements are not expected to be used by a third party (management use only) and when no report is issued, is the firm required to have a peer review?

*Interpretation*—No. A firm that elects to enroll in the peer review program, and its only level of service is performing management use only compilation engagements, is not required to have a peer review but may elect to do so. If a firm elects to undergo a peer review, the peer review is required to be performed under these standards.

**6-4 Question**—Specifically, what should the peer reviewer be reviewing on such an engagement in a System or Engagement Review?

*Interpretation*—AR section 80 requires the accountant to document the understanding of the engagement with the entity through the use of an engagement letter. The reviewer is to inquire about the engagement letter to determine that it documents that understanding. The reviewer should also review the financial statements to determine that the required restriction of their use is on each page. Except for the restriction of use, the reviewer should not be reviewing the financial statements, disclosures, or supplementary information for accuracy, appropriateness, or conformity with professional standards.

**6-5 Question**—Must a peer reviewer select such an engagement in a System or Engagement Review?

*Interpretation*—No. This engagement is not considered a different level of service. It is a compilation that either contains all disclosures required by generally accepted accounting principles (GAAP) or another comprehensive basis or the disclosures are omitted. The standards already discuss the engagement selection process for such engagements in an Engagement Review. In addition, a System Review requires the peer reviewer to use a risk-based approach when selecting engagements. Management use only financial statements do not change the existing engagement selection process.

**6-6 Question**—Should the standard language in the peer review report be tailored on a System or Engagement Review, if such engagement(s) are selected for review, to reflect the fact that these are compilations with documentation requirements and issued without a compilation report?

*Interpretation*—No.

## Engagements Performed and/or Reported Under International Standards

**6-7 Question**—Paragraph .06 of the standards provides the definition of an accounting and auditing practice for the purposes of these standards as all engagements covered by SASs, SSARS, SSAEs, Government Auditing Standards and audits of non-SEC issuers performed pursuant to PCAOB standards. What about International Standards on Auditing, Assurance Engagements and Related Services (ISAs), any other standards issued by the International Auditing and Assurance Standards Board (IAASB) or any other audit or assurance standards outside of the U.S. ("international standards")?

*Interpretation*—ET appendix A identifies the bodies recognized by AICPA Governing Council to set standards. The IASB (International Accounting Standards Board) which issues International Financial Reporting Standards (IFRS) is included (as is the FASB, FASAB and GASB). Although peer review standards do not refer to the accounting standard setters, this means that IFRS is within the scope of our peer review process.

However, the IAASB is not currently recognized by the AICPA (nor is the International Public Sector Accounting Standards Board), therefore compliance with ISAs issued by the IAASB, and any other audit or assurance standards outside of the U.S., is not included in the scope of peer review. Firms performing such engagements are required to follow certain US professional standards—see Interpretation No. 6-8.

**6-8 Question**—Is an *engagement* performed under the ISAs, any other standards issued by the IAASB or any other audit or assurance standards outside of the U.S. ("international standards") included in the scope of the peer review?

*Interpretation*—Yes, an engagement performed under international standards would be included in the scope of the peer review. Under U.S. professional standards, the engagement would comply with elements of both the international standards and U.S. professional standards. However, the peer reviewer should only test compliance with the U.S. professional standards described in paragraph .06 of the peer review standards, that is, SASs, SSARS, SSAEs, *Government Auditing Standards*, and auditing standards for non-SEC issuers performed pursuant to the standards of the PCAOB. Testing of compliance with any international standards is not included in the scope of the review.

The peer reviewer should inquire of the firm during planning about whether any engagements were performed under international standards. If yes, the peer reviewer should inquire if the firm understands professional guidance for reporting on statements for international use, specifically addressing the following issues:

- *For audit engagements.* AU-C section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*, indicates that if a U.S. auditor reports on U.S. entity financial statements that are used only outside of the United States, he or she should comply with generally accepted accounting standards (GAAS), except for requirements related to the

form and content of the report. He or she should determine whether the application of GAAS requires special consideration in the circumstances of the engagement. However, when the audited financial statements of the entity are intended for use in the United States, then all GAAS standards must be followed, including the reporting standards.

- *For review and compilation engagements.* Interpretation Nos. 13–15 of AR section 80, *Compilation of Financial Statements* (AR sec. 9080 par. .49–.60), and Interpretation Nos. 8–10 of AR section 90, *Review of Financial Statements* (AR sec. 9090 par. .29–.40), conformed for SSARS No. 19, *Compilation and Review Engagements*, provide paralleling guidance to AU-C section 910. Any distribution in the United States would lead to the requirement to follow SSARS No. 19 reporting standards.
- *For any other types of engagements.* If not directly addressed in the applicable professional standards, reference should be made to the SAS or SSARS guidance.

In all cases, the peer reviewer should conclude whether the firm's classification for an engagement's report of "distribution in the U.S.," "distribution only outside of the U.S.," or "limited distribution in the U.S." was appropriate and reasonable. Then, the peer reviewer should determine that the appropriate general, fieldwork, and reporting (if applicable) aspects of U.S. professional standards were followed. A misunderstanding of U.S. professional guidance for reporting on statements for international use increases the risk of an engagement not performed and reported on in accordance with professional standards (for instance, financial statements made available on the Web may not reasonably be considered "limited" distribution in the U.S.).

The peer reviewer should consult with AICPA program staff for further guidance, if necessary.

## Engagements Under Peer Review

**7-1 Question**—Paragraph .07 of the standards indicates that the *Standards* are not intended for and exclude the review of the firm's accounting and auditing practice applicable to SEC issuers. Firms that perform audits of employee benefit plans that are required to file a Form 11-K, must also comply with Generally Accepted Auditing Standards (GAAS) for ERISA/DOL reporting purposes by preparing a separate set of GAAS based financial statements. Since the firm must be registered with the PCAOB and perform the employee benefit plan audit in accordance with PCAOB standards, should the scope of the peer review include the review of the GAAS based financials for 11-K filers?

*Interpretation*—Since the engagement is already included under the scope of the PCAOB inspection process, and the PCAOB's requirements are more restrictive than GAAS requirements, it is not subject to peer review.

## Performing System Reviews at a Location Other Than the Reviewed Firm's Office

**8-1 Question**—Paragraph .08 of the standards states that the majority of the procedures in a System Review should be performed at the reviewed firm's office. What criteria have been established by the board for procedures to be performed at a location other than the reviewed firm's office?

*Interpretation*—If the review can reasonably be performed at the reviewed firm's office, it should be. Although certain planning procedures may be performed at the peer reviewer's office, it is expected that a majority of the peer review procedures, including the review of engagements, testing of functional areas, interviews, and concluding procedures should be performed at the reviewed firm's office.

However, it is recognized that there are some situations that make an on-site peer review cost prohibitive or extremely difficult to arrange, or both. In these situations, if the firm and reviewer mutually agree on the appropriateness and efficiency of an approach to the peer review such that it can be performed at a location other than the reviewed firm's office, then the reviewer can request the administering entity's approval to perform the review at a location other than the reviewed firm's office. This request should be made prior to the commencement of fieldwork, and the firm and reviewer should be prepared to respond to the administering entity's inquiries about various factors that could affect their determination. These factors, which are not mutually exclusive and will be considered judgmentally, include but are not limited to

- the availability of peer reviewers qualified to review the firm, including whether they have the experience in the industries and related levels of service for which the firm practices, whether they are independent of the firm and not, for instance, competitors within the same close geographic area, and whether the firm is reasonably accessible to those reviewers.
- whether the review conducted at the reviewer's office or another agreed-upon location can still achieve the objectives of a System Review.
- whether the results are expected to be the same as they would be if the peer review was performed at the reviewed firm's office.
- the size of the reviewed firm, including the number of personnel and where they perform their work (for instance, whether they work solely at clients' offices and the firm does not have its own office).
- the number of engagements covered by the Statements on Auditing Standards (SASs), *Government Auditing Standards*, examinations of prospective financial statements or examinations of a service organization's controls likely to be relevant to user entities' internal control over financial reporting under the Statements on Standards for Attestation Engagements (SSAEs), or audits of non-SEC issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB).
- the ability of the reviewed firm and the peer reviewer to hold one or more effective meetings by telephone to discuss the firm's responses to the quality control policies and procedures questionnaire and other practice aid questionnaires (including various interviews), Engagement Review results, the reviewer's conclusions on the peer review, and any recommended corrective actions.
- the prior peer review results of the firm, including whether the firm received a report with a peer review rating of *pass with deficiencies* or *fail* (formerly known as modified or adverse reports) on its last System or Engagement Review (or a report review with significant comments), or if it is the firm's first System Review.
- whether the firm is able to effectively comply with the reviewer's requests for materials to be sent to the reviewer prior to the review

(except as noted in the following list). Those requests should include, in addition to materials outlined in section 4100, *Instructions to Firms Having a System Review* (AICPA, *Peer Review Program Manual*), the following materials:

- a. All documentation related to the resolution of independence questions (1) identified during the year under review with respect to any audit or accounting client or (2) related to any of the audit or accounting clients selected for review, no matter when the question was identified if the matter still exists during the review period
- b. The most recent independence confirmations received from other firms of CPAs engaged to perform segments of engagements on which the firm acted as principal auditor or accountant
- c. The most recent representations received from the sole practitioner concerning his or her conformity with applicable independence requirements
- d. A written representation, dated the same as the peer review report, as described in paragraph .05(f) and appendix B of the standards
- e. Documentation, if any, of consultations with outside parties during the year under review in connection with audit or accounting services provided to any client
- f. A list of relevant technical publications used as research materials, as referred to in the quality control policies and procedures questionnaire
- g. A list of audit and accounting materials, if any, identified in response to the questions in the "Engagement Performance" section of the quality control policies and procedures questionnaire
- h. Continuing professional education (CPE) records sufficient to demonstrate compliance with state, AICPA, and other regulatory CPE requirements
- i. The relevant accounting and auditing documentation and reports on the engagements selected for review
- j. Documentation of the firm's monitoring results for each year since the last peer review or enrollment in the program
- k. Any other evidential matter requested by the reviewer

The reviewed firm should understand that in the event that matters are noted during the review of selected engagements, the scope of the review may have to be expanded before the review can be concluded.

## Peer Reviews To Be Administered by the National Peer Review Committee

**11-1 Question**—Paragraphs .11, .128, and .161 of the standards note that peer reviews intended to meet the requirements of the program should be carried out in conformity with the standards under the supervision of a state CPA society, group of state CPA societies, the National PRC or other entity (hereinafter, administering entity) approved by the board to administer peer reviews. Under what circumstances are peer reviews administered by the National PRC? What other criteria relate to the firms previously enrolled in the Center for Public Company Audit Firms Peer Review Program (CPCAF PRP) and to that program's peer reviewers?

*Interpretation*—Firms are required to have their review administered by the National PRC, if they meet any of the following criteria:

- a. The firm is required to be registered with and inspected by the PCAOB.
- b. The firm performs audits of non-SEC issuers pursuant to the standards of the PCAOB.
- c. The firm is a provider of quality control materials (QCM) (or affiliated with a provider of QCM) that are used by firms that it peer reviews.

Firms that meet any or all of the preceding criteria during the peer review year, but not as of their peer review year end (for example, since they resigned or were terminated from their SEC issuer clients, whether or not they deregistered with the PCAOB) are still ordinarily required to have their review administered by the National PRC. The firm's peer reviewer is still required to comply with guidance specific to firms administered by the National PRC, including, but not limited to, guidance at Interpretation No. 40-1 regarding other planning considerations and reporting of PCAOB inspection results. One exception is if a firm was required to be registered with and inspected by the PCAOB during the peer review year, but then did not audit an SEC issuer during that period (because they resigned or were terminated and thus were no longer the "auditor of record"), is not required to have its review administered by the National PRC if they deregister with the PCAOB prior to scheduling their review.

Firms that are not required to have their review administered by the National PRC may choose to do so. However, such firms are subject to the National PRC's administrative fee structure and should familiarize themselves with that structure prior to making such a decision.

## Timing of Peer Reviews

**13-1 Question**—Paragraph .13 of the standards notes that a firm's due date for its initial peer review is ordinarily 18 months from the date it enrolled in the program or should have enrolled, whichever date is earlier. What is meant by "should have enrolled?" In addition, what is the due date for a firm that was previously enrolled in CPCAF PRP?

*Interpretation*—When an individual becomes an AICPA member, and the services provided by his or her firm (or individual) fall within the scope of the AICPA's practice-monitoring standards, and the firm (or individual) issues reports purporting to be in accordance with AICPA *Professional Standards*, the firm (or individual) should enroll in the program and submit an enrollment form by the report date of the initial engagement. If the firm (or individual) does not initially provide services falling within the scope of the standards, the firm (or individual) should enroll in the program and submit an enrollment form by the report date of their initial engagement. The administering entity will consider the firm's (or individual's) practice, the year-ends of their engagements, the report dates of their engagements, and the number and type of engagements to be encompassed in the review, in determining an appropriate due date. A firm's subsequent peer review ordinarily will be due three years and six months from this peer review year-end.

If a firm's most recent peer review was under the auspices of the CPCAF PRP, its subsequent peer review ordinarily will be due three years and six months from the year-end of that peer review.

**14-1 Question**—Paragraph .14 of the standards states that when a firm performs its first engagement requiring it to have a System Review, the firm's next due date will be 18 months from the year-end of the engagement. What does this mean?



*Interpretation*—When a firm, subsequent to the year-end of its Report or Engagement Review, performs an engagement under the SASs, *Government Auditing Standards*, examinations of prospective financial statements or examinations of a service organization's controls likely to be relevant to user entities' internal control over financial reporting under the SSAEs, or an audit of a non-SEC issuer performed pursuant to the standards of the PCAOB that would have required the firm to have a System Review, the firm should (a) immediately notify the administering entity and (b) undergo a System Review. The System Review ordinarily will be due 18 months from the year-end of the engagement (for financial forecasts and projections 18 months from the date of report) requiring a System Review or by the firm's next scheduled due date, whichever is earlier. However, the administering entity will consider the firm's practice, the year-ends of engagements and when the procedures were performed, and the number of engagements to be encompassed in the review, as well as use its judgment, to determine the appropriate year-end and due date. Firms that fail to immediately inform the administering entity of the performance of an engagement previously described will be required to participate in a System Review with a peer review year-end that covers the engagement. A firm's subsequent peer review ordinarily will be due 3 years and 6 months from this peer review year-end.

**18-1 Question**—Paragraph .18 of the standards requires that a firm maintain the same year-end on subsequent peer reviews (which is 3 years from the previous year-end) and the same review due date (which is 3 years from the previous due date). What options does a firm have to change its year-end or extend the due date?

*Interpretation*—A firm is expected to maintain the same year-end on subsequent peer reviews. Nevertheless, circumstances may arise that may influence a firm to want to change its year-end. For instance, the nature of the firm's practice may change or they may reevaluate their current year-end and determine as a result that a different year-end is more practical. In such situations, a firm may change its year-end only with prior, written approval of the administering entity.

Administering entities will consider many factors including the nature of the firm's practice (for instance, when audits are being performed and issued so they will be available for the peer review, tax season, and so on). However, a change in year-end will usually not be approved when there is a public interest concern. This may occur when the firm is requesting the change in an attempt to have an Engagement Review rather than a System Review, or when a change in year-end would cause the firm's only engagement meeting the criteria described in Interpretation No. 63-1, (engagements conducted in accordance with *Government Auditing Standards* [GAS, also known as the Yellow Book]; audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA); audits of an insured depository institution subject to the FDIC Improvement Act of 1991); or audits of carrying broker-dealers to fall out of the peer review selection process.

Ordinarily, the firm's due date for the subsequent peer review will be three years and six months from the year-end of the current peer review.

A firm is expected to maintain the same review due date. Nevertheless, circumstances may arise that require the firm to extend its review due date. In such situations, a firm may do so only with prior, written approval of the administering entity, and the extended review due date only applies to the current review. Extensions for subsequent review's due dates must be reapplied for.

Extensions of a review due date by more than three months should be rare. However, in some situations, due to the size of the firm, the complexity of the

peer review, and whether or not the review team is integrating peer review procedures with the firm's internal inspection procedures, it is not unusual for a peer review to occur over a number of months. In such situations, a firm whose peer review has oversight performed by the administering entity may extend its review due date by up to six months with prior, written approval of the administering entity.

In any of the situations previously described, it is the responsibility of the firm to ensure that any change in the review due date (or year-end) approved by the administering entity is recognized by any other organizations requiring it to have a peer review. This includes but is not limited to state boards of accountancy, the Government Accountability Office, and other regulators.

**18-2 Question**—Situations may arise where circumstances out of a firm's control, such as a natural disaster or other form of destruction, affect a firm's operations and thus its ability to comply with some or all of the peer review requirements, including timing of the peer review. What should a firm do in those circumstances?

*Interpretation*—The administering entity should be consulted, when possible, about how the firm believes the situation has affected or will affect their peer review. The administering entity will assist in determining whether there could be a possible scope limitation due to the exclusion of any affected engagements or offices, the need for a change in year-end or an extension of due date, and the effect on the firm's continuing peer review cycle. These situations will be considered on a case-by-case basis.

**19-1 Question**—Paragraph .19 of the standards states that when a firm resigns from the program and subsequently reenrolls in the program, the firm's due date is the later of the due date originally assigned or 90 days after reenrolling. How does this apply when a firm resigns from the program at the end of its peer review because it does not plan to perform engagements that require a peer review going forward, but subsequently performs such work?

*Interpretation*—If a firm performs an engagement that would require a peer review (see paragraph 7-1) subsequent to resigning from the program, the firm should immediately notify the administering entity in order to reenroll in the program and schedule its peer review. The appropriate due date for the peer review is determined as follows:

- If the firm resigned from the program and subsequently performs an engagement that requires a peer review within 3 years and 6 months of its prior peer review year-end, the current peer review due date is the later of the due date originally assigned or 90 days after reenrolling.
- If the firm resigned from the program and subsequently performs an engagement that requires a peer review after its next due date has passed (that is, the prior peer review is longer than 3 years and 6 months in the past), the current peer review due date is ordinarily 18 months from the year-end of the engagement (for financial forecasts and projections, 18 months from the date of report) requiring a peer review.

In either case, the administering entity will consider the firm's practice, the year-ends of engagements and when the procedures were performed, and the number of engagements to be encompassed in the review, as well as use its judgment, to determine the appropriate year-end and due date. A firm's subsequent peer review ordinarily will be due 3 years and 6 months from this peer review year-end.

## Independence, Integrity, and Objectivity

**21-1 Question**—Paragraph .21 of the standards states that independence in fact and in appearance should be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review and that the review team should perform all peer review responsibilities with integrity and maintain objectivity in discharging those responsibilities. What criteria have been established by the board?

*Interpretation*—The following criteria have been established:

*a. Reciprocal Peer Reviews*

Reciprocal peer reviews are not permitted. This means that a firm may not perform a review of the firm that performed its most recent review. It also means that a reviewer may not serve on a review team carrying out a review of a firm whose personnel participated in the most recent review of that reviewer's firm.

*b. Relationships With Clients of the Reviewed Firm*

Review team members and, in the case of a review performed by a firm, the reviewing firm and its personnel are not precluded from owning securities in or having family or other relationships with clients of the reviewed firm. However, a review team member who owns securities of a reviewed firm's client shall not review the engagement of that client because that individual's independence would be considered to be impaired. In addition, the effect on independence of family and other relationships and the possible resulting loss of the appearance of independence must be considered when assigning team members to engagements.

*c. Relationships With the Reviewed Firm*

Reviewing firms should consider any family or other relationships, affiliate relationships, alternative practice structures, and common ownership of entities that provide products or services between the management at organizational and functional levels of the reviewing firm and the firm to be reviewed and should assess the possibility of an impairment of independence. For peer review purposes (including QCM reviews), entities that are affiliated to, are part of an alternative practice structure with, or share common ownership with a reviewing firm are considered to be a part of the reviewing firm when assessing the independence of the reviewing firm.

If the fees for any services provided between firms (whether paid by the referring firm or by the client) are material to the reviewed firm, the reviewing firm, or the firm of any member of the review team, independence for the purposes of this program is impaired.

If arrangements exist between the reviewed firm and the reviewing firm (and any of its affiliates or related entities) or the firm of any member of the review team whereby expenses, office facilities, or personnel are shared, independence for the purposes of this program is impaired. Similarly, independence would be considered to be impaired by sharing arrangements involving, for example, extensive consultation, or preissuance reviews of financial statements and reports. In such circumstances, the firms involved are sharing services that are an integral part of their systems of quality control.

If the reviewing firm has provided or sold QCM to the reviewed firm (such as manuals, guides, checklists, practice aids, etc.) independence for the purposes of this program is impaired. However, the impairment would be removed if an independent peer review of the QCM was performed and

submitted to the National PRC before the commencement of the reviewed firm's peer review (see paragraphs .159–.160 and Interpretation No. 200-1). In addition, regardless of whether an independent review of the QCM was performed, the review team members cannot be directly involved in the development or maintenance of the provider firm's materials, report to those who were directly responsible for the development or maintenance of the materials, or receive more than a de minimus amount of revenues or other monies generated by the sale of the materials.

**21-2 Question**—Can an individual from Firm A be engaged by Firm B to conduct monitoring of Firm B's accounting and auditing practice or a consulting review and then be engaged to perform Firm B's subsequent peer review? What about another individual from Firm A?

*Interpretation*—In both cases, yes, except if the monitoring of Firm B's accounting and auditing practice or consulting review is performed for the year immediately preceding or during the peer review year.

**21-3 Question**—Firm A is engaged by Firm B to perform a quality control document review, a preliminary quality control procedures review, or both. Could Firm A then be engaged to perform a peer review of Firm B?

*Interpretation*—Yes, except if the quality control document review, preliminary quality control procedures review, or both are performed for the year immediately preceding or during the peer review year.

**21-4 Question**—Firm A is engaged to perform the peer review of Firm B. However, Firm A performed a preissuance review on one of Firm B's reports and accompanying financial statements for an accounting or auditing engagement during the period since the last peer review year-end. Can Firm A perform the peer review of Firm B?

*Interpretation*—Yes, unless the preissuance review(s) was performed on an engagement within the year immediately preceding or during the peer review year.

**21-5 Question**—Firm A audits the financial statements of Firm B's pension plan. Could either firm perform a peer review of the other?

*Interpretation*—Yes, provided that the fees incurred for the audit are not material to either of the firms. An audit of financial statements is a customary service of an accounting firm. However, reciprocal peer reviews are not permitted.

**21-6 Question**—A partner in Firm A serves as an expert witness for Firm B or for a party opposing Firm B. Are Firms A and B independent of each other?

*Interpretation*—Yes, provided that the fee is not material to either firm and provided that the outcome of the matter, if adverse to Firm B, would not have a material effect on its financial condition or its ability to serve clients.

**21-7 Question**—Firm A is engaged to perform the peer review of Firm B. Firm B's staff attends CPE programs developed by Firm A. Can Firm A perform a peer review of Firm B?

*Interpretation*—Yes, as long as Firm A has not effectively become part of Firm B's system of quality control. If Firm A, or any affiliates of or entities related to Firm A, develop and customize CPE specifically to Firm B's needs, both firms would need to assess the extent and degree of customization to determine whether Firm A has become a part of Firm B's system of quality control or had a significant enough impact on that system such that Firm A's independence would be impaired. Factors to consider include the degree of customization, the significance of the programs to Firm B's system of quality control, whether Firm A was involved in determining the type of CPE programs that Firm B

needs, and so on. Based on the factors considered, if the nature of Firm A's relationship with Firm B effectively makes Firm A a part of Firm B's system of quality control, Firm A's independence is impaired for the first peer review immediately subsequent to the training provided.

For example, if Firm A developed and presented CPE programs and training for Firm B that were customized to Firm B's practice, including using some of Firm B's engagements as examples and learning tools, Firm A's independence is impaired for the first peer review immediately subsequent to the training provided. However, Firm A would be permitted to perform any successive peer reviews.

This assessment should be made by both firms prior to the commencement of the peer review. Firm B should consult with the administering entity if needed.

**21-8 Question**—Firm A occasionally consults with Firm B with respect to specific accounting, auditing, or financial reporting matters. Are Firms A and B independent of each other?

*Interpretation*—Yes, unless the frequency and extent of the consultation is such that Firm B is an integral part of Firm A's consultation process.

**21-9 Question**—Firm B uses Firm A's internally-developed accounting and auditing manual as its primary reference source. Can Firm A perform a peer review of Firm B, or can Firm B perform a peer review of Firm A?

*Interpretation*—No, unless Firm A has had a QCM review performed that covers its accounting and auditing manual and any other of its reference material used by Firm B as a primary reference source (see "Performing and Reporting on Reviews of Quality Control Materials (QCM)" in the standards). This is also applicable if the manual is developed by an affiliate of Firm A, or any other entity related to Firm A. If this is Firm A's initial QCM review, then Firm A is not independent to perform the peer review of Firm B until the QCM review is accepted. For all subsequent QCM reviews, Firm A will remain independent with respect to Firm B, as long as the QCM review is submitted by the due date. If Firm A elects not to have a QCM review performed before Firm B's peer review commences, Firm A would not be considered independent for purposes of conducting the peer review. In all circumstances, the review team members cannot be directly involved in the development or maintenance of Firm A's accounting and auditing manual, report to those who were directly responsible for the development or maintenance of the manual, or receive more than a de minimus amount of fees or other monies from the total revenues generated by the sale of the manual.

**21-10 Question**—Firm A performs a peer review of Firm B. Subsequently, Firm C performs a peer review of Firm B, and Firm D of Firm A. Would the restriction against reciprocity be violated if Firm B were now to review Firm A?

*Interpretation*—No. Although the standards state that reciprocal peer reviews are not permitted, that provision is intended only to prohibit back-to-back peer reviews when each firm has not had an intervening peer review by another firm or team. However, this may be a situation where the administering entity elects to perform oversight.

**21-11 Question**—A manager from Firm A served as a team member on the most recent peer review of Firm B. Can a reviewer from Firm B serve on the peer review team of Firm A?

*Interpretation*—No, because that would be considered a reciprocal review.

**21-12 Question**—Can an individual from Firm A be engaged by Firm B to perform a peer review of Firm B and subsequently be engaged the following

year(s) to conduct an inspection of Firm B's accounting and auditing practice or a consulting review? What about another individual from Firm A?

*Interpretation*—In both cases, yes; however, individual(s) from Firm A would not be eligible to perform Firm B's subsequent peer review except as noted in Interpretation No. 21-2.

**21-13 Question**—Firm A included the qualifications of Firm B in a proposal for one or more specific engagements. Could either firm perform a peer review of the other following a successful proposal?

*Interpretation*—No, unless any fees paid to Firm B are not material to either of the firms; the firms do not share directly or indirectly, or participate in, the profits of the other; the firms do not share fees, office facilities, or personnel; the firms do not have joint ownership of a for-profit entity; and the firms do not exercise any direct or indirect management control over the professional or administrative functions of the other.

**21-14 Question**—A group of firms places an advertisement in a trade journal indicating that its members are "specialists" and provide the "best advice." Although the firms are not specifically identified in the advertisement, a toll-free telephone number or Internet site is provided for contact. Can one firm in the group perform the peer review of another member firm in the same group?

*Interpretation*—No, because the group is marketing or selling services to potential clients on behalf of the firms, where the representations about the firms and the quality of their services are not objective or quantifiable.

**21-15 Question**—A group of firms places an advertisement in a trade journal. The advertisement indicates the number and geographical location of the member firms and states that its members provide professional accounting and auditing services to over 2,500 industry clients nationwide and that each of the member firms passed its most recent peer review. A toll-free telephone number or Internet site is provided for contact. Can one firm in the group perform the peer review of another member firm in the same group?

*Interpretation*—Yes, provided that the group is not a *network* as defined by Interpretation No. 26-2, the group has submitted the Association Information Form (AIF) to the board; and the group has received notification that the AIF was accepted because the representations in the advertisement are objective or quantifiable.

**21-16 Question**—What would be *objective and quantifiable* with respect to representations made in advertisements by an association of CPA firms, such as in brochures, pamphlets, websites, and the like?

*Interpretation*—Representations made in advertisements by an association of CPA firms would be considered *objective and quantifiable* provided that the association of CPA firms maintains documentation to support the representations and such documentation is available for review by the board. For example, if an association of CPA firms advertises that its members provide professional accounting and auditing services to a designated number of industry clients in a certain geographic area, some form of client listing should be maintained in support of the representation. If an association of CPA firms advertises that each of its member firms have passed peer review, letters from the entities accepting the peer review documents of those firms should be maintained. Representations should not be made by an association of CPA firms in their advertisements that designate themselves as "the best," "the finest," "uniquely qualified," "prestigious," "elite," or other similar language. These superlative descriptions are generic words and terms that are too subjective. Also, such representations in

advertisements by an association of CPA firms cannot be readily supported by any form of documentation that can be reviewed.

**21-17 Question**—Certain members of an association (that is, parent association) may form a partnership or subassociation, which is a grouping of association member firms for the purpose of cooperating to enhance the firms' capabilities to provide professional services. Can members of the subassociation perform peer reviews on firms of the parent association that are not involved in the activities of the subassociation?

*Interpretation*—Although a member of a subassociation cannot peer review another member of the same subassociation, the existence of a subassociation by itself should not disqualify members of the subassociation from performing peer reviews of nonaffiliated member firms of the parent association. However, members of a subassociation should not perform peer reviews on firms of the parent association that are not involved in the activities of the subassociation if the parent association and subassociation belong to the same *network* as defined by Interpretation No. 26-2.

**21-18 Question**—Is independence impaired when the reviewers' firm and the firm subject to peer review have arrangements with the same non-CPA owned entity (including all entities owned or controlled by a common parent company) where the partners of both firms are also employees of that non-CPA owned entity and remit revenues or profits, or both, to the non-CPA owned entity for payment of the lease of employees, office facilities, equipment, or other services provided by the non-CPA owned entity?

*Interpretation*—Yes, independence is impaired, and the firms involved with the non-CPA owned entity are precluded from participating in the peer review of one another or of other firms related to the non-CPA owned entity.

**21-19 Question**—A state CPA society places an advertisement promoting the CPA profession without identifying any specific firms. May firms whose personnel belong to that state CPA society provide peer review for each other?

*Interpretation*—Yes.

**21-20 Question**—Firm A and Firm B have shared office facilities for the last several years. Due to the growth of both firms, Firm B moved into new offices on January 1, 2007. In March 2009, Firm A engaged Firm B to perform the peer review of Firm A. Firm A's peer review year-end is December 31, 2008. Can Firm A perform the peer review of Firm B?

*Interpretation*—Yes, because the firms did not share office facilities within the current peer review year and any subsequent periods thereafter.

**21-21 Question**—Firm A purchases an accounting and auditing manual developed by an association that it belongs to as its primary reference source. Personnel from Firm B who are also peer reviewers aided the association with the development of the manual by authoring significant sections of the manual. The association receives annual approval to form review teams for its member firms. Can the association include reviewers from Firm B on the review team to peer review Firm A?

*Interpretation*—Yes, as long as the following personnel from Firm B are not included on the review team: personnel directly involved in the development or maintenance of the association's accounting and auditing manual (such as those who authored sections of the manual), personnel who report to those who were directly responsible for the development or maintenance of the manual, or personnel who receive more than a de minimus amount of fees or other monies from the total revenues generated by the sale of the manual.

**21-22 Question**—ABC, Inc. (an affiliate of Firm A) is a provider of audit manuals and guides for various industries. Firm B purchases an industry-specific audit manual from ABC, Inc., to assist with performing audit engagements for a niche industry. The niche industry represents an insignificant portion of Firm B's overall audit and attest practice. Firm B does not purchase any other practice aids or manuals from ABC, Inc. Can Firm A perform the peer review of Firm B?

*Interpretation*—Yes, unless either the niche industry grows to become a more significant part of the firm's overall practice and the same audit manual is used, or the niche industry is a must-select industry. If either occurs, then the industry manual would be assessed as being integral to Firm B's system of quality control, and Firm A's independence would be impaired (see Interpretations Nos. 21-1c and 159-1 for additional information on affiliate relationships). If ABC, Inc. had the relevant audit manual undergo an independent QCM review in compliance with the standards, Firm A's independence would not be impaired. However, any reviewers from Firm A who participated in the development or maintenance of ABC, Inc.'s materials, report to those who were directly responsible for the development or maintenance of the materials, or receive more than a de minimus amount of the revenues generated from the sale of the materials would not be independent of Firm B and would not be approved as a part of the review team under any circumstances. This is applicable regardless of the nature of the materials purchased by Firm B, and includes audit programs, practice aids, and so on.

If the nature of the audit manual or guide purchased and adopted is not integral to Firm B's system of quality control, independence would not be impaired. Factors that should be considered in assessing whether the manual is an integral part of the system of quality control include the size of the impacted portion of the firm's practice (by industry, level of service, engagement hours, and so on); the risk associated with that portion of the firm's practice (for example, must-select industries); the degree of reliance placed on the manual; the significance of the guidance provided by the manual to the related engagements; and so on.

**21-23 Question**—Reviewers from Firm A provide technical consultation to a third-party provider of QCM. The extent of the consultation entails reviewing portions of various guides for technical accuracy and providing feedback (if any) to the provider. The reviewers have no control over whether their feedback is addressed or how it impacts the end products ultimately marketed as the guides. Firm B uses guides developed by the provider as an integral part of its system of quality control. Can Firm A perform the peer review of Firm B?

*Interpretation*—Yes, Firm A would be independent for purposes of conducting the peer review of Firm B. However, when reviewers provide consulting or other services to third-party providers, they should assess whether their individual contributions were sufficiently significant to make them a part of the provider's system. In this circumstance, the extent of the reviewers' contributions does not make them a part of the provider's system of quality control. Similarly, if the reviewers from Firm A authored or edited portions of a third-party provider's guides or other materials, they should also assess the degree and impact of their contributions.

If the reviewers' contributions went beyond simple consultation and entailed more formal technical review and approval procedures as a part of the development and maintenance process, or if the reviewers exercised control within the development and maintenance process such that feedback and comments had to be addressed or incorporated into the materials, then the independence of Firm A is impaired. Firm A's independence would also be impaired if the reviewers authored or edited substantial portions of the guides. In both of these



scenarios, the reviewers' contributions are significant to the provider's development and maintenance process such that the reviewers has effectively become a part of the provider's system of quality control.

If the provider elected to have an independent QCM review, and the scope of the review included the materials technically reviewed, authored, and so on by the reviewers, then Firm A's independence would no longer be impaired. However, the specific reviewers from Firm A who participated in the development or maintenance of the materials, report to those that were directly responsible for the development or maintenance of the materials, or receive more than a de minimus amount of the revenues generated from the sale of the materials would not be independent of Firm B.

## Illegal Acts

**23-1 Question**—Paragraph .23 of the standards discusses the obligation for all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner. What responsibilities do reviewers have to detect illegal acts during a peer review?

*Interpretation*—Reviewers have no responsibility to detect illegal acts that have either a direct or indirect effect on the firm's ability to practice public accounting. If a reviewer comes across an illegal act during a review, he or she should consider consulting with his or her attorney, and consult with appropriate AICPA staff.

## Peer Review Documentation and Retention Policy

**24-1 Question**—Paragraph .24 of the standards notes peer review documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. How should the peer review be documented to comply with this requirement?

*Interpretation*—Among other things, peer review documentation includes records of the planning and performance of the work, the procedures performed, and conclusions reached by the peer reviewer. This includes documenting the risk assessment, the understanding of the firm's system of quality control, and tests of compliance (including checklists for the review of engagements and staff interviews when there are professional staff). The board has authorized the issuance of materials and checklists, including checklists for the review of engagements, to guide team captains, review captains, and other members of the review team in carrying out their responsibilities under these standards.

Ordinarily, materials and checklists developed and issued by the board are to be used by reviewers in carrying out their responsibilities under these standards. Based on its understanding of the reviewed firm's system of quality control and its assessment of peer review risk, the review team should determine if materials and checklists issued by the board are not sufficiently comprehensive to use on the review. In this event, other materials and checklists may be used; however, they must include the same elements as, and must be more comprehensive than those versions issued by the board. Reviews conducted utilizing alternate materials and checklists will require advance notice to the administering entity and the review must be subject to on-site oversight. The electronic Matter for Further Consideration (MFC) and Disposition of Matter for Further Consideration forms provided by the board must be used for all peer reviews and alternative forms will not be accepted. It is the responsibility of the team captain or review captain to ensure that the materials and checklists used meet these standards. Failure to complete all relevant materials and checklists may

create the presumption that the review has not been performed in conformity with these standards, and thus the administering entity should be consulted in advance of use of any equivalents to assist in reaching these conclusions.

**25-1 Question**—Paragraph .25 of the standards notes that all peer review documentation should not be retained for an extended period of time after the peer review's completion, with the exception of certain documents that are maintained until the subsequent peer review's acceptance and completion. What period of time should peer review documentation be retained and what documentation should be maintained until the subsequent peer review's acceptance and completion?

*Interpretation*—Peer review documentation prepared during system and Engagement Reviews, with the exception of those documents described in the following paragraphs, should be retained by the reviewing firm, the administering entity, and the association in an association formed review team (if applicable) until 120 days after the peer review is completed (see Interpretation No. 25-2). The reviewing firm and administering entities should retain the following documents until the firm's subsequent peer review has been completed:

- a. Peer review report and the firm's response, if applicable
- b. Letter notifying the firm that its peer review has been accepted
- c. Letter indicating that the peer review documents have been accepted with the understanding that the firm agrees to take certain actions, if applicable. The administering entity should retain the version signed by the firm
- d. Letter notifying the firm that certain required actions have been completed, if applicable
- e. Finding for Further Consideration (FFC) forms, if applicable
- f. Letter requesting the reviewed firm's completion of an implementation plan, if applicable (the administering entity should retain the version signed by the firm)
- g. Letter notifying the firm that the implementation plan has been completed, if applicable
- h. Letter(s) relating to peer review document recall considerations

Administering entities may also retain the following administrative materials until the firm's subsequent peer review has been completed:

- a. Engagement letters
- b. Scheduling information
- c. Review team appointment acceptance letters
- d. Due date extension and year-end change requests and approvals
- e. Settlement agreements received by the administering entity from the AICPA Professional Ethics Division related to individual members' performance on accounting, auditing, or attestation engagements

The administering entity's peer review committee or the board may indicate that any or all documentation for specific peer reviews should be retained for a longer period of time than specified in the preceding paragraphs because, for example, the review has been selected for oversight. All peer review documentation is subject to oversight or review by the administering entity, the board, or other bodies the board may designate, including their staff. All peer review documentation prepared by the administering entities is subject to oversight.

If a firm has been enrolled in an institute-approved practice-monitoring program but has not undergone a peer review in the last three years and six months

since its last peer review because the firm has not performed engagements and issued reports requiring it to have a peer review, the documents previously noted should still be retained. The administering entity may also choose to retain the administrative documents noted, as applicable. The documents for a firm that has not been enrolled in an Institute-approved practice-monitoring program for the last consecutive three years and six months are not required to be retained.

**25-2 Question**—The standards and interpretations refer to *acceptance* and *completion* of peer reviews in several contexts, such as in relation to the retention policy for peer review documentation (paragraph .25 of the standards), when a review can be publicized (paragraph .146) and the qualifications for service as a peer reviewer (paragraph .31[c]) and a report acceptance body member (Interpretation No. 132-1). Is there a difference between the acceptance and completion dates of a peer review?

*Interpretation*—There is no difference in those cases in which the report and letter of response thereto, if applicable (peer review documents), are presented to the administering entity's peer review committee, and the committee requires no additional corrective action(s) related to the deficiencies or significant deficiencies in a peer review report with a rating of *pass with deficiency(ies)* or *fail* by the reviewed firm, nor are there any revisions necessary to the peer review documents. In this circumstance, the date that the committee (or technical reviewer in most cases on an Engagement Review) makes this decision is defined as the acceptance date, and is also defined as the completion date of the peer review. The acceptance date is noted in a letter from the administering entity to the reviewed firm.

There is a difference between the acceptance and completion dates of a peer review when the peer review documents are presented to the committee and the committee does not require any revisions to the peer review documents but does require the reviewed firm to take corrective action(s) related to deficiencies or significant deficiencies in the report. In this circumstance, the acceptance date is defined as the date that the reviewed firm signs the letter from the administering entity agreeing to perform the required corrective action(s). The completion date is then defined as the date the committee decides that the reviewed firm has performed the agreed-to corrective action(s) to the committee's satisfaction and the committee requires no additional corrective action(s) by the reviewed firm. This date is noted in a final letter from the administering entity to the reviewed firm.

In either of the situations described in the preceding paragraphs, the committee may require revisions to any of the peer review documents or have other matters that require resolution. In those cases, a review may not be deemed as accepted nor completed until such date that the peer review document(s) is (are) revised or the matter is resolved to the satisfaction of the committee. When there are required revisions or other matters that require resolution and a follow up action has been requested by the committee, the date of acceptance is the later of the date the required revisions are made or the matters are resolved, OR the date the firm has agreed to the follow up action.

## Associations of CPA Firms and Association Formed Review Teams

**26-1 Question**—Paragraph .26 of the standards states that a review team may be formed by a firm engaged by the firm under review (a firm-on-firm review) or an association of CPA firms authorized by the board to assist its members in forming review teams (an association formed review team). What

criteria have been established by the board for association formed review teams?

*Interpretation*—Associations of CPA firms include any group, affiliations, or alliances of accounting firms. The term also applies to two or more firms or a group of firms (whether a formal or informal group) that jointly market or sell services. Firms and other entities in the association cooperate with one another to enhance their capabilities to provide professional services.

A member firm of an association may conduct a peer review of another association-member firm enrolled in the program, provided that the association is not a *network* as defined by Interpretation No. 26-2 and the association receives annual approval from the board. The National PRC administers this process on behalf of the board. The association must submit an AIF to the National PRC that must be approved by the board prior to any aspect of the review being planned, scheduled, or performed.

The AIF contains questions regarding general information about the association, independence matters, and whether the association requests to be approved to assist its members in the formation of review teams, provide technical assistance to such review teams, or do both. All review teams must still be approved by the administering entity. The AIF is subject to oversight by the board.

The approval of the AIF specifically relates to AICPA members of an association having the ability to perform peer reviews of other AICPA members in the same association enrolled in the program. Furthermore:

- a. Annual approval of the AIF does allow, where the association is not a network and has answered the specific questions making such a request, the association the ability to assist its members in the formation of review teams (association formed review teams) or to provide technical assistance to such review teams.
- b. The reviewed firm and administering entity, not the association, is ultimately responsible for ensuring that its peer review is scheduled, performed, and completed in a timely manner.
- c. Annual approval of the AIF does not grant the association the authority to administer the program; therefore, the association is not deemed an approved administering entity.
- d. Approval of the AIF is not an endorsement of, approval of, or has any applicability to a separate peer review program that an association may conduct or administer for non-AICPA members.
- e. If the association makes any representations (in brochures, directories, pamphlets, webpages, or any marketing or selling materials regarding its member firms in obtaining engagements), in order for the AIF to be approved such representations must be objective and quantifiable.

For a member firm of an association to conduct peer reviews of another association-member firm enrolled in the program, in addition to the independence requirements related to network firms appearing in Interpretation No. 26-2 and other peer review independence requirements, the association and its member firms must meet the following independence criteria:

- a. The association, as distinct from its member firms, does not perform any professional services other than those it provides to its member firms or affiliates. For purposes of this requirement, *professional services* include accounting, tax, personal financial planning, litigation support, and professional services for which standards are promulgated by bodies designated by AICPA Council.

- b. The association does not make representations regarding the quality of professional services performed by its member firms to assist member firms in obtaining engagements unless the representations are objective or quantifiable. However, member firms may independently publicize their membership in the association. In addition, an association may respond to inquiries and prepare promotional materials that firms may use to obtain professional engagements on their own behalf.
- c. Referral or participating work among member firms is arranged directly by the firms involved. An association may voluntarily elect to have an independent QCM review of its system of quality control to develop and maintain quality control materials used by its member firms (see paragraphs .154–.205 of the standards).

An association may voluntarily elect to have an independent QCM review of its system of quality control to develop and maintain quality control materials used by its member firms (see paragraphs .154–.205 of the standards). An association may wish to have such a review to enable its member firms that use the materials it develops to have more efficient peer reviews. Associations that elect to have this type of review should consult with AICPA program staff.

An association formed review team

- a. requires that a majority of the review team members, including the team captain in a System Review and all members in an Engagement Review, be from association member firms.
- b. performs peer reviews in accordance with these standards, interpretations, and other guidance and the peer review report is issued on the letterhead of the team captain or review captain's firm and signed in the name of the team captain or review captain's firm (not the association).

Peer reviews performed by association-formed review teams are subject to oversight by the board and the administering entities and other bodies agreed upon by the board and the administering entity.

**26-2 Question**—How are the terms *network* and *network firm* defined for peer review purposes? Is it appropriate for a network firm to perform the peer review of a firm within the same network?

*Interpretation*—Consistent with Ethics Interpretation No. 101-17, for peer review purposes, a *network* is an association of entities that includes one or more firms that cooperate for the purpose of enhancing the firms' capabilities to provide professional services and share one or more of the following characteristics:

- a. The use of a common brand name (including common initials) as part of the firm name.
- b. *Common control* (as defined by generally accepted accounting principles in the United States of America) among the firms through ownership, management, or other means.
- c. Profits or costs, excluding costs of operating the association; costs of developing audit methodologies, manuals and training courses; and other costs that are immaterial to the firm.
- d. Common business strategy that involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the association's strategy and are held accountable for performance pursuant to that strategy.
- e. Significant part of professional resources.
- f. Common quality control policies and procedures that firms are required to implement and that are monitored by the association.

A *network firm* is a firm or other entity that belongs to a network. This includes any entity, including another firm that the network firm, by itself or through one or more of its owners, controls, as defined by generally accepted accounting principles in the United States of America is controlled by; or is under common control with. For a further description of the characteristics of a network and network firm, reference Ethics Interpretation No. 101-17.

It is not appropriate for a network firm to perform the peer review of a firm within the same network. A network firm is not considered to be independent with respect to other firms within the same network. The owners and employees of network firms are also not considered to be independent with respect to other firms within the same network. Whether an association is a network and whether an entity is a network firm should be applied consistently by all members of the association. Due consideration should be given to what a reasonable and informed third party would be likely to conclude after weighing all the specific facts and circumstances.

## Organizing the System or Engagement Review Team

**30-1 Question**—Paragraph .30 of the standards states that a System Review team, a review captain on an Engagement Review, and, in unusual circumstances, any additional reviewers on an Engagement Review ordinarily should be approved by the administering entity prior to the planning and commencement of the review. How is this accomplished?

*Interpretation*—The firm and the reviewer should submit scheduling information as required by the administering entity, and the System Review team, a review captain on an Engagement Review, and, in unusual circumstances, any additional reviewers on an Engagement Review should be approved by the administering entity prior to the commencement of the review. The administering entity will consider various factors, including the industries of the engagements of the firm, its size, whether or not the review is administered by the National PRC, and other factors in relation to the knowledge and experience of the members of the review team to determine if the team has the appropriate qualifications and capability to perform the review.

## Qualifying for Service as a Peer Reviewer

**31b-1 Question**—Paragraph .31(b) and (c) of the standards state that an individual serving as a peer reviewer should be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program and the firm (or all firms if associated with more than one firm) that the member is associated with should have received a report with a peer review rating of *pass* (previously referred to as an unmodified report) for its most recent System Review or Engagement Review that was accepted timely, ordinarily within the last 3 years and 6 months. Does this apply to all firms the individual is associated with? Is the individual still qualified to serve as a reviewer if the individual starts, or becomes associated with, a newly formed firm (or a firm that has not had a peer review)?

*Interpretation*—If the individual is associated as a partner with more than one firm, then each of the firms the individual is associated with should have received a report with a peer review rating of *pass* (previously referred to as an unmodified report) for its most recent System Review or Engagement Review that was accepted timely, ordinarily within the last three years and six months.

An individual who was previously a System Review team captain, a reviewer in a System Review or a review captain in an Engagement Review that starts

or becomes associated with a newly formed firm (or a firm that has not had a peer review) may continue to serve in such capacity during a transition period. The transition period begins with the earlier of the dates of disassociation from the previous firm or when the individual starts or becomes associated with a new firm. The transition period ends with the earlier of 18 months from the beginning date or the peer review due date of the new firm. In no circumstances will the transition period exceed 18 months. The previous firm should have received a report with a peer review rating of *pass* (previously referred to as an unmodified report) on its most recently accepted peer review, and the individual should meet all of the other qualifications for service as a team captain or reviewer in a System Review or review captain in an Engagement Review. An individual who was previously a team captain or reviewer in a System Review qualified to perform peer reviews administered by the National PRC or CPCAF PRP that starts or becomes associated with a newly formed firm (or a firm that has not had a peer review), or a firm enrolled in the program that has undergone a peer review administered by another administering entity, may serve as a team captain or a reviewer on a review administered by the National PRC under the same conditions and requirements mentioned previously.

**31b-2 Question**—What if the individual was a sole practitioner that has given up his or her own accounting and auditing practice, but is now serving in the capacity of an external quality control or concurring reviewer for other enrolled firms?

*Interpretation*—If the individual was a sole practitioner that has given up his or her own accounting and auditing practice, but is now serving in the capacity of an external quality control or concurring reviewer for other enrolled firms, he or she would meet many of the minimum requirements in paragraph .31(b) of the standards, except for being a professional employee of the firm the work is being performed for, and therefore he or she would not meet the qualification requirements to serve in the capacity of a peer reviewer.

**31b-3 Question**—If the individual is associated with a firm who received a report with a peer review rating of *pass with scope limitation* on its most recent System Review or Engagement Review, does this meet the qualification requirements to be a peer reviewer?

*Interpretation*—There are three different grades which can be considered "passing": *pass*, *pass with scope limitation*, and *pass with deficiencies*. Only the first two (*pass* and *pass with scope limitation*) are acceptable grades in order to qualify as a peer reviewer.

Scope limitations under the previous standards were included only in modified or adverse reports. If the individual is associated with a firm who received a report which was *modified for a scope limitation* or *adverse for a scope limitation* on its most recent System Review or Engagement Review, this does not meet the qualification requirements to be a peer reviewer.

**31b-4 Question**—What further qualifications are necessary to perform a peer review of a firm whose review is required to be administered by the National PRC?

*Interpretation*—In order to be qualified to perform a peer review of a firm required to be administered by the National PRC, ordinarily a peer reviewer must currently be with a firm whose most recent review was administered by the National PRC or the CPCAF PRP. This is not a requirement for a peer reviewer on a review of a firm that elects (but is not required) to have their peer review administered by the National PRC.

**31c-1 Question**—Paragraph .31(c) of the standards indicates that a peer reviewer should be associated with a firm (or all firms if associated with more

than one firm) that has received a report with a peer review rating of pass for its most recent System or Engagement Review that was accepted timely, ordinarily within the last three years and six months. What is meant by "accepted timely, ordinarily within three years and six months?"

*Interpretation*—Peer reviewers are expected to have their own firm's peer review performed timely. They are also expected to cooperate with the program in all matters related to the peer review that could impact the firm's enrollment in the program. The peer review workpapers and report for reviewers' firms should be submitted on or before the extended due date, ordinarily within six months of the peer review year end. If a valid extension is approved by the administering entity, the review workpapers and report should be submitted by the approved extended due date. The review should be accepted by the administering entity ordinarily within 120 days of receipt of the workpapers and report from the reviewer. Indications of his or her firm's noncooperation with the program may disqualify the peer reviewer from being able to schedule and perform reviews until the firm's peer review has been accepted.

**31d-1 Question**—Paragraph .31(d) of the standards states that an individual serving as a peer reviewer should possess current knowledge of professional standards applicable to the kind of practice to be reviewed, including quality control and peer review standards. This includes recent experience in and knowledge about current rules and regulations appropriate to the level of service applicable to the industries of the engagements the individual will be reviewing. How may such knowledge be obtained, and is there a minimum amount of CPE required to be a peer reviewer?

*Interpretation*—Such knowledge may be obtained from on-the-job training, training courses, or a combination of both.

If the administering entity determines that the peer reviewer does not have such experience, the peer reviewer may be called upon to justify why he or she should be permitted to review engagements in that industry. The administering entity has the authority to decide whether a reviewer or review team's experience is sufficient and whether they have the capability to perform a particular review whether related to high-risk engagements or other factors.

The fundamental purpose of CPE is to maintain or increase, or both, professional competence. AICPA members are required to participate in 120 hours of CPE every 3 years. In order to maintain current knowledge of accounting, auditing, and quality control standards, peer reviewers should obtain at least 40 percent of the AICPA required CPE in subjects relating to accounting, auditing, and quality control. Peer reviewers should obtain at least 8 hours in any 1 year and 48 hours every 3 years. The terms *accounting*, *auditing*, and *quality control* should be interpreted as CPE that would maintain current knowledge of accounting, auditing, and quality control standards for engagements that fall within the scope of peer review as described in paragraphs .06–.07 of the standards.

Peer reviewers have the responsibility of documenting their compliance with the CPE requirement. They should maintain detailed records of CPE completed in the event they are requested to verify their compliance. The reporting period will be the same as that maintained for the AICPA.

**31f-1 Question**—Paragraph .31(f) of the standards states that an individual serving as a peer reviewer on a System or Engagement Review should have provided the administering entity with information that accurately reflects the qualifications of the reviewer, including recent industry experience, and is updated timely. How is this accomplished?



*Interpretation*—Ordinarily, an individual serving as a reviewer on a System or Engagement Review should have completed a peer reviewer resume in accordance with guidance issued by the board that is updated timely and accurately reflects the qualifications of the reviewer, including recent industry experience. This may also be accomplished by providing similar information to those performing an on-site oversight under the direction of a National PRC panel.

**31g-1 Question**—Paragraph .31(g) of the standards indicates that a peer reviewer should be associated with a provider firm or affiliated entity that has received a QCM report with a review rating of pass for its most recent QCM review that was submitted timely (if applicable). Under what circumstances would the provider's independence with respect to user firms be impaired due to receiving a QCM report with a rating other than *pass*?

*Interpretation*—If the provider receives a report with a rating of *pass with deficiencies*, then the provider's independence with respect to user firms will be impaired and the provider will not be permitted to perform or schedule future peer reviews of user firms starting on the date that the QCM review is submitted. After accepting the report, the National PRC will identify a corrective action that will be communicated to the provider. Although the corrective action falls outside the reporting and acceptance process for reviews of QCM, it affords the provider an opportunity to maintain his or her independence with respect to users by remediating the deficiency identified in the report. The National PRC will set a date by which evidence of completion of the corrective action should be received. If evidence of completion of the corrective action is submitted by the date set by the National PRC, upon acceptance of the corrective action by the National PRC the provider's independence with respect to user firms will no longer be impaired. If evidence of completion of the corrective action is not submitted by the date set by the National PRC, the provider's independence with respect to user firms will be impaired until the completion of the provider's subsequent QCM review.

If the provider receives a report with a rating of *fail*, then the provider's independence with respect to user firms will be impaired and the provider will not be permitted to perform or schedule future peer reviews of user firms starting on the date that the QCM review is submitted. The provider's independence with respect to user firms will remain impaired until the completion of the provider's next QCM review.

**32-1 Question**—Paragraph .32 of the standards states that a team captain, or the review captain in limited circumstances, is required to ensure that all team members possess the necessary capabilities and competencies to perform assigned responsibilities and that team members are adequately supervised. The team captain or review captain has the ultimate responsibility for the review, including the work performed by team members. What do those responsibilities include?

*Interpretation*—Team members should be brought on to a team when the team captain, or the review captain in limited circumstances, does not possess the adequate qualifications necessary in order to perform the review of engagements within certain industries or type of engagement in the reviewed firm's practice. In addition, there may be reasons, for instance depending on the size of the firm and its practice, that team members may be brought onto a team to assist the team captain in performing the review in an efficient and effective manner. Whether the team member is brought onto the team to cover certain industries or types of engagement, or just to assist the team captain in performing the review, it is still the responsibility of the team captain or review captain to ensure the team member selected has the appropriate qualifications and to supervise and review the work of the team member. The team captain or review

captain is essentially relying on the work of the team member and accepting it as his/her own. The team captain or review captain should ensure that all of the workpapers (engagement questionnaires, MFCs, and so on) completed by the team member are reviewed by the team captain or another appropriately qualified team member, and follow up with the reviewed firm or team member as necessary. By signing off on the Team Captain Checklist or Review Captain Checklist, the team captain or review captain is approving the team member's workpapers and accepting responsibility for the work of the team member.

Team members may review their engagements prior to the team captain or review captain beginning their field work. Reviews of engagements that are performed by team members at locations other than the reviewed firm's office are acceptable, but the quality of work must be at the same level as it would be had the review been performed at the reviewed firm's office. In these situations, a review is considered to have commenced when the team member begins the review of engagements (if this is prior to the team captain or review captain beginning their fieldwork). All engagement checklists, MFC and FFC forms should be signed off by the team member prior to the exit conference. The team captain or review captain should consider if the team member should participate in the exit conference.

**33-1 Question**—Paragraph .33 of the standards states that a team captain in a System Review or a review captain in an Engagement Review should "have completed peer review training that meets the requirements established by the board." Interpretation No. 132-1 states that each report acceptance body member should demonstrate proficiency in the standards, interpretations, and guidance of the program. Interpretation No. 132-1 also states that a technical reviewer charged with the responsibility for performing technical reviews should meet the requirements of the team captain or review captain training requirements established by the board. What peer review training meets the requirements established by the board and what are the criteria for demonstrating proficiency?

*Interpretation*—The peer review training and the criteria for demonstrating proficiency in the standards, interpretations, and guidance of the program is established from time to time by the board. Those criteria are located on the Peer Review page of the AICPA website.

**33-2 Question**—Paragraph .33 of the standards discusses the qualifications necessary to serve as a team captain in a System Review. Are there any other qualifications to be met to serve as a team captain?

*Interpretation*—For firms with greater than 400 professionals, with a *professional* defined as an individual who spends more than 25 percent of his or her time on accounting and auditing work that meets the criteria for a peer review, an individual who serves as the reviewed firm's team captain or review captain for 2 successive peer reviews may not serve in that capacity for the reviewed firm's next peer review.

**34-1 Question**—Paragraph .34 of the standards discusses that a peer reviewer or reviewing firm may have received communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of the peer reviewer or reviewing firm's accounting and auditing practice. A peer reviewer or reviewing firm may also have received notifications of limitations or restrictions on the peer reviewer's or reviewing firm's ability to practice. How do these allegations/investigations, limitations/restrictions, or both, affect the reviewer's or reviewing firm's ability and qualifications to perform the peer review?

*Interpretation*—The peer reviewer and reviewing firm should notify the relevant administering entity of any communications relating to allegations or investigations from regulatory, monitoring, or enforcement bodies in the conduct of accounting, audit, or attestation engagements performed by the reviewer. For these purposes, an allegation/investigation is defined as a formal declaration, statement, or other similar assertion, the validity of which has not been established, indicating that there may be deficiencies in the reviewer or reviewing firm's compliance with a regulatory, monitoring, or enforcement body's (regulatory body) rules (procedures, laws, professional standards, or practices).

The peer reviewer and reviewing firm should notify the AICPA technical staff, then their relevant administering entity, of any limitations/restrictions on the peer reviewer's or reviewing firm's ability to practice. For these purposes, a limitation or restriction is a corrective/disciplinary action or sanction imposed on a reviewer or reviewing firm by a regulatory body). Examples include constraint of scope or volume of accounting and auditing engagements, required periodic reporting to the regulatory body, pre-issuance reviews of engagements, and/or additional peer review or professional education requirements.

The notifications should occur prior to the peer reviewer or reviewing firm's being engaged to perform a peer review, or immediately (if after engaged). The objective of the reviewer or reviewing firm informing the relevant administering entity or AICPA technical staff (as applicable) of such allegations/investigations, limitations/restrictions or both, is to enhance the program's oversight process, which includes ensuring that peer reviewers and reviewing firms are appropriately qualified to perform reviews.

The fact that a reviewer or reviewing firm has received communication(s) relating to allegations or investigations does not automatically mean that he, she, or it is ineligible to perform peer reviews. However, there could be situations where the nature, significance, or pervasiveness of the alleged deficiencies, and/or an already existing preponderance of evidence, would necessitate immediate action in order to address the public interest. The administering entity's peer review committee will consider and investigate, as deemed necessary, the specific circumstances, including whether any action, including performing oversight on the reviewer or reviewing firm, is appropriate. This decision can only initially be appealed to the administering entity's peer review committee. For actions previously appealed to the committee, if the reviewer or reviewing firm disagrees with the action(s), he or she may appeal the decision by writing the board, explaining why he or she believes that the action(s) are unwarranted. The board will review and consider the request and respond to it as necessary and appropriate.

However, an individual may not serve as a peer reviewer if his or her ability to practice public accounting has been limited or restricted in any way (including any specific industry restrictions) by the regulatory body beginning on the date he or she is notified by the regulatory body of the limitation or restriction, until it has been removed. If the limitation or restriction has been placed on the reviewer's firm, or one or more of its offices, then the board will consider and investigate the specific circumstances, including how the limitation or restriction relates to the firm's accounting and auditing practice and personnel, to determine whether any of the individuals associated with the firm may serve as reviewers.

The reviewer, reviewing firm, the relevant administering entity, and/or the AICPA technical staff may receive notification or knowledge of a limitation/restriction on a reviewer/reviewing firm when a review is in different stages (scheduling, commencement, fieldwork, acceptance or completion, within working paper retention period or not). In these circumstances, the board will

consider various factors in determining if the review should be rescheduled, oversighted or other additional procedures performed, or a new review performed.

**34-2 Question**—What if a reviewer or reviewing firm fails to notify the relevant administering entity and/or AICPA technical staff, as applicable, of any such allegations/investigations, limitations/restrictions or both relating to the conduct of his, her or its performance of accounting, audit, or attestation engagements within the specified time requirements?

*Interpretation*—If a reviewer or reviewing firm fails to notify the relevant administering entity and/or AICPA technical staff, as applicable, of such allegations/investigations, limitations/restrictions or both, within the specified time requirements of "prior to being engaged to perform a peer review, or immediately, (if after engaged)" the reviewer/reviewing firm is not cooperating with the program. The board will consider and investigate, as deemed necessary, what actions should be taken in the specific circumstances. These actions may include, but are not limited to, on-site oversight at the reviewer's expense, permanent removal from the list of qualified peer reviewers and referral to the AICPA's Professional Ethics Division for violating the AICPA Code of Professional Conduct.

**34-3 Question**—What are some types of communications of allegations/investigations or notifications of limitations/restrictions that are appropriately related to meeting the objectives described in this interpretation?

*Interpretation*—There are many types of communications and notifications that are appropriately related to meeting the objectives described in this interpretation. See Interpretation No. 208-1b-1 for a list, which is not intended to be all-inclusive, that represents examples of the types of organizations where communications of allegations/investigations or notifications of limitations/restrictions would be relevant to meeting the objectives of the requirement.

## Other Planning Considerations and Reporting of PCAOB Inspection Results

**40-1 Question**—Paragraph .40 of the standards notes that the peer reviewer should inquire of the firm regarding the areas to be addressed in the written representation. What should be discussed with the firm regarding the PCAOB's report as referred to in paragraph .181 of the standards (paragraph 1(e) of appendix B, "Considerations and Illustrations of Firm Representations")?

*Interpretation*—If the firm has undergone a PCAOB inspection or inspections, the team captain should discuss with appropriate firm personnel the reports submitted by the PCAOB or in the absence of such reports, any findings that may have been communicated orally. The discussion should cover the reports or findings from the PCAOB's most recent inspections, both immediately prior to or during the peer review year and subsequent to the peer review year covered, if applicable. The team captain should inquire about any open PCAOB inspections, the status of those inspections, and the firm's corrective action plans. These discussions should focus on the results of the PCAOB's inspection related to the firm's system of quality control. The review team should consider what effects, if any, the matters contained in the reports could have on the planning or other procedures to be performed on the peer review. Although the PCAOB's inspection only covers the firm's SEC issuer practice, the PCAOB's inspection reports may contain information related to offices, partners, or other matters that could assist the reviewer in assessing risk and planning peer review procedures. Discussion of these findings should not be interpreted to permit the peer

reviewer to request the confidential portions of the PCAOB's reports. Rather, relevant matters in the PCAOB's reports are required to be discussed with the peer reviewer.

## Understanding the Firm's System of Quality Control

**42-1 Question**—Paragraph .42 of the standards requires the review team to obtain a sufficient understanding of the reviewed firm's system of quality control. How should the review team address elements of the system that reside outside of the firm?

*Interpretation*—The review team should inquire of the firm regarding elements of the system of quality control residing outside of the firm, for instance, membership in associations, joint ventures, non-CPA owned entities, alternative practice structures, arrangements with outside consultants, third party quality control materials (QCM), or CPE (including whether they are peer reviewed), and other. The inquiries should include how they influence the firm's system of quality control, for instance by providing consultation opportunities, CPE, and monitoring services. These elements should be considered and documented within the risk assessment.

**42-2 Question**—Many firms rely on third party quality control materials (QCM) as integral portions of the firm's system of quality control. Many third party providers elect to undergo QCM reviews. How should the review team evaluate the results of a QCM review in its consideration of the design of a reviewed firm's system of quality control?

*Interpretation*—An independent QCM review entails an assessment of the provider's system of quality control to develop and maintain the QCM, and an assessment of the resultant materials. The QCM review report includes two opinions: one on the provider's system to develop and maintain reliable aids (see paragraph .175) and a second on the reliability of the specific QCM covered by the review. The specific QCM opined on in the report will either be listed in the first paragraph of the report or in an addendum to the report. Firms utilize QCM as one of several key controls within their systems of quality control. Since the review team ordinarily assesses the suitability of the QCM as a part of its evaluation of the design of the reviewed firm's system of quality control, placing reliance on the provider's QCM review results affects the assessment of the reviewed firm's peer review risk and impacts the nature, timing, and extent of the review team's evaluation of the firm's system of quality control.

The review team should obtain the QCM review results (that is, the report, LOR [if applicable], and so on) to consider the impact on the reviewed firm's system of quality control. The provider's QCM review results may be obtained from the AICPA's website, the provider, or the reviewed firm. The review team should review the definitions of deficiencies and significant deficiencies in QCM reviews provided in paragraph .178 to understand the impact to the reviewed firm:

- If the provider received a pass report, then the review team can place reliance on the provider's QCM review results with respect to that portion of the reviewed firm's design of its system. This should be reflected in the review team's discussion of control risk in the overall peer review risk assessment. Ordinarily, a pass QCM report on materials that are integral to the firm will help lower control risk.
- If the provider received a pass with deficiencies report, the review team should first determine whether the deficiency(ies) impacted the reliability of one or more of the QCM listed in the report. Next, the review team should consider the reasons for the deficiencies identified

in the report and assess their relevance to the reviewed firm. Once this assessment is made, the review team can determine the degree of reliance it can place on the provider's results.

- a. If a deficiency or deficiencies is (are) impacting the reliability of one or more QCM used by the reviewed firm, the review team should determine whether the reviewed firm has mitigated the risk that its reliance on the QCM may lead to the firm not addressing one or more integral components of professional standards in its performance of audit or attest engagements.
- b. If a deficiency or deficiencies that is (are) on the provider's system of quality control but do not directly affect the separate opinion on the QCM or is (are) specific to QCM that are not used by the reviewed firm (for example, a deficiency related to an employee benefit plan manual, but the firm only uses a construction manual from that provider), then once this assessment is made, the review team can determine the degree of reliance it can place on the provider's results.

The impact (or lack thereof) of a pass with deficiencies QCM report should be fully explained in the discussion of control risk in the overall peer review risk assessment.

- If the provider received a fail report, no reliance can be placed on the results, and the review team should evaluate and document the impact on the reviewed firm's system of quality control in the peer review risk assessment. The review team will also need to consider the impact on the peer review scope if the firm fully relied on QCM that are not reliable aids.

If the provider obtained a QCM review, but the specific QCM used by the reviewed firm were not opined on in the QCM report, the review team will need to perform the appropriate procedures to evaluate whether the QCM were suitably designed. See Interpretation No. 42-3 for additional information.

Independent reviews of providers of QCM generally occur on a triennial basis. The review team should always obtain the most recently accepted QCM report.

In addition, the review team should consider (a) the version date of the materials relative to the period covered by the report, and (b) the amount of time that's passed since the period covered by the report in determining the degree of reliance that can be placed on the QCM review results. Factors to consider include the following:

- The issuance of new standards
- Changes in regulatory requirements
- Changes in economic conditions that affect the provider
- Limitations or restrictions on authors of the materials
- Any substantial changes or updates to the materials

Regardless of the degree of reliance placed on the provider's QCM review results, the review team is still responsible for determining which forms, checklists, programs, etc. are used by the reviewed firm as a part of its system of quality control, how often the materials are updated, the degree of reliance that the reviewed firm placed on the materials, and assessing compliance with their use. The results of the provider's QCM review should weigh in the assessment of control risk, and be documented in the risk assessment.

For additional information on QCM reviews, please see paragraphs .154–.204, and appendix A of the standards.

**42-3 Question**—How should the review team evaluate the adequacy of the materials relied upon by the reviewed firm when the materials were developed by a third party, and an independent QCM review was not completed?

*Interpretation*—To plan the review, similarly to when materials are internally developed, the review team should obtain a sufficient understanding of the reviewed firm's system of quality control with respect to compliance with each of the quality control elements of the Statements on Quality Control Standards (SQCS). As a part of obtaining that understanding, the review team should assess the suitability of the QCM utilized by the reviewed firm. See paragraphs .167–.176 for the procedures typically performed in assessing QCM.

## Considering the Firm's Monitoring Procedures

**45-1 Question**—Paragraph .45 of the standards notes that the review team should obtain a sufficient understanding of the reviewed firm's monitoring policies and procedures since its last peer review, and their potential effectiveness, to plan the current peer review. In doing so, the review team may determine that the current year's internal monitoring procedures could enable the review team to reduce, in a cost-beneficial manner, the number of offices and engagements selected for review or the extent of the functional area review. What are some factors to consider in obtaining an understanding of the firm's monitoring procedures? If the review team plans to consider the current year's internal inspection procedures to reduce the scope of the peer review, what procedures are necessary?

*Interpretation*—Factors to consider in obtaining the understanding of the firm's monitoring procedures include

- a. the qualifications of personnel performing the monitoring procedures.
- b. the scope of the monitoring procedures (coverage of functional areas and engagements and the criteria for selecting offices and engagements for review).
- c. the appropriateness of the materials used for monitoring procedures (for example, questionnaires or checklists and instructions).
- d. the depth of the review of individual engagements, particularly with respect to the review of working papers and coverage of significant areas.
- e. the findings of the monitoring procedures, including internal inspections.
- f. the nature and extent of reporting and communicating the results of the monitoring procedures.
- g. the follow-up of findings resulting from the monitoring procedures.

In making a judgment about the effects that the firm's current year's internal inspection procedures will have on the selection of offices and engagements to be reviewed, the review team should consider the size of the firm and the potential effectiveness of the internal inspection procedures.

If internal inspection procedures were not, or will not be, performed to cover the review year, the review team may not consider the prior year's internal inspection procedures to reduce the scope of the peer review.

If the review team does not plan to consider the reviewed firm's current year's internal inspection procedures to reduce the scope of the peer review, the review team need not necessarily perform the review of any of the engagements on which internal inspection procedures were performed by the reviewed firm. However, the review team may still wish to reperform the review of a few such engagements to assist the review team in obtaining a better understanding

of the effectiveness of the internal inspection procedures performed by the reviewed firm.

If the review team plans to consider the current year's internal inspection procedures to reduce the scope of the peer review, the review team should test the firm's internal inspection procedures at selected offices and on selected engagements. These tests should be sufficient to provide the review team with a basis for determining whether (a) the reviewed firm's internal inspection procedures were applied properly in the reviews of individual practice offices and engagements, (b) the practice office and Engagement Reviews were carried out conscientiously by competent persons with appropriate expertise and objectivity, and (c) the findings from the reviewed firm's internal inspection procedures are indicative of the work performed in the particular office and therefore can be considered by the review team to reach an overall conclusion regarding the reviewed firm's compliance with its quality control policies and procedures. The testing of internal inspection procedures can be performed (a) contemporaneously with the reviewed firm's internal inspection procedures (commonly called *piggyback reviews*) or (b) after the internal inspection procedures are completed. Because of the insight gained from observing the performance of internal inspection procedures, a review team testing the effectiveness of internal inspection procedures contemporaneously is generally in a better position to assess the effectiveness of the procedures.

When the review team tests the effectiveness of the internal inspection procedures contemporaneously with the performance by the internal inspection team performing the procedures, the review team should visit selected practice offices during the performance of the internal inspection procedures to (a) reperform the review of a sample of engagements subjected to internal inspection procedures and (b) reperform the review of a sample of the quality control policies and procedures (functional elements) subjected to internal inspection procedures in the office. During the visits, the review team should compare its findings to the internal inspection team's findings and resolve any differences. In addition, if applicable, the review team should attend discussions of engagement findings and the overall office findings.

When the review team tests the effectiveness of the internal inspection procedures after the procedures have been completed, the review team should reperform the review of a sample of engagements and the quality control policies and procedures (functional elements) subjected to internal inspection procedures in the office(s). The review team should compare its findings to the internal inspection team's findings and resolve any differences.

**45-2 Question**—Is there more guidance regarding the extent that scope may be reduced, and what factors must be considered and steps performed in order to conclude on the effectiveness? In addition, may a review team apply this same guidance to the involvement of and results from regulatory oversight?

*Interpretation*—Peer reviewers should refer to guidance on reducing scope included in section 3100 *Supplemental Guidance*. If, after considering that guidance, the peer reviewer plans on significantly reducing the scope of the procedures he or she will be performing, he or she is required to inform AICPA technical staff during peer review planning.

## Understanding, Assessing, and Documenting Peer Review Risk Factors and Risk Assessment

**52-1 Question**—Paragraphs .46–.52 discuss peer review risk factors and risk assessment. What other guidance should be considered?



*Interpretation*—Reviewers must assess peer review risk and use a risk-based approach in the selection of engagements and offices for review. Reviewers should formalize the risk assessment before arriving on-site in the reviewed firm's office and before selecting one or more engagements for review, otherwise they should expect ineffectiveness and, at the very least, inefficiency.

#### *Inherent Risk Factors*

In assessing inherent risk factors, the reviewer should consider

- circumstances arising within the firm (for example, the firm or individual partners have engagements in several specialized industries);
- circumstances outside the firm that impact the firm's clients (for example, new professional standards or those being applied initially for one or more clients, changes in regulatory requirements, adverse economic developments in an industry in which one or more of the firm's clients operate, or significant developments in the client's organization); and
- variances that may occur from year to year, engagement to engagement or, perhaps, from partner to partner, within the firm (for example, inherent risk will always be higher for an audit of a company or organization operating in a high-risk industry than for a compilation of financial statements without disclosure for a company operating in a noncomplex industry; and there are many situations between these two extremes).

#### *Control Risk Factors*

Assessing control risk requires reviewers to evaluate the effectiveness of the reviewed firm's quality control policies and procedures in preventing the performance of engagements that do not comply with professional standards. When assessing control risk, the review team should evaluate the reviewed firm's quality control policies and procedures and discuss with the firm if it considered the guidance in AICPA Accounting and Auditing Practice Aid *Establishing and Maintaining A System of Quality Control for a CPA Firm's Accounting and Auditing Practice*. The reviewer should evaluate whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control in the context of the firm's overall control environment and the inherent risk embodied in its accounting and auditing practice.

The assessed levels of risk are the key considerations in deciding the number and types of engagements to review and, where necessary, offices to visit. Through the assessment of risk, the reviewer determines the coverage of the firm's accounting and auditing practice that will result in an acceptably low peer review risk. Engagements selected should provide a reasonable cross-section of the firm's accounting and auditing practice, with a greater emphasis on those engagements in the practice with higher assessed levels of peer review risk.

Reviewers must document, as part of the Summary Review Memorandum (SRM), the risk assessment of the firm's accounting and auditing practice and its system of quality control, the number of offices and engagements selected for review, and the basis for that selection in relation to the risk assessment. To effectively assess risk of the firm's accounting and auditing practice and its quality control policies, risk assessment documentation should not only address the engagements selected and the reasoning behind that selection, but also the environment of the firm and its system of quality controls. Some factors that should be considered in assessing risk include the following:

- The relationship of the firm's audit hours to total accounting and auditing hours

- Size of the firm's major engagement(s), relative to the firm's practice as a whole
- Initial engagements and their impact on the firm's practice
- The industries in which the firm's clients operate, especially the firm's industry concentrations
- The results of the prior peer review
- The results of any regulatory or governmental oversight or inspection procedures
- Owners' CPE policies and the firm's philosophy toward continuing education (Accumulate the necessary hours or maintain the needed skills and improve delivery of professional services.)
- The firm's monitoring policies
- Adequacy of the firm's professional library
- Risk level of the engagements performed (For example, does the firm perform audits of employee benefit plans, entities subject to Circular A-133, and others under *Government Auditing Standards*, HUD-regulated entities, and others with high-risk features or complex accounting or auditing applications?)
- Have there been any major changes in the firm's structure or personnel since the prior peer review?

### *Detection Risk*

Inherent risk and control risk directly relate to the firm's accounting and auditing practice and its system of quality control, respectively, and should be assessed in planning the review. Based on the combined assessment, the reviewer selects engagements for review and determines the scope of other procedures to reduce the peer review risk to an acceptable level. The lower the combined inherent and control risk, the higher the detection risk that can be tolerated. Conversely, a high combined inherent and control risk assessment results in a low detection risk and the resulting increase in the scope of review procedures. See section 3100, *Supplemental Guidance*, for an example of an appropriately documented risk assessment in the SRM.

## **Review of CPE Records During a Peer Review**

**53-1 Question**—Paragraph .53 discusses testing the functional areas of a firm. What are some factors to consider regarding continuing professional education (CPE) records?

*Interpretation*—In accordance with SQCS No. 8, a firm should establish policies and procedures designed to provide it with reasonable assurance that its personnel have the appropriate competence, capabilities, and commitment to ethical principles. Such policies and procedures should address, among other items, professional development (including training or CPE). The fundamental purpose of CPE is to maintain/increase professional competence. Team captains on System Reviews should carefully consider a firm's CPE policies and the firm's philosophy toward continuing education when assessing risk during planning. In addition, team captains should carefully test a firm's CPE records to the extent deemed necessary during their testing of the functional areas of a firm. They should ascertain that the appropriate amounts and types (accounting, auditing, and quality control) of CPE are being taken by the appropriate firm personnel, including that personnel are in compliance with CPE requirements

for boards of accountancy in states in which the firm's personnel are licensed. The team captain should also consider if the firm is taking appropriate action to correct situations where personnel are not in compliance with CPE requirements. The lack of appropriateness and/or quality of a firm's compliance with CPE requirements can be the systemic cause of a matter, finding or deficiency and thus affect the firm's peer review results. A team captain's diligence in considering and testing CPE can impact the quality of the peer review and hence the program's goal of improving audit quality. A team captain's steps in considering and testing CPE during a peer review are subject to review and oversight by the administering entity.

## Planning and Performing Compliance Tests of Requirements of Voluntary Membership Organizations

**54d-1 Question**—Paragraph .54(d) discusses the peer reviewer's requirement in a System Review to review other evidential material as appropriate, including selected administrative or personnel files. Should the reviewer test the firm's compliance with requirements of voluntary membership organizations?

*Interpretation*—Voluntary membership requirements that are not directly imbedded into the firm's written system of quality control for its accounting and auditing practice are not tested as a part of the peer review. In addition, voluntary membership requirements, even those included in the firm's written system of quality control, that do not directly contribute to the firm's compliance with the requirements of the SQCSs are not tested, addressed, or reported on in the peer review process. Those membership requirements that are specifically imbedded into the firm's written system of quality control and directly contribute to the firm's compliance with the SQCSs are within the scope of peer review, but not because they are a membership requirement, but rather because they are an integral part of the firm's system of quality control for the firm to comply with the SQCSs. In this instance, any matters, findings, or deficiencies noted in these areas would only be addressed as they relate to the firm's system of quality control and they would not be described as related to the voluntary membership requirements.

## Inclusion of Engagements and Aspects of Functional Areas in the Scope of the Peer Review

**55-1 Question**—Paragraph .55 of the standards notes that there is a presumption that all engagements and all aspects of functional areas otherwise subject to the peer review will be included in the scope of the review. Could a firm have a legitimate reason for an exclusion and what is the effect on the performance of the review?

*Interpretation*—In rare situations a reviewed firm may have legitimate reasons for excluding certain engagements or certain aspects of functional areas, for example when an Engagement or an employee's personnel records are subject to pending litigation. In those instances a reviewer should carefully consider the implication of such exclusions. Those considerations should include assessing the reasonableness of the reasons for the exclusions and assessing the affect on peer review risk assessments and scope, including whether alternate procedures can be performed. To reduce the potential for disagreement about such matters among the reviewed firm, the reviewer, and the administering entity, ordinarily, when the reviewed firm contemplates excluding engagement(s) or

aspect(s) of functional area(s), it should notify the team captain in a timely manner and submit a written statement to the administering entity, ordinarily prior to the commencement of the review, indicating (a) it plans to exclude an engagement(s) or aspect(s) of functional area(s) from the peer review selection process, (b) the reasons for the exclusion, and (c) it is requesting a waiver for the exclusion. The administering entity should satisfy itself concerning the reasonableness of the explanation before agreeing to the exclusion.

For peer reviews overseen by a panel preassigned by the administering entity for on-site oversight purposes, the reviewed firm should notify the team captain in advance that it is probable that engagement(s) or aspect(s) of functional area(s) will be excluded from the review, the general reasons for such exclusion, and a detailed description of the procedures used to identify and assess those situations. The panel as previously described should determine that those procedures are appropriate in light of the circumstances. They should consider the level of oversight to which the review may be subject and the level of involvement that members of the board have in that oversight. In addition, they should consider the practicality of selecting a replacement and the availability of other engagement(s) or aspect(s) of functional area(s) as appropriate replacements. Ordinarily, the greater the population to select from, the more there is an opportunity to find an appropriate replacement, and the less there is a risk that there is a scope limitation.

The administering entity (or panel as previously described) should approve the request to exclude engagement(s) or aspect(s) of functional area(s) as the situation arises only when it is satisfied that, based on the reasonableness of the procedures used to identify and assess the situations and the other factors described in the preceding, there will be no limitations on the scope of the review.

Regardless of the approach used to notify the administering entity of exclusions, the reasons for the exclusions and the risk assessment implications should be fully documented in the peer review working papers, and the peer review committee should consider those factors as part of its evaluation and acceptance process.

An administering entity may conclude that scope has been limited due to circumstances beyond the firm's control and the review team cannot accomplish the objectives of those procedures through alternate procedures, thus precluding the application of one or more peer review procedure(s) considered necessary in the circumstances. For example, ordinarily, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began. In these circumstances, the team captain or review captain should consider issuing a report with a peer review rating of *pass (with a scope limitation)*, *pass with deficiency (with a scope limitation)*, or *fail (with a scope limitation)*, as applicable. The existence of a scope limitation in and of itself does not result in a report with a peer review rating of *pass with deficiencies* or *fail*; it is in addition to the grade that was determined to be issued (which is why it is possible to have a report with a grade of *pass (with a scope limitation)* to which there would be no letter of response).<sup>3</sup>

If the administering entity (or panel as previously described) concludes that there is not a legitimate reason for the requested exclusion and the firm

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<sup>3</sup> This is different than the pre-2009 standards whereby a scope limitation was treated as a modified peer review report.

continues to insist on the exclusion, it should be evaluated whether this is a matter of noncooperation (see Interpretation No. 5h-1).

## Office and Engagement Selection in System Reviews

**56-1 Question**—Paragraph .56 of the standards provides factors to consider when assessing peer review risk at the office level. What are some other examples of factors to consider?

*Interpretation*—Other examples of factors to consider when assessing peer review risk at the office level follow. This list is for illustrative purposes only, and does not include all possible inherent and control risk factors, nor is the peer reviewer required to consider every item on the list when assessing inherent and control risk:

- Offices with one or a few engagements comprising a significant portion of the office's accounting and auditing practice
- Offices with concentrations of high risk engagement
- Offices with a pattern of litigation or regulatory actions
- Offices identified in the preceding peer review or through monitoring procedures as operating at a level significantly below the firm's quality standards
- Offices with an unreasonably large number of accounting and auditing hours per engagement partner
- Offices with only one or a few engagements in a specialized industry
- Offices not subjected to monitoring procedures or not scheduled to be subject to monitoring procedures since the last peer review
- Offices where individual partners practice in many industries
- Offices in geographic areas that are experiencing economic hardships
- Offices with numerous clients in industries experiencing economic hardships

**58-1 Question**—Paragraph .58 of the standards provides guidance on steps to follow if a current year's engagement has not been completed and issued. What is the impact, if any, for audit engagements subject to professional standards, statutes, regulations, or the firm's quality control policies, which may allow a specified time for an assembly process after issuance?

*Interpretation*—Professional guidance indicates that auditors should not date the audit report until they have obtained sufficient appropriate audit evidence to support the opinion. At that point audit documentation should have been reviewed, financial statements should have been prepared, and management should have asserted its responsibility for them. Document completion dates specify a date certain by which assembly of the audit file must be completed. During the period leading up to that date, changes can be made to the audit documentation to complete the documentation and assembly of audit evidence, perform routine file-assembling procedures, sign off on file completion checklists and add information received after the date of the auditor's report; for example, an original confirmation that was previously faxed. However, the sufficient appropriate audit evidence would have already been required to be in place when the report was dated and thus would be in place when it was issued. Thus, there is no impact on the process of selecting engagements for review.

**58-2 Question**—What if the incomplete engagement is an initial engagement and there is no comparable engagement?

*Interpretation*—If there is an incomplete engagement (which is an initial engagement) and there is no comparable engagement, the firm should request an extension from the administering entity. The administering entity will consider the circumstances and evaluate whether there is actually a matter of noncooperation (see Interpretation No. 5h-1). Although the administering entity will otherwise likely grant the extension, the firm needs to consider if it will be meeting the requirements of its state board of accountancy or other regulatory bodies. If an extension is not possible, the peer review should be performed and the report should include a scope limitation.

If the situation arose due to a permanent change in the nature of the firm's business, the firm should consider requesting a change in its peer review year-end date. If there is any uncertainty concerning how the situation should be handled, the administering entity should be contacted. See section 3100, *Supplemental Guidance*, for an example when there is an initial engagement performed under *Government Auditing Standards* (GAS, also known as the Yellow Book) meeting the preceding criteria.

**58-3 Question**—Paragraph .58 of the standards indicates that if the subsequent year's engagement has been completed and issued, the review team should consider, based on its assessment of peer review risk, whether the more recently completed and issued engagement should be reviewed instead. What are some factors to be considered and implications on the peer review?

*Interpretation*—Other than consideration of the firm's risk assessment and the factors that contributed to it, the reviewer may consider if the subsequent engagement was performed during or after the peer review year. In addition, the reviewer should consider the number of subsequent engagements available and selected for review, as well as the differences in issues encountered in the engagements whether the year-end was within the peer review year or subsequent to it. The greater the number of subsequent year engagements selected, the greater the risk that the results of the review are not appropriate or matched in relation to the peer review year covered by the report and the related peer review results. In some situations, the team captain should consider whether it is more appropriate to issue the peer review report on the subsequent year. However, this should be a rare situation, would require advance approval from the administering entity, and that entity may request that the next review be accelerated to put the firm back on cycle. If many of the subsequent engagements have been issued, the reviewer should discuss the timing of the peer review with the firm so that future reviews may benefit from the results of the peer review before the subsequent engagements are issued.

**59-1 Question**—Paragraph .59 of the standards requires that engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk, and the guidance provides examples of factors to consider when assessing peer review risk at the engagement level. What are some other considerations?

*Interpretation*—A reasonable cross section of a firm's accounting and auditing practice, not only includes consideration of the specific industries that are required to be selected, but other industries that have a significant public interest. Industries that have a significant public interest are those that benefit the general welfare of the public, such as those that have recent regulatory and legislative developments (for example broker-dealers). Public interest industries will vary across firms and reviewers should consider the composition of a firm's accounting and auditing practice when determining if their risk assessment should address a public interest industry. The reviewer also needs to carefully consider the industries that the firm has identified in the category

of "other audits" when determining whether to select such an engagement(s). A selection consisting solely of public interest industries would not necessarily represent a reasonable cross section. Other factors to consider in selecting a reasonable cross section may include the number of partners, the number of practice offices, and materiality thresholds of accounting and auditing hours.

The reviewer should explain and document in the *Summary Review Memorandum* key decisions that he or she made when he or she chose not to select any one or more of the following: a level of service, industries in which a significant public interest exists, and industries in which the firm performs a significant number of engagements. This does not give authority to the reviewer to avoid selecting an engagement(s) by simply documenting the reason(s) why he or she did not select certain engagement(s). Therefore the reviewer should document important considerations regarding the engagement selection process.

A reasonable cross section does not always require that at least one engagement from every level of service provided by the firm be selected for review; however, it often may be appropriate in the circumstances. There is no percentage of coverage that necessarily ensures a reasonable cross section. Therefore, there is a relationship between a risk-based approach and a reasonable cross section when selecting engagements, and in that regard each peer review needs to be considered on a case-by-case basis.

The following are examples of risk considerations when addressing obtaining a reasonable cross section of the engagements, including engagements that must be selected and non-carrying broker-dealers. It is expected that the various types of engagements within an industry are specifically addressed in the risk assessment. Similar considerations should be made for industries that have a significant public interest.

- a. *Governmental—Government Auditing Standards*—Inclusion of a must select engagement should not supersede the reviewer's consideration of engagements and industries that have a significant public interest such as state and local governments, school districts and HUD engagements. For example, if for-profit HUD multi-family housing project audit engagements constitute a significant percentage of a firm's practice, one would expect the reviewer to select at least one such engagement for review. However, if the firm also performed an audit of an engagement subject to Circular A-133, such as a local government or not-for-profit organization, one such engagement must also be selected to perform an evaluation of the firm's compliance with Circular A-133. Peer reviewers should also consider audit firm experience such as how many governmental audits the firm performs, the length of experience in performing these engagements, the size of the audit firm, team members with experience, and CPE or specialized training. Further consideration should be given to communications from regulatory agencies.
- b. *Employee benefit plans*—For employee benefit plans under ERISA, the peer reviewer should consider whether the engagement selection process has adequately addressed the risks involved in limited versus full scope audits and in different types of benefit plans such as defined benefit, defined contribution, and voluntary health and welfare plans. If a firm has more than one of the preceding types of plans, the reviewer must consider the unique risks associated with that type of plan and document how these risks were addressed in the risk assessment. Peer reviewers should also consider audit firm experience such as how many ERISA audits the firm performs, the length of experience in performing these engagements, the size of the audit firm, team members with

experience, and CPE or specialized training. Further consideration should be given to communications from regulatory agencies.

- c. *Depository Institutions*—For FDICIA engagements, peer reviewers should take into consideration the amount of total assets held by the federally insured depository institution (less than \$500 million, more than \$500 million, more than \$1 billion). Peer reviewers should also consider audit firm experience such as how many FDICIA audits the firm performs, the length of experience in performing these engagements, the size of the audit firm, team members with experience, and CPE or specialized training. Further consideration should be given to the risks of the audited company such as the level of reporting the institution complies with (the holding company level or the bank subsidiary level and the regulatory issues associated with each), the balance of the lending portfolio (the industries and concentration percentage of the portfolio), any regulatory correspondence and examination results, capital ratios, financial institution management experience, economic environment and geographic location of the institution, number of branches, and experience and longevity of the board of directors and audit committee.
- d. *Broker-dealers*—The peer reviewer should consider whether the engagement selection process has adequately addressed the risks involved in carrying and non-carrying broker-dealers. Consideration of carrying broker-dealers should include carrying, clearing, and custodial broker-dealers. Consideration of non-carrying broker-dealers should include introducing broker-dealers. The peer reviewer should also consider other types of broker-dealers that fit the description of carrying and non-carrying broker-dealers in Interpretation No. 63-2. If a firm has more than one of the preceding types of audits, the reviewer must consider the unique risks associated with that type of audit and document how these risks were addressed in the risk assessment. For all broker-dealer engagements, the peer reviewer should consider audit firm experience such as how many broker-dealer audits the firm performs, the length of experience in performing these engagements, the size of the audit firm, team members with experience, and CPE or specialized training. Further consideration should be given to communications from regulatory agencies. For non-carrying broker-dealers, the peer reviewer's risk assessment is expected to address the risks associated with those broker-dealers (for example, if the broker-dealer has some form of custody and control that may create risk and require additional internal controls).

**59-2 Question**—Paragraph .59 of the standards provides factors to consider when assessing peer review risk at the engagement level. What are some other examples of factors to consider?

*Interpretation*—Other examples of factors to consider when assessing peer review risk at the engagement level follow. This list is for illustrative purposes only, and does not include all possible inherent and control risk factors, nor is the peer reviewer required to consider every item on the list when assessing inherent and control risk:

- Engagement size, in terms of the hours required to plan and perform it
- Engagements involving experienced personnel hired from other firms, and partners who also have office, regional or firm-wide management, administrative, or functional responsibilities



- Engagements where work on segments has been referred to other firms, foreign offices, domestic or foreign affiliates, or correspondents
- Engagements where one or more affiliated entities (for example, parent companies and subsidiaries or brother and sister companies) constitute a large portion of the firm's overall clientele
- Engagements identified in the firm's quality control System or guidance material as having a high degree of risk
- Engagements where departures from professional standards and failure to comply with the firm's quality control policies and procedures were noted in the preceding year's monitoring procedures
- Engagements in industries where the firm has experienced high instances of litigation, proceedings, or investigations
- Engagements affected by recently implemented revisions of the firm's quality control policies and procedures
- Engagements affected by newly effective professional standards
- Clients in industries in poor financial condition
- Clients in industries with complex or sophisticated transactions
- Engagements from merged-in practices
- Engagements subject to *Government Auditing Standards*
- Engagements subject to the Employee Retirement Income Security Act of 1974 (ERISA)
- Engagements subject to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)
- Audits of securities and commodities broker-dealers

**59-3 Question**—What factors should be considered if a firm has an office in a foreign country or other territory?

*Interpretation*—The standards are intended for firms of AICPA members who are engaged in the practice of public accounting in the United States or its territories. Some firms also have offices in foreign countries or their territories ("foreign jurisdictions"), including the Cayman Islands and Bermuda. One important factor to consider in determining whether reports issued for clients in those foreign jurisdictions are to be included in the scope of the peer review is the letterhead of the report issued. For instance, ordinarily if a U.S. firm issues a report on letterhead from its office in that foreign jurisdiction, the engagement would not be included in the scope of the peer review. Another factor is whether the reports issued for clients in the foreign jurisdictions are addressed by guidance from the state board of accountancy(s) that issues the firm's license(s). Team or review captains should consult with AICPA technical staff if there is any question of whether an engagement is subject to peer review under these circumstances. In addition, reviewed firms need to consider whether there are peer review or practice monitoring requirements issued by the licensing authority of the foreign jurisdiction which are applicable to the reviewed firm.

**61-1 Question**—Paragraph .61 of the standards requires that at least one engagement from the initial selection to be reviewed should be provided to the firm once the review commences and not provided to the firm in advance (the surprise engagement). What steps should be followed when making the selection of the surprise engagement?

*Interpretation*—The following steps should be followed:

1. Complete the risk assessment as described in paragraphs .46–.52 of the standards.
2. Plan the compliance tests as described in paragraphs .53–.63 of the standards and determine which engagements should be selected for the review, independent of any surprise selections.
3. Based on those engagements selected for review, determine which engagement should be the surprise engagement. If the risk assessment warrants, more than one surprise engagement may be selected.

Although the standards indicate that the engagement should be the firm's highest level of service (which ordinarily means an audit), in situations where the audit cannot be the surprise selection (for instance, if there is only one audit required to be selected or the only audit is a must select engagement), an engagement from the next highest level of service should be selected. It is not always possible for the reviewer to know whether a reviewed firm expects a certain engagement to be selected. Reviewers are asked to use their professional judgment in these situations. The selection should be based on the risk assessment performed in step 1 and the engagement should be from the list of engagements determined in step 2. The team captain should not increase the original scope of the selection whether another audit or another level of service is selected as the surprise engagement.

See section 3100, *Supplemental Guidance*, for several examples for selecting surprise engagements.

**61-2 Question**—How does the requirement to select a surprise engagement apply for a System Review performed at a location other than the reviewed firm's offices (Interpretation No. 8-1)?

*Interpretation*—For System Reviews approved by the administering entity to be performed at a location other than a reviewed firm's offices, engagements selected to be reviewed are submitted to the reviewer by the firm. As a result, the requirement to select a surprise engagement on a System Review performed at a location other than the reviewed firm's offices is not applicable.

**62-1 Question**—Paragraph .62 of the standards requires that the team captain consult with the administering entity about the selection of engagements for review if the team captain finds that meeting all of the criteria in the related guidance results in the selection of an inappropriate scope of the firm's accounting and auditing practice. What items should the team captain consider to determine if the selection is appropriate?

*Interpretation*—The team captain should carefully consider whether

- a. significant risk areas have appropriate coverage (see paragraph .65 of the standards).
- b. appropriate weight has been given to reviewing work performed by all or most supervisory personnel.
- c. adequate consideration has been given to engagement selection based on peer review risk on a firm-wide basis. For example, if two offices are selected for review and each has a large client in the same specialized industry, peer review risk should be considered in determining whether more than one of these engagements should be selected for review.

If an engagement(s) within the team captain's selection is not available for review, a comparable engagement within the peer review year-end is also not available, nor is there a prior year's engagement that may be reviewed; the team captain should consult with the administering entity to determine the effects on the timing or year-end of the peer review, if any, and whether a report with a peer review rating with a scope limitation should be issued.

**63-1 Question**—Paragraph .63 of the standards requires that specific types or number of engagements must be selected in a System Review as well as specific audit areas. In a System Review, what specific types and number of engagements, if any, should be included in the sample of engagements selected for review or assessed at a higher level of peer review risk?

*Interpretation*—At least one of each of the following types of engagements is required to be selected for review in a System Review:

- a. *Governmental—Government Auditing Standards*, issued by the U.S. Government Accountability Office, requires auditors conducting engagements in accordance with those standards to have a peer review that includes the review of at least one engagement conducted in accordance with those standards. If a firm performs an engagement of an entity subject to GAS and the peer review is intended to meet the requirements of those standards, at least one engagement conducted pursuant to those standards should be selected for review. Additionally, if the engagement selected is of an entity subject to GAS but not subject to the Single Audit Act/OMB Circular A-133 and the firm performs engagements of entities subject to OMB Circular A-133, at least one such engagement should also be selected for review. The review of this additional engagement must evaluate the compliance audit requirements and may exclude those audit procedures strictly related to the audit of the financial statements.
- b. *Employee Benefit Plans*—Regulatory and legislative developments have made it clear that there is a significant public interest in, and a higher risk associated with, audits conducted pursuant to ERISA. Therefore, if a firm performs the audit of one or more entities subject to ERISA, at least one such audit engagement conducted pursuant to ERISA should be selected for review.
- c. *Depository Institutions*—The 1993 FDIC guidelines implementing the FDICIA require auditors of federally insured depository institutions having total assets of \$500 million or greater at the beginning of its fiscal year to have a peer review that includes the review of at least one audit of an insured depository institution subject to the FDICIA. If a firm performs an audit of a federally insured depository institution subject to the FDICIA and the peer review is intended to meet the requirements of the FDICIA, at least one engagement conducted pursuant to the FDICIA should be selected for review. The review of that engagement should also include a review of the reports on internal control if applicable because those reports are required to be issued under the FDICIA when total assets exceed \$1 billion.
- d. *Broker-Dealers*—Regulatory and legislative developments have made it clear that there is a significant public interest in, and a higher risk associated with, audits of broker-dealers. The type of broker-dealer with the highest risk is a carrying broker-dealer. Therefore, if a firm performs the audit of one or more carrying broker-dealers, at least one such audit engagement should be selected for review. It is also expected that if a firm's audits of broker-dealers include only non-carrying broker-dealers, the team captain should be aware of and give special consideration to the risks associated with such broker-dealer audits in making engagement selections.

In complying with the requirements in the previous list, peer reviewers should also ensure that the engagements selected include a reasonable cross section of the firm's accounting and auditing engagements, appropriately weighted considering risk. Thus, the peer reviewer may need to select greater than the

minimum of one engagement from these industries in order to attain this risk weighted cross section.

For benefit plans under ERISA, the peer reviewer should also consider whether the engagement selection process has adequately addressed the risks involved in limited versus full scope audits and in different types of benefit plans such as defined benefit, defined contribution, and voluntary health and welfare plans. Similar considerations should be made on GAS, FDICIA, and broker-dealer engagements.

The team captain's consideration of this coverage should be discussed in his or her risk assessment documentation. This discussion should include any factors considered when the reviewed firm has a significant number of engagements in one of these high risk areas and it is not otherwise evident why only one engagement from the industry has been included in the scope of the review.

**63-2 Question**—For purposes of the AICPA Peer Review Program, what is the difference between a carrying and non-carrying broker-dealer?

*Interpretation*—Carrying broker-dealers include all broker-dealers that clear customer transactions, carry customer accounts or hold custody of customer cash or securities. Examples of carrying broker-dealers include (a) clearing broker-dealers who receive and execute customer instructions, prepare trade confirmations, settle the money related to customer trades and arrange for the book entry (or physical movement) of the securities and (b) carrying broker-dealers that hold customer accounts or clear customer trades for introducing broker-dealers. Non-carrying broker-dealers are those broker-dealers that do not clear customer transactions, carry customer accounts, or hold custody of customer cash or securities. Examples of non-carrying broker-dealers are (a) introducing broker-dealers that introduce transactions and accounts of customers or other broker-dealers to another registered broker-dealer that carries such accounts on a fully disclosed basis and does not receive or hold customer or other broker-dealers securities and (b) a broker-dealer whose business does not involve customer accounts, such as proprietary trading firms, investment banking firms, and firms that sell interest in mutual funds or insurance products.

## Concluding on the Review of an Engagement

**66-1 Question**—Paragraphs .66-.67, and .109 of the standards requires the review team to conclude on the review of an engagement by determining whether the engagement was performed or reported on in conformity with applicable professional standards in all material respects. How should this conclusion be made?

*Interpretation*—The review team should use practice aids that document, for each engagement reviewed, whether anything came to the review team's attention that caused it to believe the following, as applicable:

- a. The financial statements were not in conformity with GAAP in all material respects or, if applicable, with an other comprehensive basis of accounting and the auditor or accountant's report was not appropriately modified.
- b. The firm did not perform or report on the engagement in all material respects in accordance with generally accepted auditing standards and other applicable standards, for example, *Governmental Auditing Standards*.
- c. The firm did not perform or report on the engagement in all material respects in accordance with SSARSs.

- d. The firm did not perform or report on the engagement in all material respects in accordance with SSAEs or any other applicable standards not encompassed in the preceding.

In Engagement Reviews, these results should be considered by the review captain in determining the type of report to issue.

**67-1 Question**—Paragraphs .67 and .109 of the standards notes that the team captain or review captain should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards and remind the firm of its obligations under professional standards to take appropriate actions. How is this communication made and what other responsibilities does the team captain or review captain have in regard to the affected engagements?

*Interpretation*—If the reviewer answers *yes* with respect to any of the preceding items, the team captain or review captain should promptly inform an appropriate member of the reviewed firm on an MFC form. The team captain or review captain should remind the reviewed firm of its obligations under professional standards to take appropriate actions as addressed in the section of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, or SSARS No. 19, *Compilation and Review Engagements*, as applicable, or, if the firm's work does not support the report issued, as addressed in AU-C section 585, *Consideration of Omitted Procedures After the Report Date*. The reviewed firm should investigate the issue questioned by the review team and determine what timely action, if any, should be taken, including actions planned or taken to prevent unwarranted continued reliance on its previously issued reports. The reviewed firm should then advise the team captain or review captain of the results of its investigation, including parties consulted, and document on the MFC form prepared by the reviewer the actions planned or taken or its reasons for concluding that no action is required.

Reviewers or administering entities should not instruct reviewed firms to recall accounting or auditing reports, to have them reissued, or to revise previously issued financial statements because those are decisions for the firm and its client to make. However, the firm's actions may affect other corrective actions the administering entity's peer review committee may impose.

If the firm has taken action, the review team should review documentation of such actions (for example, reissued report and financial statements or letter recalling previously issued reports) and consider whether the action is appropriate. If the firm has not taken action, the review team should consider whether the planned actions are appropriate.

## Determining the Cause for a Finding in a System Review

**83-1 Question**—Paragraph .83 of the standards notes that when a review team is faced with an indication that a matter(s) could be a finding and/or that the firm failed to perform or report in conformity with applicable professional standards in all material respects, the review team's first task in such circumstances is to determine the cause of the finding or failure. Why?

*Interpretation*—The evaluation of a firm's system of quality control is the primary objective of a System Review and the basis for the peer review report.

As such, when a reviewer in a System Review discovers a matter, including an engagement that was not performed or reported in conformity with applicable professional standards in all material respects, he or she should avoid considering the type of report to issue until the underlying cause of the matter

(to determine if it rises to the level of a finding, deficiency or significant deficiency) is identified, where it is reasonably possible to do so.

Reviewers in a System Review must think of matters as symptoms of weaknesses in the firm's system of quality control. Further, reviewers must make a good faith effort to try to identify the underlying systemic cause for those matters to determine if they rise to the level of a finding. A finding has a systemic definition; a finding is one or more related matters that result from a *condition* in the reviewed firm's system of quality control or compliance with it such that there is more than a remote possibility that the reviewed firm would not perform and/or report in conformity with applicable professional standards. With a finding, the reviewer is considering more than just the "matter;" they are considering the condition (that is, systemic cause) that resulted in the matter(s) occurring. Otherwise said, the reviewer must determine why the matters occurred. Upon further evaluation, a finding may rise to a systemically oriented deficiency or significant deficiency.

Causes for one or more matters are only documented when one or more matters rise to the level of a finding or a deficiency or significant deficiency (and then are documented on an FFC form or in the report, respectively). Furthermore, since the cause may not ultimately be documented for all matters, the only way to determine if one or more matters rise to the level of a finding or higher, is to try to identify the underlying systemic cause.

One reliable method for identifying a matter's systemic cause is to require complete answers on all MFC forms, instead of merely a check mark for the "yes we agree" response. The reviewer may also survey firm personnel for causes of matters. Reviewers should consider that separate matters that are exactly the same may result from completely different quality control weaknesses in the firm.

Without identifying and understanding the underlying cause(s), a reviewer cannot make meaningful recommendations that help reduce the likelihood of the repeat finding(s), deficiency(ies), or significant deficiency(ies) recurring (or findings that develop into deficiencies or significant deficiencies in the future).

Reviewers should not assume that the recommendation of the use of standard forms and checklists will improve a firm's system of quality control. Although forms and checklists are helpful in many circumstances, their use may not change behavior, improve performance, or cure findings, deficiencies, and significant deficiencies. For example, checklists will not help firms that lack overall knowledge of accounting and auditing matters or knowledge in the specific area in which the deficiency arose. Nor will standard checklists help firms in which policies and procedures for the review of engagements are routinely overridden.

Additional guidance on the systemic approach of a System Review is included in chapter 4 of PRP 3300, *AICPA Peer Review Program Report Acceptance Body Handbook*.

**83-2 Question**—For System Reviews and Engagement Reviews, what is considered a repeat finding on a finding for further consideration (FFC) form?

*Interpretation*—On System Reviews, a repeat finding is one or more related matters that result from a condition in the reviewed firm's system of quality control or compliance with it that is noted during the current review and also on an FFC form in the prior peer review.<sup>4</sup> The review team should read the prior review documentation, including the report, letter of response, FFC forms and letter of comments, if applicable, and evaluate whether the firm's planned actions noted on those forms were implemented. If the firm's planned actions to

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<sup>4</sup> Or the letter of comments, or both, if applicable, for reviews commenced prior to January 1, 2009.

remediate the prior review findings were implemented, and the same finding is occurring, the review team should determine the condition in, or compliance with, the firm's system of quality control that caused the current finding. If it is determined to be the same systemic cause, the FFC form should indicate that similar findings were noted in the prior review. If the prior remedial actions (corrective actions, implementation plans, or as discussed in the firm's response on the FFC form) appear to be effective, the finding may be caused by some other condition in, or compliance with, the firm's system of quality control. If the underlying cause of the finding is different from that noted in the prior review, it would not be a repeat.

See section 3100, *Supplemental Guidance*, for an example of identifying repeat findings, deficiencies, and significant deficiencies in a System Review.

On Engagement Reviews, a repeat is one in which the identified finding is substantially the same (that is, the same kind or very similar) as noted on an FFC form in the prior peer review<sup>5</sup> as it relates to reporting, presentation, disclosure or documentation. For example, if a reviewer notes an engagement that had a disclosure or financial statement presentation finding on an FFC form in the prior peer review, the disclosure or financial statement presentation finding noted in the current review would need to be substantially the same disclosure or financial statement presentation finding to qualify as a repeat.

A firm that repeatedly receives peer reviews with consistent findings that are not corrected may be required to complete an implementation plan.

**83-3 Question**—Paragraph .83 of the standards notes the importance of determining the cause of the identified findings or failures to determine whether they are systemic in nature. How do the results of regulatory or governmental oversight or inspection factor into this determination?

*Interpretation*—The review team should consider the results of applicable regulatory or governmental oversights or inspections (for example, PCAOB or DOL inspections, DHHS desk reviews, and so on) and compare those results to the peer review results. If similar issues to those noted in the peer review arise from such oversights or inspections, the review team should further understand the remediation taken by the firm in response to the identified oversight or inspection findings and consider the effectiveness of the actions taken. If the firm did not remediate the issues raised in a regulatory or governmental oversight or inspection, the reviewer should consider whether the failure to remediate is indicative of a weakness in the firm's system of quality control. See Interpretation No. 40-1 for additional considerations.

## Isolated Matters in a System Review

**84-1 Question**—Paragraph .84 refers to isolated matters in a System Review. What is an isolated matter and what further guidance is there to address isolated matters?

*Interpretation*—An isolated matter occurs when there is an incident (or limited incidents) of noncompliance with professional standards or the firm's quality control policies and procedures on one or more engagements (or aspect of a functional area) and the identical standards or policies and procedures were complied with on the remaining engagements or aspect of a functional area.

Reviewers should follow the guidance in paragraph .68, "Expansion of Scope," and paragraphs .84–.85, "Determining the Cause for a Finding," of the standards. The reviewer needs to evaluate the pervasiveness of the issue, including

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<sup>5</sup> See footnote 4.

expanding scope if necessary. In some instances the team captain should expand scope to other engagements or aspects of functional areas, and determine that such matters did not occur elsewhere, thus evidencing that the noncompliance with the firm's system of quality control was truly isolated. In these situations, team captains should focus on the underlying cause of the matter when analyzing if it is isolated and may consider a key area approach when expanding scope to other engagements or aspects of functional areas to determine if the matter is isolated. The reviewer's ability to conclude a matter is isolated may be dependent on his or her ability to expand scope to engagements or aspects of functional areas that are classified by common characteristics such as, but not limited to, the industry, level of service, the practitioners in charge, or engagements that must be selected in a peer review.

The reviewer should consider that a single disclosure matter and a single documentation matter may be isolated when taken individually but they may have resulted from the same underlying systemic cause. They should further consider that an isolated matter may be materially significant in amount or nature or both.

Reviewers should document their consideration of an isolated matter and the conclusions reached in the MFC form. Team captains should document the same in the Summary Review Memorandum. The documentation should include the details of the matter noted, how the reviewer expanded scope, if applicable, and why the reviewer concluded the matter was isolated. The documentation should provide enough information for the administering entity's peer review committee to determine if the team captain's conclusion is appropriate.

## Communicating Conclusions at the Exit Conference

**91-1 Question**—Paragraph .91 of the standards instructs a team captain on communicating conclusions at the exit conference in a System Review. What other guidelines should be followed?

*Interpretation*—The team captain should consider the need to have the team member(s) participate (in person or via teleconference) in the exit conference or be available for consultation during the exit conference, especially when, in unusual circumstances, the team captain does not have the experience to review the industry of an engagement that was reviewed by the team member. Furthermore, the exit conference is not the appropriate place or time to surprise the firm with the intention of issuing a *pass with deficiency* or *fail* Report or to discuss any unresolved accounting and auditing issues. It is expected that the team captain will have an open means of communication with various levels of personnel leading up to the exit conference, having at a minimum and as applicable, promptly informed them when an engagement is not performed or reported on in conformity with applicable professional standards, having discussed MFC and FFC forms including the systemic causes and related recommendations for any matters, findings, deficiencies, and significant deficiencies in advance, and having followed up on open questions and issues.

## Notification and Submission of Peer Review Documentation to the Administering Entities by the Team Captain or Review Captain

**94-1 Question**—Paragraphs .94, .120, and .190 of the standards instruct a reviewer to see the interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity. What



materials should be submitted by the team captain or review captain, and when should they be submitted by?

*Interpretation*—The team captain or review captain should notify the administering entity that the review has been performed and should submit to that administering entity within 30 days of the exit conference date in a System Review (or the review captain's discussions with the reviewed firm regarding the results of the review in an Engagement Review) or by the firm's peer review due date, whichever date is earlier, a copy of the report, and the following documentation required by the administering entities at a minimum (consider sending by an insured carrier or retaining or sending copies, or both):

*For System and Engagement Reviews:* The firm-wide Summary Review Memorandum (including the Disposition of MFC), Team Captain Checklist or Review Captain Checklist (as applicable), and MFC and FFC forms, as applicable. Note that other working papers on these peer reviews (including the representation letter) are subject to oversight procedures and may be requested at a later date.

*For:*

- *Committee-appointed review team Engagement Reviews*
- *All System Reviews, Engagement Reviews, and quality control materials reviews administered by the National PRC*

In addition to the preceding, include all other working papers incorporated by reference, as applicable, including engagement checklists; quality control documents and related practice aids; staff interview, focus group, and other interview sessions; planning documents; and any other relevant documents.

## Reporting on System and Engagement Reviews When a Report With a Peer Review Rating of *Pass With Deficiency* or *Fail* Is Issued

**96m-1 Question**—Paragraphs .96(m) and .122(m) of the standards instruct a team captain in a System Review (or review captain on an Engagement Review), to include, for reports with a peer review rating of *pass with deficiency(ies)* or *fail*, descriptions (systemically written, in a System Review) of the deficiencies or significant deficiencies and the reviewing firm's recommendations. What is the treatment of FFCs, if any, when these reports are issued, and how are deficiencies treated for reports with a peer review rating of fail?

*Interpretation*—Any findings that are only raised to the level of an FFC remain in an FFC and are not included in a report with a peer review rating of *pass with deficiency* or *fail*.<sup>6</sup>

A *significant deficiency* in a System Review is one or more *deficiencies* that the peer reviewer has concluded results from a condition in the reviewed firm's system of quality control or compliance with it such that the reviewed firm's system of quality control taken as a whole does not provide the reviewed firm with reasonable assurance of performing or reporting in conformity with applicable professional standards in all material respects. Such *deficiencies* are communicated in a report with a peer rating of *fail*. Therefore, this is a systemic

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<sup>6</sup> Previously, when a determination was made to issue an adverse report, then any matters that ordinarily would have only been included in a letter of comment were placed in the adverse report and no letter of comment was issued.

approach to determining whether the *deficiencies* identified meet this *significant deficiency* threshold. If they do, then a report with a peer review rating of *fail* is issued and *all* of the *deficiencies* are considered *significant deficiencies* and are identified as such. Such a report would not have a section with "Significant Deficiencies" and another section for "Deficiencies," as they would all be categorized as *Significant Deficiencies*.

A *significant deficiency* on an Engagement Review exists when the review captain concludes that *deficiencies* are evident on all of the engagements submitted for review (with the exception of when more than one engagement has been submitted for review, the exact same deficiency occurs on each of those engagements, and there are no other deficiencies, which ordinarily would result in a report with a peer review rating of *pass with deficiencies*). Such *deficiencies* are communicated in a report with a peer review rating of *fail*. Therefore, on an Engagement Review, all of the engagements reviewed are considered concerning whether *deficiencies* were noted when determining if the *significant deficiency* threshold is met. If they do, then a report with a peer review rating with *fail* is issued and *all* of the *deficiencies* are considered *significant deficiencies* and are identified as such. Such a report would not have a section with "Significant Deficiencies" and another section for "Deficiencies," as they would all be categorized as *Significant Deficiencies*.

**96n-1 Question**—Paragraphs .96(n) and .122(n) of the standards instruct a team captain in a System Review (or review captain on an Engagement Review) to identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also made in the report issued on the firm's previous peer review. What further guidance is available in regards to this requirement?

*Interpretation*—On System Reviews, a repeat is a deficiency or significant deficiency noted during the current review that was caused by the same system of quality control weakness noted in the prior review's report.<sup>7</sup> The review team should read the prior report and letter of response and evaluate whether corrective actions discussed have been implemented to determine whether the systemic cause is the same. The deficiency or significant deficiency should note that "This deficiency [or significant deficiency, as applicable] was noted in the firm's previous peer review."

If the corrective actions have been implemented and the same deficiency or significant deficiency is occurring, the review team should determine the weakness in the firm's system of quality control that is causing the deficiency or significant deficiency to occur. In this case, if the prior corrective actions appear to be effective, the deficiency or significant deficiency may be caused by some other weakness in the firm's system of quality control. If the underlying cause of the deficiency or significant deficiency is different from that reported in the prior review, it would not be a repeat.

The preceding also applies when the deficiency or significant deficiency noted during the current review was caused by the same system of quality control weakness noted on an FFC form or letter of comment in the prior review. The team captain should consider if the firm's planned actions to remediate the prior review findings were implemented, including implementation plans or those discussed in the firm's response on the FFC form. If the prior remedial actions appear to be effective, the current deficiency may be caused by some

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<sup>7</sup> Or the letter of comments, or both, if applicable, for reviews commenced prior to January 1, 2009. Although the repeat was not classified as a deficiency or significant deficiency in that review, this is an appropriate approach because the finding was included in the peer review reporting package at that time.

other weakness in or compliance with the firm's system of quality control. If the underlying cause of the deficiency is different from that noted in the prior review, it would not be a repeat. If the underlying cause is determined to be the same, under these circumstances, it would still be appropriate to use the same wording as previously described "This deficiency [or significant deficiency, as applicable] was noted in the firm's previous peer review."

See section 3100, *Supplemental Guidance*, for an example of identifying repeat findings, deficiencies, and significant deficiencies in a System Review.

On Engagement Reviews, a repeat is one in which the identified engagement deficiency or significant deficiency is substantially the same (that is, the same kind or very similar) as noted in the prior review's report<sup>8</sup> as it relates to reporting, presentation, disclosure or documentation. For example, if a reviewer notes an engagement that had a disclosure or a financial statement presentation deficiency in a prior review's report, the disclosure or financial statement presentation deficiency noted in the current review would need to be substantially the same disclosure or financial statement presentation deficiency to qualify as a repeat.

The preceding also applies when the deficiency or significant deficiency noted during the current review was substantially the same as was noted on an FFC form in the prior review. Under these circumstances, it would still be appropriate to use the same wording as previously described: "This deficiency [or significant deficiency, as applicable] was noted in the firm's previous peer review."

For System Reviews and Engagement Reviews in which there are repeat deficiencies or significant deficiencies that have occurred on two or more prior reviews the reviewer should state in the current report that, "this deficiency [or significant deficiency, as applicable] was noted on previous reviews."

A firm that repeatedly receives peer reviews with consistent deficiencies or significant deficiencies that are not corrected may be deemed as a firm refusing to cooperate. For such firms that fail to cooperate, the AICPA Peer Review Board may decide, pursuant to fair procedures that it has established, to appoint a hearing panel to consider whether the firm's enrollment in the AICPA peer review program should be terminated or some other action taken. Therefore, it is critical that peer reviewers appropriately identify the underlying causes of deficiencies and significant deficiencies on System Reviews and that reporting on all System and Engagement Reviews is appropriate.

## Firm Responses in a System or Engagement Review

**97-1 Question**—Paragraphs .97 and .123 of the standards discuss the team captain or review captain's responsibility to review, evaluate, and comment on the reviewed firm's letter of response prior to its submission to the administering entity. What should be considered during that review?

*Interpretation*—The purpose of the letter of response is for a firm to stipulate, in writing, the specific action(s) that will be taken to correct deficiencies noted by the reviewer and, on a System Review, to enhance the current system of quality control. The description of the action(s) the firm has taken or will take should ensure prevention of recurrence of the deficiency or significant deficiency discussed in the report. The action(s) should be feasible, genuine, and comprehensive. The letter of response should not be vague or repetitive

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<sup>8</sup> See footnote 7.

of the deficiency or significant deficiency in the report, because then it is difficult to determine if the planned action will be appropriately implemented to ensure prevention; or if the action is inappropriate for correcting the deficiency or significant deficiency. The letter of response should not be used as a place to indicate justification for the firm's actions that related to the deficiency or significant deficiency.

## Submission of FFC Forms to the Administering Entities by the Team Captain or Review Captain

**99-1 Question**—Paragraphs .99 and .125 of the standards instruct a team captain or review captain to review and evaluate the firm's responses to all findings and recommendations not rising to the level of a deficiency or significant deficiency as reflected on the related FFC forms before they are submitted to the administering entity. When should the FFC forms be submitted to the administering entity and who should submit them?

*Interpretation*—Ordinarily, the FFC forms should be responded to by the reviewed firm during the peer review; for example, during or immediately following the exit conference (in a System Review) or before or immediately following the review captain's discussions with the reviewed firm regarding the results of the review (in an Engagement Review). This would allow the team captain or review captain to assist the firm in developing its responses and obtaining the necessary signatures on the FFC forms and allow the team captain or review captain to review the responses at that time, all of which will expedite the process.

The reviewed firm's response should describe how the firm intends to implement the reviewer's recommendation (or alternative plan if the firm does not agree with the recommendation); the person(s) responsible for implementation; the timing of the implementation; and, if applicable, additional procedures to ensure that the finding is not repeated in the future. The team captain or review captain can provide assistance in ensuring that the responses are appropriate and comprehensive. However, it is also recognized that the reviewed firm may prefer to provide its final responses after it has had the opportunity to discuss them further internally, develop a plan of action, and more formally respond. In either case, the completed FFC forms should be submitted to the team captain or review captain no later than two weeks after the exit conference (in a System Review) or the review captain's discussions with the reviewed firm regarding the results of the review (in an Engagement Review), or by the peer review's due date, whichever is earlier. FFC forms are then submitted by the team captain or review captain with the applicable working papers to the administering entity. If the reviewed firm's response is not deemed to be comprehensive, genuine, and feasible, the technical reviewer or RAB will request a revised response.

## Election to Have a System Review

**103-1 Question**—Paragraph .103 of the standards notes that firms eligible to have an Engagement Review may elect to have a System Review. What modifications are required to the peer review report under these circumstances?

*Interpretation*—Under these circumstances, any references in the peer review report to "the accounting and auditing practice" should be modified to refer only to "the accounting practice." In addition, the sentence "Firm XYZ & Co. has represented to us that the firm performed no services under the SASs; *Government Auditing Standards*; examinations of prospective financial statements or examinations of a service organization's controls likely to be relevant

to user entities' internal control over financial reporting under the Statements on Standards for Attestation Engagements (SSAEs); or audits of non-SEC issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB)" should be added.

## Impact of SQCS No. 8 on Engagement Reviews

**109-1 Question**—Paragraph .109 of the standards notes that an Engagement Review does not include a review of other documentation prepared on the engagements submitted for review (other than the documentation referred to in paragraphs .107–.108), tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a System Review. Should or may a firm's written quality control policies and procedures be inquired about, obtained by, or reviewed by the review captain on an Engagement Review? Would a firm's failure to have its quality control policies and procedures documented result in an individual engagement being deemed not performed or reported on in conformity with applicable professional standards, even if there are no other matters, findings, or deficiencies noted on the engagement?

*Interpretation*—SQCS No. 8 states that firms should document their quality control policies and procedures and that the size, structure, and nature of the practice of the firm are important considerations in determining the extent of the documentation of established quality control policies and procedures.

However, the objective of an Engagement Review is to evaluate whether engagements submitted for review are *performed and reported on* in conformity with applicable professional standards in all material respects. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations the applicable documentation required by professional standards. An Engagement Review does not provide the review captain with a basis for expressing any form of assurance on the firm's system of quality control (which is what the documentation requirements are related to).

Further, AR section 100 paragraph .72 states, "deficiencies in or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular review or compilation engagement was not performed in accordance with SSARS." This is also consistent with the SSAEs (and SASs).

Therefore, if reading the firm's documented quality control policies and procedures or the inability for the review captain to do so has no impact on whether the actual engagements submitted for review are performed and reported on in conformity with SSARS and the SSAEs in all material respects, reading the documented quality control policies and procedures would only appear to give a review captain the insight concerning the *underlying cause* concerning why a matter, finding, or deficiency occurred. Although this may be useful information in preparing MFCs or FFCs, the systemic reasons for these items are beyond the scope of an Engagement Review.

Therefore, obtaining or reviewing a firm's documented quality control policies and procedures would not be applicable to Engagement Reviews.

Although the standards allow for "reading the applicable documentation required by professional standards," and the SQCSs are a part of professional standards, it might appear that the standards do not prohibit the reviewer from obtaining and reading the firm's documented quality control policies and

procedures; however, it is deemed as beyond the scope of an Engagement Review.

SQCS No. 8 also states that at least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in Rule 101, *Independence*, and its related interpretations and rulings of the AICPA Code of Professional Conduct (ET sec. 101) and the rules of state boards of accountancy and applicable regulatory agencies. Written confirmation may be in paper or electronic form. Analogous to the preceding situation, obtaining or reviewing a firm's written independence confirmations would not be applicable to Engagement Reviews because the requirement is imbedded in the SQCSs and not a procedure required by SSARSs or the SSAEs.

## Qualifying for Service as a Peer Review Committee Member, Report Acceptance Body Member, or Technical Reviewer

**132-1 Question**—Paragraphs .132 and .136 of the standards note that minimum requirements must be met to be a peer review committee member, a report acceptance body member, or a technical reviewer. What are those requirements?

*Interpretation*—

### *Peer Review Committee Member*

A majority of the peer review committee members and the chairperson charged with the overall responsibility for administering the program at the administering entity should possess the qualifications required of a team captain in a System Review. A committee member who is suspended or restricted from scheduling or performing peer reviews no longer meets the qualifications until such suspension or restriction is removed. Reinstatement as a committee member would be at the discretion of the administering entity or committee.

### *Report Acceptance Body Member*

Each member of an administering entity's report acceptance body charged with the responsibility for acceptance of peer reviews should

- a. be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program, as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities. To be considered currently active in the accounting or auditing function, a reviewer should be presently involved in the accounting or auditing practice of a firm supervising one or more of the firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements.
- b. be associated with a firm (or all firms if associated with more than one firm) that has received a report with a peer review rating of *pass* (previously referred to as an unmodified report) on its most recently accepted System or Engagement Review that was accepted timely, ordinarily within the last 3 years and 6 months<sup>9</sup> (see Interpretation No. 31b-1).

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<sup>9</sup> If a committee member firm's most recent review was a report review, then the member is not eligible to be charged with the responsibility for acceptance of any peer reviews.

- c. demonstrate proficiency in the standards, interpretations, and guidance of the program (see Interpretation No. 33-1).

A majority of the report acceptance body members and the chairperson charged with the responsibility for acceptance of System Reviews should possess the qualifications required of a System Review team captain.

A national list of consultants will be maintained by the AICPA, so that the administering entity has an available pool of consultants with GAS, ERISA, FDICIA, and carrying broker-dealer experience to call upon in the instance when it does not have an experienced RAB member to consider the review of a firm when circumstances warrant. The national RAB consultant would not necessarily have to participate physically in the RAB meeting (teleconference option). The national RAB consultant will not be eligible to vote on the acceptance of a review. Determination that a review requires a national RAB consultant should be made prior to assigning the review to a RAB. The national RAB consultant would have to meet the following qualifications for RAB participation:

- a. Currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program, as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities. To be considered currently active, a consultant should be presently involved in the supervision of one or more of his or her firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements. To be considered a consultant on GAS, ERISA, FDICIA, or carrying broker-dealer engagements, the current activity must include the respective industry asked to consult upon.
- b. Associated with a firm (or all firms, if associated with more than one firm) that has received a report with a peer review rating of *Pass* (previously referred to as an unmodified report) on its most recently accepted System Review that was accepted timely, ordinarily within the last three years and six months.
- c. Not associated with an engagement that was deemed not performed in accordance with professional standards on the consultant's firm's most recently accepted System Review.

A report acceptance body member who is suspended or restricted from scheduling or performing peer reviews no longer meets the qualifications until such suspension or restriction is removed. Reinstatement as a report acceptance body member would be at the discretion of the administering entity or committee.

#### *Technical Reviewers*

Each technical reviewer charged with the responsibility for performing technical reviews should

- a. demonstrate proficiency in the standards, interpretations, and guidance of the program applicable to the type of peer reviews being evaluated and that meet the requirements of the team captain or review captain training requirements established by the board (see Interpretation No. 33-1).
- b. participate in at least one peer review each year, which may include participation in an on-site oversight of a System Review.
- c. have an appropriate level of accounting and auditing knowledge and experience suitable for the work performed. Such knowledge may be obtained from on-the-job training, training courses, or a combination of

both. Technical reviewers are to obtain a minimum amount of CPE to maintain the appropriate level of accounting and auditing knowledge.

If a technical reviewer does not have such knowledge and experience, the technical reviewer may be called upon to justify why he or she should be permitted to perform technical reviews or oversights. The administering entity has the authority to decide whether a technical reviewer's knowledge and experience is sufficient and whether he or she has the capability to perform a particular technical review or oversight whether there are high-risk engagements involved or other factors.

The fundamental purpose of CPE is to maintain or increase, or both, professional competence. AICPA members are required to participate in 120 hours of CPE every 3 years. In order to maintain current knowledge of accounting, auditing, and quality control standards, technical reviewers should obtain at least 40 percent of the AICPA-required CPE in subjects relating to accounting, auditing, and quality control. Technical reviewers should obtain at least 8 hours in any 1 year and 48 hours every 3 years in subjects relating to accounting, auditing, and quality control. The terms *accounting*, *auditing*, and *quality control* should be interpreted as CPE that would maintain current knowledge of accounting, auditing, and quality control standards for engagements that fall within the scope of peer review as described in paragraphs .06–.07 of the standards.

Technical reviewers have the responsibility of documenting their compliance with the CPE requirement. They should maintain detailed records of CPE completed in the event they are requested to verify their compliance. The reporting period will be the same as that maintained for the AICPA.

A technical reviewer who is also a peer reviewer and is suspended or restricted from scheduling or performing peer reviews no longer meets the qualifications until such suspension or restriction is removed. Reinstatement as a technical reviewer would be at the discretion of the administering entity or committee.

## Accepting Engagement Reviews by the Technical Reviewer

**137-1 Question**—The standards and interpretations indicate that the technical reviewer should be delegated the authority from the committee to accept Engagement Reviews in certain circumstances. What are those circumstances?

*Interpretation*—The technical reviewer should be delegated the authority from the committee to accept Engagement Reviews on the committee's behalf when the technical reviewer determines that any MFC forms prepared only relate to compilations under SSARs, that no MFC forms should have been prepared except as related to compilations under SSARs, and there are no other issues associated with the peer review warranting committee consideration or action that could potentially affect the results of the peer review.

The technical reviewer may identify reviewer feedback that should be considered and approved by the peer review committee prior to issuance. The technical reviewer should still be delegated the authority from the committee to accept Engagement Reviews on the committee's behalf when such feedback may be provided to the review captain unless the circumstances leading up to the feedback may have affected the results of the review. Accordingly, if the feedback being provided to the review captain involves issues which could potentially affect the results of the peer review, the technical reviewer should not accept the Engagement Review but present it to the committee for consideration.



## Cooperating in a Peer Review—Implementation Plans and Correction Action Plans

**143-1 Question**—Paragraph .143 of the standards notes that an implementation plan in addition to the plan described by the firm in its responses on the FFC forms may be requested by the administering entity's peer review committee. Can this plan only be requested when a report with a rating of *pass* has been issued?

*Interpretation*—No, an implementation plan may be requested whether a report with a rating of *pass*, *pass with deficiency*, or *fail* is issued for any findings that were only raised to the level of an FFC and did not get elevated further. Thus, it is possible to have a required corrective action as a condition of acceptance of the peer review stemming from a report with a rating of *pass with deficiencies* or *fail* and a required implementation plan as a condition of cooperation (unrelated to the acceptance of the review) for the findings included in the FFCs.

## Publicizing Peer Review Information

**146-1 Question**—Paragraph .146 of the standards discusses that neither the administering entity nor the AICPA shall make the results of the review available to the public, except as authorized or permitted by the firm under certain circumstances. What are examples of those circumstances?

*Interpretation*—A firm may be a voluntary member of one of the AICPA's audit quality centers or sections that has a membership requirement such that certain peer review documents be open to public inspection. Other firms may elect not to opt out of the program's process for voluntary disclosure of peer review results to state boards of accountancy where the firm's main office is located. Also, firms may voluntarily instruct their administering entity to make the peer review results available to certain other state boards of accountancy. In these cases, the firm permits the AICPA or administering entities to make their peer review results available to the public or to state boards of accountancy, respectively.

## Peer Reviewers' Performance and Cooperation

**147-1 Question**—A team captain, review captain, or reviewer (hereinafter, reviewer) has a responsibility to perform a review in a timely, professional manner. What happens when a reviewer fails to perform the review in a timely and professional manner?

*Interpretation*—When a reviewer fails to perform the review in a timely and professional manner, the reviewer may be deemed as not cooperating. Such situations might include, but are not limited to, the following:

- Failure to submit the report; FFC forms, if applicable; and required peer review documents to the administering entity within the required specified time
- Failure to respond or resolve questions from the technical reviewer or committee or RAB within the specified time including requests for additional procedures such as the expansion of scope on the review
- Failure to revise the report and FFC forms, if applicable, as requested by the committee or RAB
- Failure to respond to requests for documents (in addition to those originally required to be submitted) or requests to complete documents

- Failure to submit peer review documents and other information for oversight
- Failure to update or verify reviewer resume on a periodic basis

Situations such as those previously indicated, arise when the reviewer fails to cooperate with the administering entity. This development warrants communication to the reviewer and may result in his or her potential suspension from scheduling peer reviews.

**148-1 Question**—The board or committee may consider the need to impose corrective actions on the service of the reviewer. What are examples of corrective actions?

*Interpretation*—The board or committee may require the reviewer to comply with certain prescribed actions in order for the reviewer to continue performing peer reviews, such as (but not limited to) the following:

- Oversight at the discretion of an administering entity until evidence of attendance at a future reviewer's training or accounting or auditing course(s) is received or performance improves.
- Having committee oversight on the next review(s) performed by the reviewer at the expense of the reviewer's firm (including out-of-pocket expenses, such as cost of travel).
- Completing all reviews to the satisfaction of the committee including submitting all reports and appropriate documentation on all outstanding peer reviews before scheduling or performing another review, thus limiting the number of reviews that the reviewer may schedule or have open at one time.
- Having preissuance review(s) of the report and peer review documentation on future peer reviews by an individual acceptable to the committee chair or designee who has experience in performing peer reviews.
- Consultations with the administering entity to discuss the planning and performance of the next review.
- Remove or revise rsum code until appropriate proof of experience and knowledge have been provided to the satisfaction of the committee.

**149-1 Question**—When one or more corrective actions are imposed on a reviewer, the administering entity will inform the board and may request that the board ratify the action(s) to be recognized by other administering entities. When can these actions be imposed by other administering entities without board ratification?

*Interpretation*—When the reviewer is notified of performance issues through deficiency letters, corrective actions or restrictions placed upon the reviewer. For reviewers who perform reviews in multiple administering entities, any corrective action or restriction included in a deficiency letter should be considered by other administering entities regarding whether they want to enforce the action or restriction on all or some reviews performed by the reviewer in their jurisdiction.

**151-1 Question**—When the board or committee require the reviewer to comply with such actions and the reviewer fails to correct the poor performance or refuses to cooperate, what procedures should be followed?

*Interpretation*—The committee or board must assess if the reviewer is making a reasonable effort to improve performance. After being provided reasonable time to improve performance, if the prescribed actions are not resulting in the necessary performance improvements, the committee or board may determine that the reviewer's action warrant board consideration. If a reviewer is referred

to the board, the board will consider whether the reviewer should be prohibited from performing reviews or whether some other action should be taken.

## Independent QCM Reviews

**159-1 Question**—Paragraph .159 of the standards refers to an affiliate or related entity as considerations in determining whether the QCM review is required. What does affiliate mean in this context, and how can an affiliate relationship lead to a required QCM review?

*Interpretation*—For QCM review purposes, a CPA firm has an affiliate relationship with another entity if the firm controls or has the power to control the other entity (or vice versa), if there is mutual ownership of the firm and the other entity, or if a third party controls or has the power to control both the firm and other entity. If a CPA firm is affiliated with an entity that is a provider of QCM, and the CPA firm performs peer reviews of other firms, the CPA firm is considered a provider firm. The CPA firm's independence will be impaired to perform peer reviews of firms that use the QCM sold by the affiliate, unless an independent review on the QCM is completed.

**161-1 Question**—The standards note that in the event of substantial changes in a provider's system of quality control to develop and maintain materials, or substantial changes in the materials themselves, the provider should consult with the National PRC to determine whether an accelerated QCM review is warranted. What are factors that the National PRC will consider in making this determination?

*Interpretation*—The National PRC will consider the following (at a minimum) in determining whether the provider should have an accelerated review:

- The reasons for and types of changes in the system, the resultant materials, or both
- The period of time since the last QCM review
- The rating of the last QCM report

If the provider is a provider firm that performs peer reviews of user firms, and the provider firm's system of quality control or the resultant materials underwent substantial changes, it may be necessary for the provider firm to have an accelerated QCM review in order to maintain independence with respect to user firms.

**166-1 Question**—Paragraph .166 of the standards indicates that the National PRC will consider other factors (in addition to the qualifications set forth in the paragraphs under "Organizing the System or Engagement Review Team" and "Qualifying for Service as a Peer Reviewer") in determining whether a peer reviewer is appropriately qualified to perform a QCM peer review. What are the other considerations?

*Interpretation*—The National PRC, as the administering entity for QCM reviews, establishes the qualifications necessary to perform a QCM review. In addition to the peer reviewer qualifications set forth in paragraphs .26–.35 of the standards, reviewers of QCM must have relevant and current industry experience in their own firm. The National PRC will also consider the history and nature of reviewer feedback, AICPA or administering entity-imposed peer reviewer restrictions, and other pertinent factors.

Subsequent to the approval of a QCM reviewer, situations may arise that causes the QCM reviewer to no longer meet the qualifications for serving as a QCM reviewer. Such situations include, but are not limited to, the following:

- Suspension or termination of AICPA membership
- Change in the status of the reviewer's CPA license from active status
- Eligibility criteria in paragraph .31 of the standards to serve as a peer reviewer are no longer met
- Communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of the peer reviewer's firm's accounting and auditing practice or notifications of limitations or restrictions on the peer reviewer's firm's right to practice

It is the responsibility of the provider to ensure that QCM review team members continue to meet the qualifications. Peer reviewers that have a conflict of interest with respect to the QCM under review will not be approved as a QCM review team member. Examples of individuals with conflicts of interest include someone who assisted in the materials' development or maintenance process, uses the materials as an integral part of his or her firm's system of quality control, or is an individual from a firm that is a member of the association whose materials are under review.

**175-1 Question**—In a QCM review, the standards note that the QCM review team determines and documents the extent to which individual manuals, guides, checklists, practice aids, and so on are reviewed. What should the QCM reviewer consider when making this judgment?

*Interpretation*—Because the QCM review report opines on both the quality control system and the specific materials or aids listed in the report, all those materials or aids listed must be tested to some extent in order to support the opinion. However, the QCM reviewer can judgmentally determine the extent of testing or review procedures necessary on each aid. Considerations include areas within the materials or aids that address new guidance or changes in professional standards, areas that address procedures that rely heavily on judgment, or areas that contain methodology unique to the materials reviewed or unique interpretations of professional standards or other guidance. The assessment of the provider's system, including the review and editorial process, update and revision procedures, and so on should also factor into the QCM reviewer's judgment. The QCM reviewer's considerations for determining the extent of testing necessary for the materials or aids should be documented in the risk assessment. In addition, the QCM review working papers should document the actual testing or review procedures performed for each aid.

**176-1 Question**—Paragraph .176 of the standards discusses the QCM review team's assessment of whether the materials are reliable aids by assessing the level of instructions and explanatory guidance in the materials, and determining whether the methodology inherent in the materials is appropriate. What other information is available to further explain these considerations?

*Interpretation*—Many firms place a high degree of reliance on QCM, based on the nature and use of such materials. Because of this reliance, there are expectations that the materials are stand-alone aids, and use of the materials as designed by a professional with an appropriate level of experience and expertise provides reasonable assurance of assisting users in performing audit or attest engagements in accordance with professional standards. Accordingly, the QCM review team should assess and document how the materials address each of these considerations in order to be reliable aids:

- a. Instructions should include, but are not limited to, the aids' applicability for different firms or clients (for example, based on size, industry, or engagement complexity; levels of experience or knowledge; and so on); a reminder for the need to tailor the materials as appropriate;

and a reminder to use professional judgment in the application of the materials based on the facts and circumstances of each engagement. The instructions should also address the documentation requirements in professional standards, and specifically discuss whether completion of the aids will assist users with fulfilling those requirements.

- b. Guidance should be sufficient and technically accurate to assist users with conforming with the components that are integral to the professional standards that the materials purport to encompass, regardless of whether such standards are encompassed explicitly or implicitly. Explanatory guidance ranges from specific cross references to professional standards or directly quoting the standards, to explanations of the standards or integrating the verbiage of the standards into audit checklists or programs. QCM limited to audit program steps without explanatory guidance or specific reference to applicable professional standards would be considered insufficient and do not constitute reliable aids. In addition, materials that are industry specific should appropriately address the relevant professional standards and industry guidance from a completeness standpoint (for example, an aid that purports to assist users with performing risk assessment procedures for an ERISA engagement should include AU-C section 320, *Materiality in Planning and Performing an Audit*, considerations tailored to the industry; the reviewer should question if AU-C section 320 considerations are omitted).
- c. The methodology inherent in the materials (if applicable), including the provider's stance on the application of professional standards or alternative procedures, should be evaluated to determine if the methodology provides reasonable assurance to users of performing an engagement performed in conformity with the components that are integral to the applicable professional standards that the materials purport to encompass. This is especially important when the methodology addresses the treatment of unique transactions or accounts, contains unique interpretations of professional standards, incorporates elements of widely recognized and accepted industry practice when higher levels of guidance are not available, or suggests departures from professional standards in certain circumstances.

QCM reviewers should refer to section 3100 for additional illustrative guidance for reliable aids.

Aids either lacking or containing an insufficient level of instructions or guidance or that contain inappropriate methodology, should be further evaluated by the QCM review team to determine if the aids are reliable. The QCM review team should also evaluate the impact on the provider's system of quality control for the development and maintenance of the aids. If an aid is deemed to not be a reliable aid, this should be reflected in a QCM review report with a rating of pass with deficiencies or fail, depending on the underlying cause of the issue.

Note that the intent of QCM is to assist in providing firms and practitioners with reasonable assurance of complying with professional standards as a part of their overall system of quality control. The independent review of such materials does not provide firms or practitioners with absolute assurance of compliance solely through reliance on the materials, nor is it intended to.

**200-1 Question**—Paragraph .200 of the standards states that if a provider refuses to cooperate during the course of a QCM review, the provider's firm's independence with respect to user firms may be impaired. Under what circumstances would the provider's independence with respect to user firms be impaired due to non-cooperation?

*Interpretation*—If the required QCM review documents are not submitted by the due date due to the provider's non-cooperation, the provider's independence with respect to user firms will be impaired and the provider will not be permitted to perform or schedule future peer reviews of user firms until the provider's QCM review is completed (see Interpretation No. 25-2).

Once all the required QCM review documents have been submitted timely but before the report has been accepted, the National PRC may make whatever inquiries or initiate whatever actions of the provider or QCM review team it considers necessary under the circumstances. The National PRC will set a date by which responses to inquiries and evidence of completion of required actions must be received. If, as a result of non-cooperation by the provider, inquiries or required actions remain unresolved as of the due date established by the National PRC, the provider's independence with respect to user firms will be impaired and the provider will not be permitted to perform or schedule future peer reviews of user firms until the provider's QCM review is completed.

## Definition of Commencement

**206-1 Question**—There are a number of instances in which the standards and interpretations refer to the "commencement" date of a review to determine whether a situation applies. Some examples are cooperating in a peer review (Interpretation No. 5h-1), approval of the review team by the administering entity (Interpretation No. 30-1), provision of the surprise engagement to the firm (Interpretation No. 61-1) and when the standards are effective for a firm's peer review (paragraph .206 of the standards). What is meant by "commencement"?

*Interpretation*—Interpretation No. 5g-1 notes that "A peer review commences when the review team begins field work, ordinarily at the reviewed firm's office in a System Review, or begins the review of engagements in an Engagement Review." The easiest measure is "when fieldwork begins". However, there are times when this may not apply. Therefore, Interpretation No. 32-1 further notes that "team members may review their engagements prior to the team captain or review captain beginning their field work. In these situations, a review is considered to have commenced when the team member begins the review of engagements (if this is prior to the team captain or review captain beginning their fieldwork)." In certain circumstances, fieldwork may commence before the review of engagements, such as during planning.

The significance of this enhanced definition of "commencement" is emphasized by how it affects a firm's ability to resign from the program once a review commences. Once a team captain, review captain or team member learns information that affects the results of the review, the review is deemed to have commenced. Some examples are if the team captain identifies a design deficiency, or learns about the firm's noncompliance with state board of accountancy licensing requirements, during planning. Another example is the identification of a finding during a team member's review of a specialized industry at a location other than the reviewed firm's offices, prior to the team captain beginning fieldwork at the reviewed firm's offices.

As indicated in Interpretation No. 5g-1, a firm whose peer review has commenced may not resign from the program unless certain steps are followed which include the firm evidencing their noncooperation with the program and the AICPA publishing notice of the action so that the public interest is served.

## Firm Representations

**208-1-1 Question**—Paragraph .208(1) (appendix B) of the standards advises that the firm is not prohibited from making additional representations

beyond the required representations, in its representation letter to the team captain or review captain. What parameters should be used in expanding the representation letter?

*Interpretation*—The representation letter is not intended to be onerous for the reviewed firm. Allowing reviewers to add whatever they want to the representation letter would make it very difficult to maintain consistency in the program. In addition, this becomes a very important issue because a firm's failure to sign the representation letter may be considered a noncooperation.

However, at a minimum the representation letter should comply with the spirit of the guidance, there is value to the reviewer of obtaining certain representations in writing. Thus, if during the review, something comes to the reviewer's attention whereby the reviewer believes the reviewed firm is providing contradicting or questionable information, the reviewer should investigate the matter further and may consider having the firm include the matter in the representation letter.

## Firm and Individual Licenses

**208-1a-1 Question**—Paragraph .208 (1)(a) (appendix B) of the standards advises that firms include representations to the team captain or review captain concerning when management is aware that the firm or its personnel has not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies (including applicable firm and individual licensing requirements in each state in which it practices for the year under review). What further guidance should be followed in regards to firm and individual licenses?

*Interpretation*—Firms are required to comply with the rules and regulations of state boards of accountancy and other regulatory bodies in the states where they practice. As a part of the peer review, firms should submit written representations from the firm's management indicating compliance with such required rules and regulations. If the reviewed firm is aware of any situation whereby they are not in compliance with the rules and regulations of the state boards of accountancy or other regulatory bodies, they should tailor the representation letter to provide information on the areas of non-compliance.

Reviewers should continue to make inquiries of the firm to determine if it is appropriately licensed as required by the state boards of accountancy in the state or states in which it practices. In addition, a reviewer is not prohibited, as a part of a System or Engagement Review, from verifying the *practice unit* license (firm license) in the state in which the practice unit is domiciled (main office is located). A reviewer is also not prohibited from verifying an out-of-state *practice unit* license on an individual engagement basis when that engagement is selected for review and was performed by the reviewed firm in another state requiring a firm license.

Testing *individual* licenses should be limited to inquiry and should not extend to verification unless there is evidence obtained as a part of the peer review that the firm is not accurately representing its compliance with individual licensure requirements.

The reviewer must analyze the information obtained through inquiry and in the written representation letter to determine the impact on the peer review.

### *Communication of Report Acceptances*

The state board of accountancy may be sent a list of firms with *accepted* peer reviews ("accepted" as defined in the Interpretations to the standards) in a given period which would allow the state board of accountancy to verify that firms undergoing peer review are licensed in that state.

Entities administering the AICPA Peer Review Program are not prohibited outside of the peer review process from gathering information from firms and communicating to the state boards of accountancy on licensure compliance matters.

## **Communications Received by the Reviewed Firm Relating to Allegations or Investigations in the Conduct of Accounting, Auditing, or Attestation Engagements From Regulatory, Monitoring, or Enforcement Bodies**

**208-1b-1 Question**—Paragraph .208(1)(b) and (e) (appendix B) of the standards discusses the reviewed firm's requirement to inform the reviewer of communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, auditing, or attestation engagement performed and reported on by the firm. What are the objectives of this requirement and what are some examples, although not an all inclusive list, of such communications?

*Interpretation*—The objective of the firm informing its reviewer of such communications or summaries of communications is to enhance the risk-based approach to peer review by allowing the reviewer to better plan and perform the review, including engagement, industry, office, and owner selection that should be given greater emphasis in the review. It is expected that the reviewer and the firm will discuss these communications and that the firm will be able to submit the actual documentation to the reviewer in those circumstances that the reviewer deems appropriate. The reviewed firm is not required to submit confidential documents to the reviewer but should be able to discuss the relevant matters and answer the reviewer's questions.

It is also expected that the reviewer and firm will discuss notifications of limitations/restrictions on the reviewed firm's ability to practice public accounting by regulatory, monitoring or enforcement bodies.

There are many types of communications that are appropriately related to meeting the objectives described in this interpretation. The following list, which is not intended to be all inclusive, represents examples of the types of organizations where communications would be relevant to meeting the objectives of the requirement:

- a. AICPA or State CPA Society Ethics Committees
- b. AICPA Joint Trial Board
- c. State boards of accountancy
- d. SEC
- e. PCAOB
- f. State auditor
- g. Department of Labor
- h. Employee Benefits Security Administration
- i. Government Accountability Office
- j. Office of Management and Budget
- k. Department of Housing and Urban Development
- l. FDIC
- m. Office of Thrift and Supervision
- n. Federal or State Inspector General's Offices



- o. Rural Utility Service
- p. Other governmental agencies or other organizations that have the authority to regulate accountants (in connection with the firm's accounting, auditing, or attestation engagements)

**208-1b-2** *Question*—What if a reviewed firm chooses not to discuss or make such communications or notifications available to the reviewer during the review?

*Interpretation*—If a firm fails to discuss such communications with the reviewer, the reviewer should immediately consult with the relevant administering entity because this constitutes a failure to cooperate, and the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations).

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## TS Section

# TAX SERVICES

## STATEMENTS ON STANDARDS FOR TAX SERVICES

The Statements on Standards for Tax Services (SSTSs) and interpretations, promulgated by the Tax Executive Committee, reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The statements are intended to be part of an ongoing process that may require changes to and interpretations of current SSTSs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. *Interpretation No. 1-2* was approved by the Tax Executive Committee on August 21, 2003; its effective date is December 31, 2003.

The SSTSs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for interpretations to meet a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain items undefined. These terms and concepts are generally rooted in tax concepts, and therefore should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, *General Standards* (ET sec. 201 par. .01), and Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

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## Preface

Standards are the foundation of a profession. The AICPA aids its members in fulfilling their ethical responsibilities by instituting and maintaining standards against which their professional performance can be measured. Compliance with professional standards of tax practice also reaffirms the public's awareness of the professionalism that is associated with CPAs as well as the AICPA.

This publication sets forth enforceable tax practice standards for members of the AICPA, Statements on Standards for Tax Services (SSTSs or statements) (sections 100–700). These statements apply to all members providing tax services regardless of the jurisdictions in which they practice. Interpretations of these statements may be issued as guidance to assist in understanding and applying the statements. The SSTSs and their interpretations are intended to complement other standards of tax practice, such as Treasury Department Circular No. 230, *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service*; penalty provisions of the Internal Revenue Code; and state boards of accountancy rules.

The SSTSs are written in as simple and objective a manner as possible. However, by their nature, practice standards provide for an appropriate range of behavior and need to be interpreted to address a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain terms undefined. These terms are generally rooted in tax concepts and, therefore, should be readily understood by tax practitioners. Accordingly, enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, *General Standards* (ET sec. 201 par. .01), and Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), will be undertaken on a case-by-case basis. Members are expected to comply with them.

## History

The SSTSs have their origin in the Statements on Responsibilities in Tax Practice (SRTPs), which provided a body of advisory opinions on good tax practice. The guidelines as originally set forth in the SRTPs became more important than many members had anticipated when the guidelines were issued. The courts, the IRS, state accountancy boards, and other professional organizations recognized and relied on the SRTPs as the appropriate articulation of professional conduct in a CPA's tax practice. The SRTPs became *de facto* enforceable standards of professional practice, because state disciplinary organizations and courts regularly held CPAs accountable for failure to follow the guidelines set forth in the SRTPs.

The AICPA's Tax Executive Committee concluded it was appropriate to issue tax practice standards that would become a part of the AICPA's *Professional Standards*. At its July 1999 meeting, the AICPA Board of Directors approved support of the executive committee's initiative and placed the matter on the agenda of the October 1999 meeting of the AICPA's governing Council. On October 19, 1999, Council approved designating the Tax Executive Committee as a standard-setting body, thus authorizing that committee to promulgate standards of tax practice. As a result, the original SSTSs, largely mirroring the SRTPs, were issued in August 2000.

The SRTPs were originally issued between 1964 and 1977. The first nine SRTPs and the introduction were promulgated in 1976; the tenth SRTP was issued in 1977. The original SRTPs concerning the CPA's responsibility to sign

the tax return (SRTP No. 1, *Signature of Preparers*, and No. 2, *Signature of Reviewer: Assumption of Preparer's Responsibility*) were withdrawn in 1982 after Treasury Department regulations were issued adopting substantially the same standards for all tax return preparers. The sixth and seventh SRTPs, concerning the responsibility of a CPA who becomes aware of an error, were revised in 1991. The first interpretation of the SRTPs, Interpretation No. 1-1, "Realistic Possibility Standard," was approved in December 1990. The SSTSs and Interpretation No. 1-1, "Realistic Possibility Standard," of SSTS No. 1, *Tax Return Positions* (sec. 100), superseded and replaced the SRTPs and their Interpretation No. 1-1, effective October 31, 2000. Although the number and names of the SSTSs, and the substance of the rules contained in each of them, remained the same as in the SRTPs, the language was revised to both clarify and reflect the enforceable nature of the SSTSs. In addition, because the applicability of these standards is not limited to federal income tax practice (as was the case with the SRTPs), the language was changed to indicate the broader scope. In 2003, in connection with the tax shelter debate, SSTS Interpretation No. 1-2, "Tax Planning," of SSTS No. 1 (sec. 100) was issued to clarify a member's responsibilities in connection with tax planning; that interpretation became effective December 31, 2003.

When the original SSTSs were issued, an effort was made to keep to a minimum any changes in the language of the SSTSs from that of the predecessor SRTPs. This was done to alleviate concerns regarding the enforceability of standards that differed from the SRTPs under which members had been practicing. Since the issuance of the original SSTSs, members have asked for clarification on certain matters, such as the duplication of the language in SSTS No. 6, *Knowledge of Error: Return Preparation*, and No. 7, *Knowledge of Error: Administrative Proceedings*. Also, certain changes in federal and state tax laws have raised concerns regarding the need to revise SSTS No. 1 (sec. 100). As a result, in 2008, the original SSTS Nos. 1–8 (sections 100–800) were updated, effective January 1, 2010. The original SSTS Nos. 6–7 were combined into the revised SSTS No. 6, *Knowledge of Error: Return Preparation and Administrative Proceedings* (sec. 600). The original SSTS No. 8, *Form and Content of Advice to Taxpayers*, was renumbered SSTS No. 7 (sec. 700). In addition, various revisions were made to the language of the original SSTSs.

## Ongoing Process

The following SSTSs and any interpretations issued thereunder reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The statements are intended to be part of an ongoing process of articulating standards of tax practice for members. These standards are subject to change as necessary or appropriate to address changes in the tax law or other developments in the tax practice environment.

Members are encouraged to assess the adequacy of their practices and procedures for providing tax services in conformity with these standards. This process will vary according to the size of the practice and the nature of tax services performed.

The Tax Executive Committee promulgates the SSTSs and their interpretations. Acknowledgment is also due to the many members who have devoted their time and efforts over the years to developing and revising the AICPA's standards.

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## TS Section 100

### Tax Return Positions

Source: SSTS No. 1

Effective date, unless  
otherwise indicated:  
January 2010

#### Introduction

**.01** This statement sets forth the applicable standards for members when recommending tax return positions, or preparing or signing tax returns (including amended returns, claims for refund, and information returns) filed with any taxing authority. For purposes of these standards

- a. a *tax return position* is (i) a position reflected on a tax return on which a member has specifically advised a taxpayer or (ii) a position about which a member has knowledge of all material facts and, on the basis of those facts, has concluded whether the position is appropriate.
- b. a *taxpayer* is a client, a member's employer, or any other third-party recipient of tax services.

**.02** This statement also addresses a member's obligation to advise a taxpayer of relevant tax return disclosure responsibilities and potential penalties.

**.03** In addition to the AICPA, various taxing authorities, at the federal, state, and local levels, may impose specific reporting and disclosure standards with regard to recommending tax return positions or preparing or signing tax returns.<sup>1</sup> These standards can vary between taxing authorities and by type of tax.

#### Statement

**.04** A member should determine and comply with the standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position, or preparing or signing a tax return.

**.05** If the applicable taxing authority has no written standards with respect to recommending a tax return position or preparing or signing a tax return, or if its standards are lower than the standards set forth in this paragraph, the following standards will apply:

- a. A member should not recommend a tax return position or prepare or sign a tax return taking a position unless the member has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits if challenged.

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<sup>1</sup> A member should refer to the current version of Internal Revenue Code Section 6694, *Understatement of taxpayer's liability by tax return preparer*, and other relevant federal, state, and jurisdictional authorities to determine the reporting and disclosure standards that are applicable to preparers of tax returns.

- b. Notwithstanding paragraph .05(a), a member may *recommend a tax return position* if the member (i) concludes that there is a reasonable basis for the position and (ii) advises the taxpayer to appropriately disclose that position. Notwithstanding paragraph .05(a), a member may *prepare or sign a tax return* that reflects a position if (i) the member concludes there is a reasonable basis for the position and (ii) the position is appropriately disclosed.

**.06** When recommending a tax return position or when preparing or signing a tax return on which a position is taken, a member should, when relevant, advise the taxpayer regarding potential penalty consequences of such tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.07** A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows

- a. exploits the audit selection process of a taxing authority, or
- b. serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.

**.08** When recommending a tax return position, a member has both the right and the responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.

## Explanation

**.09** The AICPA and various taxing authorities impose specific reporting and disclosure standards with respect to tax return positions and preparing or signing tax returns. In a given situation, the standards, if any, imposed by the applicable taxing authority may be higher or lower than the standards set forth in paragraph .05. A member is to comply with the standards, if any, of the applicable taxing authority; if the applicable taxing authority has no standards or if its standards are lower than the standards set forth in paragraph .05, the standards set forth in paragraph .05 will apply.

**.10** Our self-assessment tax system can function effectively only if taxpayers file tax returns that are true, correct, and complete. A tax return is prepared based on a taxpayer's representation of facts, and the taxpayer has the final responsibility for positions taken on the return. The standards that apply to a taxpayer may differ from those that apply to a member.

**.11** In addition to a duty to the taxpayer, a member has a duty to the tax system. However, it is well established that the taxpayer has no obligation to pay more taxes than are legally owed, and a member has a duty to the taxpayer to assist in achieving that result. The standards contained in paragraphs .04–.08 recognize a member's responsibilities to both the taxpayer and the tax system.

**.12** In reaching a conclusion concerning whether a given standard in paragraph .04 has been satisfied, a member may consider a well-reasoned construction of the applicable statute, well-reasoned articles or treatises, or pronouncements issued by the applicable taxing authority, regardless of whether such sources would be treated as *authority* under Internal Revenue Code Section 6662, *Imposition of accuracy-related penalty on underpayments*, and the regulations thereunder. A position would not fail to meet these standards merely because it is later abandoned for practical or procedural considerations during an administrative hearing or in the litigation process.

**.13** If a member has a good-faith belief that more than one tax return position meets the standards set forth in paragraphs .04–.05, a member's advice concerning alternative acceptable positions may include a discussion of

the likelihood that each such position might or might not cause the taxpayer's tax return to be examined and whether the position would be challenged in an examination. In such circumstances, such advice is not a violation of paragraph .07.

**.14** A member's determination of whether information is appropriately disclosed by the taxpayer should be based on the facts and circumstances of the particular case and the disclosure requirements of the applicable taxing authority. If a member recommending a position, but not engaged to prepare or sign the related tax return, advises the taxpayer concerning appropriate disclosure of the position, then the member shall be deemed to meet the disclosure requirements of these standards.

**.15** If particular facts and circumstances lead a member to believe that a taxpayer penalty might be asserted, the member should so advise the taxpayer and should discuss with the taxpayer the opportunity, if any, to avoid such penalty by disclosing the position on the tax return. Although a member should advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

**.16** For purposes of this statement, preparation of a tax return includes giving advice on events that have occurred at the time the advice is given if the advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a tax return.

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## TS Section 9100

# ***Tax Return Positions: Tax Services Interpretations of Section 100***

### **Notice to Readers**

The Statements on Standards for Tax Services (SSTSs) and interpretations, promulgated by the AICPA Tax Executive Committee (TEC), reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The SSTSs are intended to be part of an ongoing process that may require changes to, and interpretations of, current SSTSs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. The original Interpretations No. 1-1, "Realistic Possibility of Success," and No. 1-2, "Tax Planning," were adopted in 2000 and 2003, respectively, and updated in 2010. The TEC adopted the updated Interpretations No. 1-1, "Reporting and Disclosure Standards," and No. 1-2, "Tax Planning," on August 15, 2011, effective on January 31, 2012.<sup>1</sup>

The SSTSs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for interpretations to satisfy a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and leaving certain terms undefined. These terms and concepts are generally rooted in tax concepts and, therefore, they should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA Code of Professional Conduct, Rule 201, *General Standards* (ET sec. 201 par. .01), and Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

### **Preface**

SSTS No. 1, *Tax Return Positions* (sec. 100), provides that a member should not recommend a tax return position or take a position on a tax return that the member prepares unless that position satisfies applicable reporting and disclosure standards. The tax laws of various taxing jurisdictions contain similar limitations on the ability to recommend or take certain tax return positions. This preface provides an overview of the most common tax return reporting

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<sup>1</sup> These interpretations do not consider any impact of Section 1409 of the Health Care and Education Reconciliation Act of 2010, P.L. 111-152 (Codification of Economic Substance Doctrine and Penalties). Under Section 7701(o) of the Internal Revenue Code (IRC), in the case of any transaction to which the economic substance doctrine is relevant, the transaction shall be treated as having economic substance only if the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into such transaction. Understatements of tax attributable to a failure to satisfy the economic substance doctrine, where relevant, can result in substantial taxpayer penalties.

standards and issues to be considered in determining if the applicable reporting standards and disclosure requirements have been satisfied.

## Description of Various Reporting Standards

A brief description of the most common tax return reporting standards follows.<sup>2</sup>

**More likely than not.** The more likely than not standard generally is satisfied if it is reasonable to conclude in good faith that there is a greater than 50 percent likelihood that the position will be upheld on its merits if it is challenged.<sup>3</sup>

**Substantial authority.** The substantial authority standard is an objective standard and is satisfied if the weight of the authorities supporting the position is substantial in relation to the weight of authorities supporting a contrary treatment.<sup>4</sup> In practice, the substantial authority standard generally is interpreted as requiring approximately a 40 percent likelihood that the position will be upheld on its merits if it is challenged.<sup>5</sup>

**Realistic possibility of success.** The realistic possibility of success standard generally is satisfied if there is approximately a 1-in-3 (33 percent) likelihood that the position will be upheld on its merits if it is challenged.<sup>6</sup>

**Reasonable basis.** The reasonable basis standard is satisfied if the position is reasonably based on one or more authorities, taking into account the relevance and persuasiveness of those authorities. The reasonable basis standard is lower than the realistic possibility of success standard but is "significantly higher than not frivolous or not patently improper . . . [and] is not satisfied by a return position that is merely arguable or that is merely a colorable claim."<sup>7</sup> In practice, the reasonable basis standard generally is interpreted as requiring that there be approximately a 20 percent likelihood that the position will be upheld on its merits if it is challenged.<sup>8</sup>

## Nature of the Analysis

The analysis used in determining if a reporting standard has been satisfied should involve a well-reasoned application of the relevant authorities to all pertinent facts and circumstances. The weight to be given to a particular authority depends on its relevance and persuasiveness. For example, all else being

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<sup>2</sup> In some cases, the taxing authority may require that more than one standard be satisfied with respect to a return position. For example, in the case of a listed transaction or other reportable transaction with a significant tax avoidance purpose, a taxpayer penalty may apply under IRC Section 6662A unless the taxpayer reasonably believed the position satisfied the more likely than not standard, and the position does or did, in fact, satisfy the substantial authority standard.

<sup>3</sup> Treasury Regulation Section 1.6662-4(g)(4).

<sup>4</sup> Treasury Regulation Section 1.6662-4(d).

<sup>5</sup> Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring And Reform Act of 1998 (Including Provisions Relating to Corporate Tax Shelters)* (JCS-3-99) (July 22, 1999), 1:152.

<sup>6</sup> Treasury Regulation Section 1.6694-2(b) (prior to the revisions made by T.D. 9436, which became effective December 22, 2008).

<sup>7</sup> Treasury Regulation Section 1.6662-3(b)(3).

<sup>8</sup> Joint Committee on Taxation, *supra* at 152, assigns a 20 percent likelihood of success for the reasonable basis standard.

equal, more weight is given to a case or ruling that has facts similar to those at issue than to a case or ruling that has distinguishable facts. Similarly, more weight may be given to a case or ruling that provides an analysis of the facts and law, as opposed to one that merely states a conclusion. Assuming the same or similar issues, the type of authority also is significant; for example, more weight is given to a case or revenue ruling than to a private letter ruling issued to a third party, and more weight is given to an appellate court decision than to a lower court decision. For additional examples, see Treasury Regulation Section 1.6662-4(d)(3), which deals with the analysis used to determine if the substantial authority standard is satisfied for purposes of the federal taxpayer substantial understatement penalty.<sup>9</sup>

Note also that what constitutes an "authority" for purposes of the analysis can vary. For example, in determining if the realistic possibility of success standard and the reasonable basis standard of paragraph 5 of SSTS No. 1 have been satisfied, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of analysis commonly used by tax advisers and return preparers. In contrast, these authorities cannot be relied upon in determining if the substantial authority or more likely than not standards have been satisfied for purposes of Internal Revenue Code (IRC) Section 6662 (or 6694).

## Appropriate Disclosure

In some instances, a member can satisfy the reporting and disclosure requirements of the applicable taxing authority or of SSTS No. 1 only if the particular tax position at issue is appropriately disclosed. The laws and regulations of the applicable taxing authority should be followed to ensure that pertinent disclosure provisions are satisfied. A member should consider all the facts and circumstances in evaluating whether a position is appropriately disclosed. SSTS No. 1 notes that, in the case of a nonsigning preparer, the adequate disclosure requirement is satisfied if the member advises the taxpayer regarding appropriate disclosure.

For purposes of the federal tax return preparer penalty provisions of IRC Section 6694(a), in general, a signing preparer satisfies the disclosure requirement if one of the following actions is taken:

1. The position is disclosed on Form 8275, "Disclosure Statement," or Form 8275-R, "Regulation Disclosure Statement," as appropriate, or in accordance with the requirements set forth in the annual revenue procedure regarding disclosure.
2. The preparer provides the taxpayer with a return that includes the appropriate disclosure.

Similarly, a nonsigning preparer who provides advice to a taxpayer satisfies the disclosure requirement for IRC Section 6694 purposes by (1) advising the taxpayer of any opportunity to avoid accuracy-related penalties that could apply with respect to the position and of the requirements for any applicable disclosure, and (2) contemporaneously documenting that advice in the files.<sup>10</sup>

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<sup>9</sup> Treasury Regulation Section 1.6694-2(b) incorporates this analysis in applying preparer standards for federal income tax purposes.

<sup>10</sup> Treasury Regulation Section 1.6694-2(d)(3).

## Interpretation No. 1-1, "Reporting and Disclosure Standards," of Statement on Standards for Tax Services No. 1, *Tax Return Positions*

### Background

**.01** SSTS No. 1 contains the standards a member should follow when recommending tax return positions or preparing or signing tax returns.

**.02** A member should determine and comply with the reporting and disclosure standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position or preparing or signing a tax return.

If the applicable taxing authority has no written standards that apply with respect to recommending a tax return position or preparing or signing a tax return or if its standards are lower than the standards set forth in this paragraph, the following standards will apply:

- a. A member should not recommend a tax return position or prepare or sign a tax return taking a position unless the member has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits, if challenged (commonly referred to as the *realistic possibility of success* standard).
- b. Notwithstanding paragraph .02a, a member may *recommend a tax return position* if the member (i) concludes that there is a reasonable basis for the position, and (ii) advises the taxpayer to appropriately disclose that position. Notwithstanding paragraph .02a, a member may *prepare or sign a tax return* that reflects a position if (i) the member concludes there is a reasonable basis for the position, and (ii) the position is appropriately disclosed.

**.03** Federal, state, local, and other taxing authorities may impose specific reporting and disclosure standards with respect to recommending tax return positions or preparing or signing tax returns that apply in addition to the AICPA standards. These standards vary among taxing jurisdictions and by type of tax. A member should refer to the current version of IRC Section 6694, "Understatement of Taxpayer's Liability by Tax Return Preparer," and the regulations thereunder to determine the reporting and disclosure standards applicable to preparers of federal tax returns.

**.04** When recommending a tax return position, or when preparing or signing a tax return on which a position is taken, a member should, when relevant, advise the taxpayer regarding the potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.05** A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows exploits the audit selection process of a taxing authority or serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.

**.06** When recommending a tax return position, a member has both the right and the responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.



**.07** A member also should consider SSTS No. 3, *Certain Procedural Aspects of Preparing Returns* (sec. 300), regarding the obligation to examine or verify certain supporting data or consider information related to another taxpayer, when preparing a taxpayer's tax return.

## General Interpretation

**.08** As described in the preface, the realistic possibility of success standard is a lower standard than the substantial authority standard and the more likely than not standard, but it is a higher standard than the reasonable basis standard. Therefore, if the standard of the applicable taxing authority is, for example, substantial authority, more likely than not, or some other standard that is higher than the realistic possibility of success standard, then the member should comply with that higher standard. In that case, the member is held to a standard higher than realistic possibility of success.

If the standard of the applicable taxing authority is lower than the realistic possibility of success standard, then the member should comply with the realistic possibility of success standard, which is reflected in paragraph .02a of this interpretation, or the reasonable basis standard with appropriate disclosure, which is reflected in paragraph .02b of this interpretation.

For purposes of this interpretation, the reporting and disclosure standards that apply in a given situation in accordance with SSTS No. 1 and this interpretation will be referred to as the *required reporting and disclosure standards*.

**.09** A member should determine and comply with the rules of the applicable taxing authority regarding reliance on authorities (cases, rulings, regulations, treatises, and so forth). However, notwithstanding the rules of the applicable taxing authority, in determining whether a tax return position satisfies the realistic possibility of success standard or the reasonable basis standard with appropriate disclosure for purposes of paragraph .02a–b of this interpretation, a member may rely on authorities in addition to those evaluated when determining whether substantial authority exists for a return position or whether a position is more likely than not to prevail under IRC Section 6662. For purposes of paragraph .02a–b of this interpretation, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of tax analyses commonly used by tax advisers and preparers of returns. A member should exercise caution in relying on materials, such as treatises, that may not be accepted as authorities in all situations, such as under federal tax law.

**.10** If particular facts and circumstances lead a member to believe that a taxpayer penalty could be asserted, then the member should so advise the taxpayer and should discuss with the taxpayer the opportunity, if any, to avoid such penalty by disclosing the position on the tax return. Although a member should so advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

**.11** In determining if the required reporting and disclosure standards have been satisfied, a member should do all of the following:

- Establish the relevant background facts.
- Consider the reasonableness of the assumptions and representations.
- Consider applicable regulations and standards regarding reliance on information and advice received from a third party.

- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that there is a business purpose or economic substance generally is insufficient.)
- Consider whether the issue involves a listed transaction or a reportable transaction (or their equivalents) as defined by the applicable taxing authority.<sup>11</sup>
- Arrive at a conclusion supported by the authorities.

**.12** A member should consider the weight of each authority to determine whether the required reporting and disclosure standards have been satisfied. In determining the weight of an authority, a member should consider its source, relevance, and persuasiveness. Therefore, the type of authority is a significant factor. Other important factors include whether the facts stated by the authority are distinguishable from those of the taxpayer's situation and whether the authority contains an analysis of the issue or merely states a conclusion.

**.13** A standard may be satisfied despite the absence of certain types of authority. For example, a member may conclude that the substantial authority standard has been satisfied when the position is supported only by a well-reasoned construction of the applicable statutory provision.

**.14** In determining whether the required reporting and disclosure standards have been satisfied, the extent of research required is left to the professional judgment of the member, given the facts and circumstances known to the member. A member may conclude that more than one position satisfies a given reporting standard, such as the substantial authority standard.

## Specific Illustrations

**.15** The following illustrations address general fact patterns only. Accordingly, the application of guidance, as discussed in the previous section, "General Interpretation," to variations in such general fact patterns or to particular facts or circumstances may lead to different conclusions. In each illustration, no authority exists other than that which is indicated. A decision regarding what are the required reporting and disclosure standards for tax return positions should be consistent with the provisions of SSTS No. 1, as explained in the previous section, "Background."

### ***Determination of the Standards***

**.16** *Illustration 1.* A member is preparing a U.S. income tax return at a time when the federal reporting standard is substantial authority for undisclosed positions and reasonable basis for disclosed positions.<sup>12</sup> One of the issues the member needs to address in preparing the return is the deductibility of a particular expenditure.

**.17** *Conclusion.* The federal standard of substantial authority is higher than the realistic possibility of success standard; therefore, the member is required to comply with the federal standard of substantial authority for undisclosed positions on the return. If the member analyzes the law and applicable authorities regarding whether the expenditure is deductible and concludes that

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<sup>11</sup> See, for example, Treasury Regulation Section 1.6011-4(b).

<sup>12</sup> See the preface for a description of the various reporting standards.

there is not substantial authority to support taking a deduction for the expenditure, the member should not prepare the return taking the deduction as an undisclosed position.

If the member concludes that there is sufficient authority to provide a reasonable basis for claiming the deduction, the member may prepare the return claiming the deduction if that position is appropriately disclosed.

**.18 Illustration 2.** A member is preparing a state inheritance tax return and needs to address the deductibility of a particular expenditure. The state does not have specific tax return reporting standards that apply.

**.19 Conclusion.** Because the applicable taxing authority (the state) does not have written tax return reporting standards that apply, the realistic possibility of success standard for an undisclosed position and the reasonable basis standard for an appropriately disclosed position apply. The member can prepare the return claiming the deduction if either of these is satisfied.

**.20 Illustration 3.** A taxpayer wants to take a position that a member has determined does not satisfy the reasonable basis standard. The taxpayer maintains that even if the taxing authority examines the return, the issue will not be raised.

**.21 Conclusion.** The member should not consider the likelihood of the issue being raised on examination when determining whether any reporting or disclosure standard has been satisfied. The member should not prepare or sign a return that contains a position that does not satisfy the reasonable basis standard, even if the position is disclosed.

**.22 Illustration 4.** A taxpayer wants to take a position on a federal tax return without disclosure; the member concludes that the position satisfies the substantial authority standard provided an assumption regarding an underlying nontax legal issue is appropriate. The member recommends that the taxpayer seek advice from its legal counsel, and the taxpayer's attorney gives an opinion on the nontax legal issue that is consistent with the assumption.

**.23 Conclusion.** A member may, in general, rely on a legal opinion on a nontax legal issue. A member should use professional judgment when relying on a legal opinion. If, on its face, the opinion of the taxpayer's attorney appears to be unreasonable, unsubstantiated, or unwarranted, the member, with appropriate consents from the taxpayer, should consult the member's attorney before relying on the opinion. A member should also refer to the illustrations in Interpretation No. 1-2, "Tax Planning," of SSTS No. 1 (sec. 9100 par. .50-.99), regarding the circumstances in which it is appropriate to rely on an opinion of legal counsel.

**.24 Illustration 5.** A taxpayer has obtained from its attorney an opinion on the tax treatment of an item and requests that a member rely on the opinion.

**.25 Conclusion.** If a member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the legal opinion, then the member may rely on that opinion when determining whether the required reporting and disclosure standards have been satisfied. The member should also refer to the illustrations in Interpretation No. 1-2 of SSTS No. 1 regarding the circumstances in which it is appropriate to rely on an opinion of legal counsel.

### ***Application of the Taxing Authority's Standards***

**.26** As noted previously, SSTS No. 1 requires a member to determine and comply with the required reporting and disclosure standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position or preparing or signing a tax return. These standards, and the

methods in which they are to be applied, vary among taxing authorities based on the laws and regulations of the relevant jurisdictions; therefore, illustrating all specific taxing authority standards is beyond the scope of this interpretation. To assist members in their analysis of whether the standards of an applicable taxing authority have been satisfied, the preface contains a description of the most common tax return reporting standards, the nature of the analysis to be applied, and the common requirements for appropriate disclosure.

### ***Application of the Realistic Possibility of Success and the Reasonable Basis Standards***

**.27** If the applicable taxing authority has no written tax return reporting or disclosure standards that apply or if its standards are lower than the realistic possibility of success standard for undisclosed positions or the reasonable basis standard for appropriately disclosed positions, SSTS No. 1 requires a member to comply with these latter standards, as stated in paragraph .02a–b of this interpretation.

The following illustrations pertain to situations in which a member is required to comply with these standards because the applicable taxing authority either has no written standards that apply or has standards that are lower than those described in paragraph .02a–b of this interpretation.

**.28 Illustration 6.** A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favorable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is inequitable as applied to the taxpayer's situation. The statute is constitutional, clearly drafted, and unambiguous. The legislative history discussing the new statute contains general comments that do not specifically address the taxpayer's situation.

**.29 Illustration 6.** A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favorable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is inequitable as applied to the taxpayer's situation. The statute is constitutional, clearly drafted, and unambiguous. The legislative history discussing the new statute contains general comments that do not specifically address the taxpayer's situation.

**.30 Illustration 7.** The facts are the same as in illustration 6 except that the legislative history discussing the new statute specifically addresses the taxpayer's situation and supports a position favorable to the taxpayer.

**.31 Conclusion.** In a case in which the statute is clearly and unambiguously against the taxpayer's position but a contrary position exists based on legislative history specifically addressing the taxpayer's situation, a return position based either on the statutory language or on the legislative history satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.32 Illustration 8.** The facts are the same as in illustration 6 except that the legislative history can be interpreted to provide some evidence or authority in support of the taxpayer's position; however, the legislative history does not specifically address the taxpayer's situation.

**.33 Conclusion.** In a case in which the statute is clear and unambiguous, a contrary position based on an interpretation of the legislative history that does not explicitly address the taxpayer's situation does not satisfy the realistic possibility of success standard. However, because the legislative history

provides some support or evidence for the taxpayer's position, a member may recommend the position to the taxpayer if the member determines that there is a reasonable basis for the position and advises the taxpayer to appropriately disclose the position. Also, a member may prepare a return for the taxpayer taking such a position if the member determines that there is a reasonable basis for the position, and the position is appropriately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.34 *Illustration 9.*** A taxpayer is faced with an issue involving the interpretation of a new statute. Following its passage, the statute was widely recognized to contain a drafting error, and a technical correction proposal has been introduced. The taxing authority issues a pronouncement indicating how it will administer the provision. The pronouncement interprets the statute in accordance with the proposed technical correction.

**.35 *Conclusion.*** A return position based on either the existing statutory language or the taxing authority's pronouncement satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.36 *Illustration 10.*** The facts are the same as in illustration 9 except that no taxing authority pronouncement has been issued.

**.37 *Conclusion.*** In the absence of a taxing authority pronouncement interpreting the statute in accordance with the proposed technical correction, only a return position based on the existing statutory language will satisfy the realistic possibility of success standard. A member may recommend the position to the taxpayer if, based on the facts and circumstances, the member determines that a reasonable basis exists for the position and advises the taxpayer to appropriately disclose the position. Also, a member may prepare a return for the taxpayer taking such a position if, based on the facts and circumstances, the member determines that there is a reasonable basis for the position, and the position is appropriately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.38 *Illustration 11.*** A taxpayer is seeking advice from a member regarding a recently amended statute. The member has reviewed the statute, the legislative history that specifically addresses the issue, and a recently published notice issued by the taxing authority. No cases, rulings, or other pronouncements exist regarding the statute. The member has concluded in good faith that, based on the statute and the legislative history, the taxing authority's position as stated in the notice does not reflect legislative intent.

**.39 *Conclusion.*** A return position supported by the statute and the legislative history satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.40 *Illustration 12.*** The facts are the same as in illustration 11 except that the taxing authority's pronouncement is a temporary regulation.

**.41 *Conclusion.*** In determining whether a tax return position satisfies the realistic possibility of success standard, a member should determine the weight to be given the temporary regulation by analyzing factors, such as whether the

regulation is legislative or interpretative and if it is consistent with the statute. If the member concludes that the position does not satisfy the realistic possibility of success standard, the member may still recommend the position if the member determines that it satisfies the reasonable basis standard, and the member advises the taxpayer to appropriately disclose the position. The member may prepare a return for the taxpayer taking that position if the member determines that the position satisfies the reasonable basis standard, and the position is adequately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.42 Illustration 13.** A statute is passed requiring the capitalization of certain expenditures. The taxpayer believes, and the member concurs, that to comply fully, the taxpayer will have to acquire new computer hardware and software and implement a number of new accounting procedures. The taxpayer and member agree that the costs of full compliance will be significantly greater than the resulting increase in tax due under the new provision. Because of these cost considerations, the taxpayer makes no effort to comply. The taxpayer wants the member to prepare and sign a return on which the new requirement is simply ignored.

**.43 Conclusion.** The return position desired by the taxpayer is frivolous, a standard below reasonable basis. The member should not prepare or sign the return.

**.44 Illustration 14.** The facts are the same as in illustration 13 except that the taxpayer has made a good-faith effort to comply with the law by calculating an estimate of expenditures to be capitalized under the new provision.

**.45 Conclusion.** In this situation, assuming the taxpayer complied with the statutory and regulatory provisions classifying expenditures to be capitalized and those to be expensed and made a good-faith effort to determine the appropriate amounts to be capitalized and expensed, the realistic possibility of success standard would be satisfied for the return positions. (The substantial authority standard also may be satisfied.) When using estimates in the preparation of a return, a member should refer to SSTS No. 4, *Use of Estimates* (sec. 400). A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.46 Illustration 15.** On a given issue, a member has located and weighed two authorities concerning the treatment of a particular expenditure. The taxing authority has issued an administrative ruling that requires the expenditure to be capitalized and amortized over several years. On the other hand, a court opinion permits the current deduction of the expenditure. The member has concluded that these are the relevant authorities, considered the source of both authorities, and concluded that both are persuasive and relevant.

**.47 Conclusion.** The realistic possibility of success standard is met by either position. (Either or both also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.48 Illustration 16.** A tax statute is silent on the treatment of an item. However, the legislative history explaining the statute directs the taxing authority to issue regulations that will require a specific treatment of the item. No regulations have been issued at the time the member must recommend a position on the tax treatment of the item.

**.49 Conclusion.** The position supported by the legislative history satisfies the realistic possibility of success standard. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

## Interpretation No. 1-2, "Tax Planning," of Statement on Standards for Tax Services No. 1, *Tax Return Positions*

### Background

**.50** SSTs are enforceable standards that govern the conduct of AICPA members in tax practice. A significant area of many members' tax practices involves assisting taxpayers in tax planning. Two of the seven SSTs issued as of the date of this interpretation's release (that is, the revised SSTs that became effective on January 1, 2010) directly set forth standards that affect the most common activities in tax planning. Several other SSTs set forth standards related to specific factual situations that may arise while a member is assisting a taxpayer in tax planning. The two SSTs that are most typically relevant to tax planning are SSTs No. 1, including Interpretation No. 1-1, "Reporting and Disclosure Standards," of SSTs No. 1 (sec. 9100 par. .01-.49), and SSTs No. 7, *Form and Content of Advice to Taxpayers* (sec. 700).

**.51** Taxing authorities, courts, the AICPA, and other professional organizations have struggled with defining and regulating *tax shelters* and *abusive transactions*. Crucial to the debate is the difficulty of clearly distinguishing between transactions that are abusive and transactions that are aggressive and legitimate. At the same time, it must be recognized that taxpayers have a legitimate interest in arranging their affairs so that they pay no more than the taxes they owe. Tax professionals, including AICPA members, have a role to play in advancing these efforts.

**.52** This interpretation is part of the AICPA's continuing efforts at self-regulation of its members in tax practice. It has its origins in the AICPA's desire to provide adequate guidance to its members with respect to providing services in connection with tax planning. This interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards, recognizing the compelling need for a comprehensive interpretation of a member's responsibilities in connection with *tax planning*. This guidance is intended to clarify how those standards would apply across the spectrum of tax planning, including those situations involving *tax shelters*, regardless of how that term is defined.

### General Interpretation

**.53** *Tax planning* encompasses a wide variety of situations. It includes situations in which the member provides advice on prospective or completed transactions, whether or not the advice reflects favorable or unfavorable treatment to the taxpayer. When providing professional services that include tax planning, a member should determine and comply with any applicable standards for reporting and disclosing tax return positions or for providing written tax advice. See SSTs No. 1 and Interpretation No. 1-1; SSTs No. 7; U.S. Treasury Department Circular 230, *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service*,<sup>13</sup> and

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<sup>13</sup> Title 31, *Money and Finance: Treasury* of U.S. Code of Federal Regulations.

any other standards that may apply. A member may still recommend a position that does not satisfy the realistic possibility standard if (a) a reasonable basis exists for the position, (b) the member recommends appropriate disclosure, and (c) a higher standard is not required under applicable taxing authority rules. For purposes of this interpretation, the reporting and disclosure standards that apply in a given situation in accordance with SSTS No. 1 and Interpretation No. 1-1 will be referred to as the *required reporting and disclosure standards*.

**.54** For purposes of this interpretation, *tax planning* includes, both with respect to prospective and completed transactions, recommending or expressing an opinion (whether written or oral) on (a) a tax return position or (b) a specific tax plan developed by the member, the taxpayer, or a third party. For tax planning with respect to a completed transaction, the member may be considered a nonsigning tax return preparer with respect to the items for which the tax planning is undertaken that subsequently are reflected on the taxpayer's tax return. The member should comply with tax return preparer standards promulgated by the applicable taxing authority.

**.55** When issuing an opinion to reflect the results of the tax planning service, a member should do all of the following:

- Establish the relevant background facts.
- Consider the reasonableness of the assumptions and representations.
- Consider applicable regulations and standards regarding reliance on information and advice received from a third party.
- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that there is a business purpose or economic substance generally is insufficient.)
- Consider whether the issue involves a *listed transaction* or a *reportable transaction* (or their equivalents) as defined by the applicable taxing authority.<sup>14</sup>
- Consider other regulations and standards applicable to written tax advice promulgated by the applicable taxing authority.
- Arrive at a conclusion supported by the authorities.

The member also should consider SSTS No. 1, SSTS No. 7, Treasury Department Circular 230, and any other standards that may apply.

**.56** In assisting a taxpayer in a tax planning transaction in which the taxpayer has obtained an opinion from a third party and is looking to the member for an evaluation of the opinion, the member should be satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion, which would include considering whether the opinion indicates the third party did all of the following:

- Established the relevant background facts.
- Considered the reasonableness of the assumptions and representations.
- Considered applicable regulations and standards.

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<sup>14</sup> See, for example, Treasury Regulation Section 1.6011-4(b).



- Applied the pertinent authorities to the relevant facts.
- Considered the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that a business purpose or economic substance exists generally is insufficient.)
- Considered whether the issue involves a listed transaction or a reportable transaction (or their equivalents) as defined by the applicable taxing authority.<sup>15</sup>
- Arrived at a conclusion supported by the authorities.

**.57** In conducting the due diligence necessary to establish the relevant background facts, the member should consider whether it is appropriate to rely on an assumption concerning facts in lieu of either (a) other procedures to support the advice, or (b) a representation from the taxpayer or another person. A member should also consider whether the member's tax advice might be communicated to third parties, particularly if those third parties may not be knowledgeable or may not be receiving independent tax advice with respect to a transaction.

**.58** In tax planning, members often rely on assumptions and representations. Although such reliance is often necessary, the member should take care to assess whether such assumptions and representations are reasonable. In deciding whether an assumption or representation is reasonable, the member should consider its source (for example, the knowledge and expertise of the issuer), and consistency with other information known to the member. For example, depending on the circumstances, it may be reasonable for a member to rely on a representation made by the taxpayer but not on a representation made by a person who is selling, or otherwise promoting, the transaction to the taxpayer.

**.59** When engaged in tax planning, the member should understand the business purpose and economic substance of the transaction when relevant to the tax consequences. If a transaction has been proposed by a party other than the taxpayer, the member should consider whether the assumptions made by the third party are consistent with the facts of the taxpayer's situation. If written advice is to be rendered concerning a transaction, the business purpose for the transaction generally should be described. If the business reasons are relevant to the tax consequences, it is not sufficient to assume merely that a transaction is entered into for valid business reasons without specifying what those reasons are. Similarly, if economic substance is relevant to the tax consequences, it is insufficient to assume merely that a transaction has economic substance without specifying the basis for making that determination. In providing written advice on these issues, the member should consider the written advice regulations and standards, if any, promulgated by the applicable taxing authority. The member also should consider SSTS No. 1, SSTS No. 7, Treasury Department Circular 230, and any other standards that may apply.

**.60** The scope of the engagement should be appropriately determined, and the member should consider the necessity for an engagement letter. The member should be diligent in applying such procedures as are appropriate under the circumstances to understand and evaluate the entire transaction. The specific procedures to be performed in this regard will vary with the circumstances and the scope of the engagement.

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<sup>15</sup> See footnote 2.

## Specific Illustrations

**.61** The following illustrations address general fact patterns. Accordingly, the application of the guidance that is discussed in the previous section, "General Interpretation," to variations in such general fact patterns or to particular facts or circumstances, may lead to different conclusions. In each illustration, no authority exists other than that which is indicated.

**.62 *Illustration 1.*** The relevant tax code imposes penalties on taxpayers for substantial underpayments that are not associated with *tax shelters* as defined in such code, unless the positions resulting in the underpayments are supported by substantial authority.

**.63 *Conclusion.*** In assisting the taxpayer in tax planning in which any associated underpayment would be considered substantial, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration if that position does not satisfy the substantial authority standard. The member also should inform the taxpayer of the opportunities, if any, to avoid such penalties through appropriate disclosure. In such a situation, applicable standards may prohibit the member from preparing the tax return without appropriate disclosure.

**.64 *Illustration 2.*** The relevant tax code imposes penalties on taxpayers for underpayments attributable to *tax shelters* as defined in such code unless the taxpayer concludes that a position taken on a tax return associated with such a tax shelter is more likely than not the correct position.

**.65 *Conclusion.*** In assisting the taxpayer in tax planning, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration if that position satisfies the substantial authority standard but does not satisfy the more likely than not standard. This would also include advice regarding whether penalties can be avoided through disclosure by the taxpayer.<sup>16</sup> In such a situation, applicable standards may prohibit the member from preparing the tax return without appropriate disclosure.

**.66 *Illustration 3.*** The relevant tax code imposes penalties on tax return preparers advising on return positions attributable to potentially abusive arrangements that are designated as listed transactions or reportable transactions with a significant purpose of avoidance or evasion of income tax, if there is a related understatement of income tax. The penalty does not apply if the preparer concludes that the position is more likely than not the correct position. The member advising the taxpayer in planning a transaction is later retained to prepare and sign the taxpayer's income tax return for the period that includes the taxpayer's participation in the transaction.

**.67 *Conclusion.*** A member engaged to prepare a return reflecting a transaction that the member assisted in planning should reevaluate the need to satisfy the more likely than not standard to avoid penalties (including potential sanction or discipline) as a preparer and whether potential penalties may be avoided through appropriate disclosure. The member also should consider whether a separate disclosure is required to avoid penalties under other statutory provisions (in addition to penalties applicable to understatement of tax). The member should inform the taxpayer of the taxpayer's penalty risks, as described in illustrations 1 and 2 of this interpretation. The member also should consider SSTS No. 1 and Interpretation No. 1-1.

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<sup>16</sup> The IRC Section 6662 substantial understatement penalty cannot be avoided by disclosure in the context of a tax shelter.

**.68 Illustration 4.** The relevant tax regulation provides that the details of (or certain information regarding) a specific transaction are required to be attached to the tax return, regardless of the level of authority supporting the associated tax return position (for example, even if there is substantial authority or a higher level of confidence for the position). While preparing the taxpayer's return for the year, the member is aware that an attachment is required.

**.69 Conclusion.** In general, if the taxpayer agrees to include the attachment required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the required reporting and disclosure standards. However, if the taxpayer refuses to include the attachment, the member should not sign the return unless the member concludes the associated tax return position satisfies the required reporting and disclosure standards, and reasonable grounds exist for the taxpayer's position with respect to the attachment. In this regard, the member should consider SSTS No. 2, *Answers to Questions on Returns* (sec. 200), which provides that the term *questions*, as used in the standard, "includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question," and that a "member should not omit an answer merely because it might prove disadvantageous to a taxpayer." The member also should consider SSTS No. 1 and Interpretation No. 1-1.

**.70 Illustration 5.** The relevant tax regulations provide that the details of certain potentially abusive transactions that are designated as listed transactions are required to be disclosed in attachments to tax returns (enhanced disclosure), regardless of the support for the associated tax return position (for example, even if the applicable taxing authority's standard is satisfied). Under the regulations, if the enhanced disclosure requirements for a listed transaction are not satisfied, the taxpayer will have additional penalty risks, including the possibility of a nonrescindable penalty. While researching the tax consequences of a proposed transaction, a member concludes that the transaction is a listed transaction.

**.71 Conclusion.** Notwithstanding the member's conclusion that the transaction is a listed transaction, the member may still recommend a tax return position with respect to the transaction if he or she concludes that the position satisfies the required reporting and disclosure standards (other than the enhanced disclosure). However, the member should inform the taxpayer of the enhanced disclosure requirements of listed transactions and the additional penalty risks for noncompliance, including the potential for enhanced or nonrescindable penalties or both.

**.72 Illustration 6.** The same regulations apply as in illustration 5. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that the taxpayer's transaction is a listed transaction.

**.73 Conclusion.** The member should inform the taxpayer of the enhanced disclosure requirements and the additional penalty risks for noncompliance. If the taxpayer agrees to make the enhanced disclosure required by the regulation, the member may sign the return if the member concludes the associated tax return position also satisfies the required reporting and disclosure standards. The member should not sign the return if the enhanced disclosure requirements are not satisfied. If the member is a nonsigning preparer of the return, the member should recommend that the taxpayer comply with the enhanced disclosure requirements regarding the transaction.

**.74 Illustration 7.** The same regulations apply as in illustration 5. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that there is uncertainty about whether the taxpayer's transaction is a listed transaction.

**.75 Conclusion.** The member should inform the taxpayer of the enhanced disclosure requirements and the additional penalty risks for noncompliance. If the taxpayer agrees to make the enhanced disclosure required by the relevant regulations, the member may sign the return if the member concludes the associated tax return position also satisfies the required reporting and disclosure standards. If the taxpayer does not want to provide the enhanced disclosure of the transaction because of the uncertainty about whether it is a listed transaction, the member may sign the return if the member concludes the associated tax return position satisfies the required reporting and disclosure standards (other than the enhanced disclosure requirements), and reasonable grounds exist for the taxpayer's position with regard to not providing enhanced disclosure of the transaction. In this regard, the member should consider SSTS No. 2, which indicates that the degree of uncertainty regarding the meaning of a question on a return may affect whether reasonable grounds exist for not responding to the question.

**.76 Illustration 8.** A member advises a taxpayer concerning the tax consequences of a proposed transaction involving a loan from a U.S. bank. In the process of reviewing documents associated with the proposed transaction, the member uncovers a reference to a deposit the taxpayer will make with an overseas branch of the U.S. bank. The transaction documents appear to indicate that this deposit is linked to the U.S. bank's issuance of the loan.

**.77 Conclusion.** The member should consider the effect, if any, of the deposit in advising the taxpayer about the tax consequences of the proposed transaction and with respect to other tax compliance matters reasonably likely to be at issue (for example, foreign bank account reporting).

**.78 Illustration 9.** Under the relevant tax law, the tax consequences of a leasing transaction depend on whether the property to be leased is reasonably expected to have a residual value of 15 percent of its value at the beginning of the lease. The member has relied on a taxpayer's instruction to use a particular assumption concerning the residual value.

**.79 Conclusion.** Such reliance on the taxpayer's instructions may be appropriate if the assumption is supported by the expertise of the taxpayer, by the member's review of information provided by the taxpayer or a third party, or through the member's own knowledge or analysis.

**.80 Illustration 10.** A member is assisting a taxpayer with evaluating a proposed equipment leasing transaction in which the estimated residual value of the equipment at the end of the lease term is critical to the tax consequences of the lease. The broker arranging the leasing transaction has prepared an analysis that sets out an explicit assumption concerning the equipment's estimated residual value.

**.81 Conclusion.** The member should consider whether it is appropriate to rely on the broker's assumption concerning the estimated residual value of the equipment instead of obtaining a representation from the broker concerning estimated residual value or performing other procedures to validate the amount to be used as an estimate of residual value in connection with the member's advice. In evaluating the appropriateness of the broker's assumption, the member should consider, for example, factors such as the broker's experience in the area,

the broker's methodology, and whether alternative sources of information are reasonably available.

**.82 Illustration 11.** The tax consequences of a particular reorganization depend, in part, on the majority shareholder of a corporation not disposing of stock received in the reorganization in a manner that would prevent the transaction from qualifying as a reorganization.

**.83 Conclusion.** The member should consider whether it is appropriate in rendering tax advice to assume that such a disposition will not occur or whether, under the circumstances, it is appropriate to request written representations regarding the intent of the shareholder and any other parties to the reorganization concerning this requirement, as a condition to issuing an opinion on the reorganization.

**.84 Illustration 12.** A taxpayer is considering a proposed transaction. The taxpayer and the taxpayer's attorney advise the member that the member is responsible for advising the taxpayer on the tax consequences of the transaction.

**.85 Conclusion.** In addition to complying with the requirements of paragraph .55 of this interpretation, the member generally should review all relevant draft transaction documents in formulating the member's tax advice relating to the transaction.

**.86 Illustration 13.** A member is responsible for advising a taxpayer on the tax consequences of the taxpayer's estate plan.

**.87 Conclusion.** Under the circumstances, the member should review the will and all other relevant documents to assess whether there appear to be any tax issues raised by the formulation or implementation of the estate plan.

**.88 Illustration 14.** A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support its recommendation, the investment bank offers a law firm's opinion on the tax consequences. The member reads the opinion and notes that it is based on a hypothetical statement of facts rather than the taxpayer's facts.

**.89 Conclusion.** The member may rely on the law firm's opinion when determining whether the required reporting and disclosure standards have been satisfied with respect to the tax consequences of the hypothetical transaction if the member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion. However, the member should be diligent in taking such steps as are appropriate under the circumstances to understand and evaluate the transaction as it applies to the taxpayer's specific situation. See paragraph .56 of this interpretation.

**.90 Illustration 15.** A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support that recommendation, the investment bank offers a law firm's opinion about the tax consequences. The member reads the opinion and notes that unlike the opinion described in illustration 14, it is carefully tailored to the taxpayer's facts.

**.91 Conclusion.** The member may rely on the opinion when determining whether the required reporting and disclosure standards have been satisfied with respect to the taxpayer's participation in the transaction if the member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion. In making that determination, the member should consider whether the opinion indicates the law firm performed the steps listed in paragraph .56 of this interpretation.

**.92 Illustration 16.** A member is assisting a taxpayer with year-end planning in connection with the taxpayer's proposed contribution of stock in a closely held corporation to a charitable organization. The taxpayer instructs the member to calculate the anticipated tax savings assuming a contribution of 500 shares to a tax-exempt organization and assuming the stock has a fair market value of \$100 per share. The member is aware that on the taxpayer's gift tax returns for the prior year, the taxpayer reported that her stock in the corporation, gifted to her daughter, was worth \$50 per share.

**.93 Conclusion.** The member's calculation of the anticipated tax savings is subject to the general interpretations described in paragraphs .57 and .58 of this interpretation. Accordingly, even though this potentially may be a case in which the value of the stock substantially appreciated during the year, the member should consider the reasonableness of the assumption and consistency with other information known to the member in connection with preparing the projection. The member should consider whether to document discussions concerning the increase in value of the stock with the taxpayer. The member also should consider the applicability of the SSTs.

**.94 Illustration 17.** The tax consequences to Target Corporation's shareholders of an acquisition turn, in part, on Acquiring Corporation's continuance of the trade or business of Target Corporation for some time after the acquisition. The member is preparing a tax opinion addressed to Target's shareholders. The opinion is based on a written representation from Acquiring Corporation that Acquiring Corporation will continue Target's business for two years following the acquisition.

**.95 Conclusion.** In conducting the due diligence necessary to establish the relevant background facts, the member should consider the reasonableness of the representation before determining that it is appropriate to rely on the representation from Acquiring Corporation.

**.96 Illustration 18.** The member receives a telephone call from a taxpayer who is the sole shareholder of a corporation. The taxpayer indicates that he is thinking about exchanging his stock in the corporation for stock in a publicly traded business. During the call, the member explains how the transaction could be structured so it will qualify as a tax-free acquisition.

**.97 Conclusion.** Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, substantial dollar-value, or complicated transactions. The member should use professional judgment about the need to document oral advice. (See SSTs No. 7.)

**.98 Illustration 19.** The member receives a telephone call from a taxpayer who wants to know whether he or she should lease or purchase a car. During the call, the member explains how the arrangement should be structured so that it helps achieve the taxpayer's objectives.

**.99 Conclusion.** In this situation, the member's response is in conformity with this interpretation in view of the routine nature of the inquiry and the well-defined tax issues. However, the member should evaluate whether other considerations, such as avoiding misunderstanding with the taxpayer, suggest that the conversation should be documented.

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## TS Section 200

# Answers to Questions on Returns

Source: SSTS No. 2

Effective date, unless  
otherwise indicated:  
January 2010

### Introduction

**.01** This statement sets forth the applicable standards for members when signing the preparer's declaration on a tax return if one or more questions on the return have not been answered. The term *questions* includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question.

### Statement

**.02** A member should make a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.

### Explanation

**.03** It is recognized that the questions on tax returns are not of uniform importance, and often they are not applicable to the particular taxpayer. Nevertheless, there are at least three reasons why a member should be satisfied that a reasonable effort has been made to obtain information to provide appropriate answers to the questions on the return that are applicable to a taxpayer:

- a. A question may be of importance in determining taxable income or loss, or the tax liability shown on the return, in which circumstance an omission may detract from the quality of the return.
- b. A request for information may require a disclosure necessary for a complete return or to avoid penalties.
- c. A member often must sign a preparer's declaration stating that the return is true, correct, and complete.

**.04** Reasonable grounds may exist for omitting an answer to a question applicable to a taxpayer. For example, reasonable grounds may include the following:

- a. The information is not readily available and the answer is not significant in terms of taxable income or loss, or the tax liability shown on the return.
- b. Genuine uncertainty exists regarding the meaning of the question in relation to the particular return.
- c. The answer to the question is voluminous; in such cases, a statement should be made on the return that the data will be supplied upon examination.

**.05** A member should not omit an answer merely because it might prove disadvantageous to a taxpayer.

**.06** A member should consider whether the omission of an answer to a question may cause the return to be deemed incomplete or result in penalties.

**.07** If reasonable grounds exist for omission of an answer to an applicable question, a taxpayer is not required to provide on the return an explanation of the reason for the omission.

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## TS Section 300

# *Certain Procedural Aspects of Preparing Returns*

Source: SSTS No. 3

Effective date, unless  
otherwise indicated:  
January 2010

### Introduction

**.01** This statement sets forth the applicable standards for members concerning the obligation to examine or verify certain supporting data or to consider information related to another taxpayer when preparing a taxpayer's tax return.

### Statement

**.02** In preparing or signing a return, a member may in good faith rely, without verification, on information furnished by the taxpayer or by third parties. However, a member should not ignore the implications of information furnished and should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to the member. Further, a member should refer to the taxpayer's returns for one or more prior years whenever feasible.

**.03** If the tax law or regulations impose a condition with respect to deductibility or other tax treatment of an item, such as taxpayer maintenance of books and records or substantiating documentation to support the reported deduction or tax treatment, a member should make appropriate inquiries to determine to the member's satisfaction whether such condition has been met.

**.04** When preparing a tax return, a member should consider information actually known to that member from the tax return of another taxpayer if the information is relevant to that tax return and its consideration is necessary to properly prepare that tax return. In using such information, a member should consider any limitations imposed by any law or rule relating to confidentiality.

### Explanation

**.05** The preparer's declaration on a tax return often states that the information contained therein is true, correct, and complete to the best of the preparer's knowledge and belief based on all information known by the preparer. This type of reference should be understood to include information furnished by the taxpayer or by third parties to a member in connection with the preparation of the return.

**.06** The preparer's declaration does not require a member to examine or verify supporting data; a member may rely on information furnished by the taxpayer unless it appears to be incorrect, incomplete, or inconsistent. However, there is a need to determine by inquiry that a specifically required condition,

such as maintaining books and records or substantiating documentation, has been satisfied and to obtain information when the material furnished appears to be incorrect, incomplete, or inconsistent. Although a member has certain responsibilities in exercising due diligence in preparing a return, the taxpayer has the ultimate responsibility for the contents of the return. Thus, if the taxpayer presents unsupported data in the form of lists of tax information, such as dividends and interest received, charitable contributions, and medical expenses, such information may be used in the preparation of a tax return without verification unless it appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member.

**.07** Even though there is no requirement to examine underlying documentation, a member should encourage the taxpayer to provide supporting data where appropriate. For example, a member should encourage the taxpayer to submit underlying documents for use in tax return preparation to permit full consideration of income and deductions arising from security transactions and from pass-through entities, such as estates, trusts, partnerships, and S corporations.

**.08** The source of information provided to a member by a taxpayer for use in preparing the return is often a pass-through entity, such as a limited partnership, in which the taxpayer has an interest but is not involved in management. A member may accept the information provided by the pass-through entity without further inquiry, unless there is reason to believe it is incorrect, incomplete, or inconsistent, either on its face or on the basis of other facts known to the member. In some instances, it may be appropriate for a member to advise the taxpayer to ascertain the nature and amount of possible exposure to tax deficiencies, interest, and penalties by taxpayer contact with management of the pass-through entity.

**.09** A member should make use of a taxpayer's returns for one or more prior years in preparing the current return whenever feasible. Reference to prior returns and discussion of prior-year tax determinations with the taxpayer should provide information to determine the taxpayer's general tax status, avoid the omission or duplication of items, and afford a basis for the treatment of similar or related transactions. As with the examination of information supplied for the current year's return, the extent of comparison of the details of income and deduction between years depends on the particular circumstances.

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## TS Section 400

### *Use of Estimates*

Source: SSTS No. 4

Effective date, unless  
otherwise indicated:  
January 2010

#### Introduction

.01 This statement sets forth the applicable standards for members when using the taxpayer's estimates in the preparation of a tax return. A member may advise on estimates used in the preparation of a tax return, but the taxpayer has the responsibility to provide the estimated data. Appraisals or valuations are not considered estimates for purposes of this statement.

#### Statement

.02 Unless prohibited by statute or by rule, a member may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. The taxpayer's estimates should be presented in a manner that does not imply greater accuracy than exists.

#### Explanation

.03 Accounting requires the exercise of professional judgment and, in many instances, the use of approximations based on judgment. The application of such accounting judgments, as long as not in conflict with methods set forth by a taxing authority, is acceptable. These judgments are not estimates within the purview of this statement. For example, a federal income tax regulation provides that if all other conditions for accrual are met, the exact amount of income or expense need not be known or ascertained at year end if the amount can be determined with reasonable accuracy.

.04 When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a taxpayer in determining the amount to be deducted for such items may be appropriate.

.05 When records are missing or precise information about a transaction is not available at the time the return must be filed, a member may prepare a tax return using a taxpayer's estimates of the missing data.

.06 Estimated amounts should not be presented in a manner that provides a misleading impression about the degree of factual accuracy.

.07 Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual circumstances where nondisclosure might mislead the taxing authority regarding

the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:

- a.* A taxpayer has died or is ill at the time the return must be filed.
  - b.* A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
  - c.* There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
  - d.* Fire, computer failure, or natural disaster has destroyed the relevant records.
-

## TS Section 500

# ***Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision***

Source: SSTS No. 5

Effective date, unless  
otherwise indicated:  
January 2010

### **Introduction**

.01 This statement sets forth the applicable standards for members in recommending a tax return position that departs from the position determined in an administrative proceeding or in a court decision with respect to the taxpayer's prior return.

.02 For purposes of this statement, *administrative proceeding* includes an examination by a taxing authority or an appeals conference relating to a return or a claim for refund.

.03 For purposes of this statement, *court decision* means a decision by any court having jurisdiction over tax matters.

### **Statement**

.04 The tax return position with respect to an item as determined in an administrative proceeding or court decision does not restrict a member from recommending a different tax position in a later year's return, unless the taxpayer is bound to a specified treatment in the later year, such as by a formal closing agreement. Therefore, the member may recommend a tax return position or prepare or sign a tax return that departs from the treatment of an item as concluded in an administrative proceeding or court decision with respect to a prior return of the taxpayer provided the requirements of TS section 100, *Tax Return Positions*, are satisfied.

### **Explanation**

.05 If an administrative proceeding or court decision has resulted in a determination concerning a specific tax treatment of an item in a prior year's return, a member will usually recommend this same tax treatment in subsequent years. However, departures from consistent treatment may be justified under such circumstances as the following:

- a. Taxing authorities tend to act consistently in the disposition of an item that was the subject of a prior administrative proceeding but generally are not bound to do so. Similarly, a taxpayer is not bound to follow the tax treatment of an item as consented to in an earlier administrative proceeding.

- b.* The determination in the administrative proceeding or the court's decision may have been caused by a lack of documentation. Supporting data for the later year may be appropriate.
- c.* A taxpayer may have yielded in the administrative proceeding for settlement purposes or not appealed the court decision, even though the position met the standards in TS section 100.
- d.* Court decisions, rulings, or other authorities that are more favorable to a taxpayer's current position may have developed since the prior administrative proceeding was concluded or the prior court decision was rendered.

**.06** The consent in an earlier administrative proceeding and the existence of an unfavorable court decision are factors that the member should consider in evaluating whether the standards in TS section 100 are met.

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## TS Section 600

# ***Knowledge of Error: Return Preparation and Administrative Proceedings***

Source: SSTS No. 6

Effective date, unless  
otherwise indicated:  
January 2010

### **Introduction**

**.01** This statement sets forth the applicable standards for a member who becomes aware of (a) an error in a taxpayer's previously filed tax return; (b) an error in a return that is the subject of an administrative proceeding, such as an examination by a taxing authority or an appeals conference; or (c) a taxpayer's failure to file a required tax return. As used herein, the term *error* includes any position, omission, or method of accounting that, at the time the return is filed, fails to meet the standards set out in TS section 100, *Tax Return Positions*. The term *error* also includes a position taken on a prior year's return that no longer meets these standards due to legislation, judicial decisions, or administrative pronouncements having retroactive effect. However, an error does not include an item that has an insignificant effect on the taxpayer's tax liability. The term *administrative proceeding* does not include a criminal proceeding.

**.02** This statement applies whether or not the member prepared or signed the return that contains the error.

**.03** Special considerations may apply when a member has been engaged by legal counsel to provide assistance in a matter relating to the counsel's client.

### **Statement**

**.04** A member should inform the taxpayer promptly upon becoming aware of an error in a previously filed return, an error in a return that is the subject of an administrative proceeding, or a taxpayer's failure to file a required return. A member also should advise the taxpayer of the potential consequences of the error and recommend the corrective measures to be taken. Such advice and recommendation may be given orally. The member is not allowed to inform the taxing authority without the taxpayer's permission, except when required by law.

**.05** If a member is requested to prepare the current year's return and the taxpayer has not taken appropriate action to correct an error in a prior year's return, the member should consider whether to withdraw from preparing the return and whether to continue a professional or employment relationship with the taxpayer. If the member does prepare such current year's return, the member should take reasonable steps to ensure that the error is not repeated.

**.06** If a member is representing a taxpayer in an administrative proceeding with respect to a return that contains an error of which the member is aware, the member should request the taxpayer's agreement to disclose the error to

the taxing authority. Lacking such agreement, the member should consider whether to withdraw from representing the taxpayer in the administrative proceeding and whether to continue a professional or employment relationship with the taxpayer.

## Explanation

**.07** While performing services for a taxpayer, a member may become aware of an error in a previously filed return or may become aware that the taxpayer failed to file a required return. The member should advise the taxpayer of the error and the potential consequences, and recommend the measures to be taken. Similarly, when representing the taxpayer before a taxing authority in an administrative proceeding with respect to a return containing an error of which the member is aware, the member should advise the taxpayer to disclose the error to the taxing authority and of the potential consequences of not disclosing the error. Such advice and recommendation may be given orally.

**.08** It is the taxpayer's responsibility to decide whether to correct the error. If the taxpayer does not correct an error, a member should consider whether to withdraw from the engagement and whether to continue a professional or employment relationship with the taxpayer. Although recognizing that the taxpayer may not be required by statute to correct an error by filing an amended return, a member should consider whether a taxpayer's decision not to file an amended return or otherwise correct an error may predict future behavior that might require termination of the relationship.

**.09** Once the member has obtained the taxpayer's consent to disclose an error in an administrative proceeding, the disclosure should not be delayed to such a degree that the taxpayer or member might be considered to have failed to act in good faith or to have, in effect, provided misleading information. In any event, disclosure should be made before the conclusion of the administrative proceeding.

**.10** A conflict between the member's interests and those of the taxpayer may be created by, for example, the potential for violating Code of Professional Conduct Rule 301, *Confidential Client Information* (ET sec. 301 par. .01) (relating to the member's confidential client relationship); the tax law and regulations; or laws on privileged communications, as well as by the potential adverse impact on a taxpayer of a member's withdrawal. Therefore, a member should consider consulting with his or her own legal counsel before deciding upon recommendations to the taxpayer and whether to continue a professional or employment relationship with the taxpayer.

**.11** If a member believes that a taxpayer may face possible exposure to allegations of fraud or other criminal misconduct, the member should advise the taxpayer to consult with an attorney before the taxpayer takes any action.

**.12** If a member decides to continue a professional or employment relationship with the taxpayer and is requested to prepare a tax return for a year subsequent to that in which the error occurred, the member should take reasonable steps to ensure that the error is not repeated. If the subsequent year's tax return cannot be prepared without perpetuating the error, the member should consider withdrawal from the return preparation. If a member learns that the taxpayer is using an erroneous method of accounting and it is past the due date to request permission to change to a method meeting the standards of TS section 100, the member may sign a tax return for the current year, providing the tax return includes appropriate disclosure of the use of the erroneous method.



**.13** Whether an error has no more than an insignificant effect on the taxpayer's tax liability is left to the professional judgment of the member based on all the facts and circumstances known to the member. In judging whether an erroneous method of accounting has more than an insignificant effect, a member should consider the method's cumulative effect, as well as its effect on the current year's tax return or the tax return that is the subject of the administrative proceeding.

**.14** If a member becomes aware of the error while performing services for a taxpayer that do not involve tax return preparation or representation in an administrative proceeding, the member's responsibility is to advise the taxpayer of the existence of the error and to recommend that the error be discussed with the taxpayer's tax return preparer. Such recommendation may be given orally.

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## TS Section 700

# *Form and Content of Advice to Taxpayers*

Source: SSTS No. 7

Effective date, unless  
otherwise indicated:  
January 2010

### Introduction

.01 This statement sets forth the applicable standards for members concerning certain aspects of providing advice to a taxpayer and considers the circumstances in which a member has a responsibility to communicate with a taxpayer when subsequent developments affect advice previously provided. The statement does not, however, cover a member's responsibilities when the expectation is that the advice rendered is likely to be relied on by parties other than the taxpayer.

### Statement

.02 A member should use professional judgment to ensure that tax advice provided to a taxpayer reflects competence and appropriately serves the taxpayer's needs. When communicating tax advice to a taxpayer in writing, a member should comply with relevant taxing authorities' standards, if any, applicable to written tax advice. A member should use professional judgment about any need to document oral advice. A member is not required to follow a standard format when communicating or documenting oral advice.

.03 A member should assume that tax advice provided to a taxpayer will affect the manner in which the matters or transactions considered would be reported or disclosed on the taxpayer's tax returns. Therefore, for tax advice given to a taxpayer, a member should consider, when relevant (a) return reporting and disclosure standards applicable to the related tax return position and (b) the potential penalty consequences of the return position. In ascertaining applicable return reporting and disclosure standards, a member should follow the standards in TS section 100, *Tax Return Positions*.

.04 A member has no obligation to communicate with a taxpayer when subsequent developments affect advice previously provided with respect to significant matters, except while assisting a taxpayer in implementing procedures or plans associated with the advice provided or when a member undertakes this obligation by specific agreement.

### Explanation

.05 Tax advice is recognized as a valuable service provided by members. The form of advice may be oral or written and the subject matter may range from routine to complex. Because the range of advice is so extensive and because advice should meet the specific needs of a taxpayer, neither a standard format nor guidelines for communicating or documenting advice to the taxpayer can be established to cover all situations.

**.06** Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, substantial dollar value, or complicated transactions. The member may use professional judgment about whether, subsequently, to document oral advice.

**.07** In deciding on the form of advice provided to a taxpayer, a member should exercise professional judgment and should consider such factors as the following:

- a. The importance of the transaction and amounts involved
- b. The specific or general nature of the taxpayer's inquiry
- c. The time available for development and submission of the advice
- d. The technical complexity involved
- e. The existence of authorities and precedents
- f. The tax sophistication of the taxpayer
- g. The need to seek other professional advice
- h. The type of transaction and whether it is subject to heightened reporting or disclosure requirements
- i. The potential penalty consequences of the tax return position for which the advice is rendered
- j. Whether any potential applicable penalties can be avoided through disclosure
- k. Whether the member intends for the taxpayer to rely upon the advice to avoid potential penalties

**.08** A member may assist a taxpayer in implementing procedures or plans associated with the advice offered. When providing such assistance, the member should review and revise such advice as warranted by new developments and factors affecting the transaction.

**.09** Sometimes a member is requested to provide tax advice but does not assist in implementing the plans adopted. Although such developments as legislative or administrative changes or future judicial interpretations may affect the advice previously provided, a member cannot be expected to communicate subsequent developments that affect such advice unless the member undertakes this obligation by specific agreement with the taxpayer.

**.10** Taxpayers should be informed that (a) the advice reflects professional judgment based upon the member's understanding of the facts, and the law existing as of the date the advice is rendered and (b) subsequent developments could affect previously rendered professional advice. Members may use precautionary language to the effect that their advice is based on facts as stated and authorities that are subject to change.

**.11** In providing tax advice, a member should be cognizant of applicable confidentiality privileges.

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## TS Section Appendix

### *Cross-Reference of Previous and Revised Statements*

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1	111	Withdrawn 1982	—		
2	121	Withdrawn 1982	—		
3	131	Superseded by Statement No. 2, August 1988	122		
3	131	Superseded by Statement No. 2, August 2000		200	
3	131	Superseded by Statement No. 2, January 2010			200
4	141	Superseded by Statement No. 5, August 1988	152		
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5	151	Superseded by Statement No. 4, August 1988	142		
5	151	Superseded by Statement No. 4, August 2000		400	
5	151	Superseded by Statement No. 4, January 2010			400

(continued)

<i>Previous Statement No.</i>	<i>Previous Section</i>	<i>Changes</i>	<i>1988 Revised Section</i>	<i>2000 Revised Section</i>	<i>2010 Revised Section</i>
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6	161	Superseded by Statement No. 6, August 2000		600	
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7	171	Superseded by Statement No. 7, August 1988; Revised May 1991	172		
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8	181	Superseded by Statement No. 8, August 1988	182		
8	181	Superseded by Statement No. 8, August 2000		800	
8	181	Superseded by Statement No. 7, January 2010			700
9	191	Superseded by Statement No. 3, August 1988	132		
9	191	Superseded by Statement No. 3, August 2000		300	
9	191	Superseded by Statement No. 3, January 2010			300

<i>Previous Statement No.</i>	<i>Previous Section</i>	<i>Changes</i>	<i>1988 Revised Section</i>	<i>2000 Revised Section</i>	<i>2010 Revised Section</i>
10	201	Superseded by Statement No. 1, August 1988	112		
10	201	Superseded by Statement No. 1, August 2000		100	
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## PFP Section

# PERSONAL FINANCIAL PLANNING

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## STATEMENT ON STANDARDS IN PERSONAL FINANCIAL PLANNING SERVICES

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### Foreword

The Personal Financial Planning Executive Committee (PFP EC) has issued Statement on Standards in Personal Financial Planning Services No. 1 (the statement) to provide guidance to members and a framework for delivering PFP services with the highest levels of integrity, professionalism, objectivity, and competence so that a CPA financial planner can serve the best interests of

his or her clients and the public. The PFP EC is the senior committee of the AICPA designated to promulgate enforceable standards of PFP practice.<sup>1</sup>

The statement applies to all members providing PFP services regardless of the jurisdictions in which they practice. Interpretations of the statement may be issued by the PFP EC as guidance to assist in understanding and applying the statement. The PFP EC interpretations are recommendations on the application of the statement. The statement and its interpretations are intended to complement other laws, regulations, and professional standards of PFP practice.

The statement is written in as simple and objective a manner as possible. However, by their nature, practice standards provide for an appropriate range of behaviors and need to be interpreted to address a broad range of personal and professional situations. Accordingly, enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rules 201, *General standards*, and 202, *Compliance with standards*, as well as Rule 91, *Applicability* (ET sec. 201 par. .01, ET sec. 202 par. .01, and ET sec. 91 par. .02), will be undertaken on a case-by-case basis.

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<sup>1</sup> Per AICPA Bylaw Section 360R, *Implementing Resolutions Under Section 3.6 Committees*, the Personal Financial Planning Executive Committee (PFP EC) is an AICPA senior committee. The PFP EC is designated as a body that may promulgate technical standards under Rules 201, *General standards*, and 202, *Compliance with standards* (ET sec. 201 par. .01 and ET sec. 202 par. .01).

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## PFP Section 100

# ***Statement on Standards in Personal Financial Planning Services***

*(Supersedes the Statement on Responsibilities in Personal Financial Planning Practice.)*

**Source: Statement on Standards in Personal Financial Planning Services No. 1.**

**January 2014**

### **Scope**

**.01** Statement on Standards in Personal Financial Planning Services No. 1 (the statement) addresses the responsibilities of AICPA members (members) who are described in paragraph .04 that follows. The statement applies when personal financial planning (PFP) services are provided, even if part of another engagement.

**.02** The statement establishes the applicable standards for members with regard to PFP engagements. (Ref: par. .A1)

### **Nature of PFP Services**

**.03** PFP is the process of identifying personal financial goals and resources, designing financial strategies, and making personalized recommendations (Ref: par. .12) (whether written or oral) that, when implemented, assist the client in achieving these goals. This process may include implementation of recommendations or monitoring or updating the engagement. PFP services encompass one or more of the following activities:

- a.* Cash flow planning
- b.* Risk management and insurance planning
- c.* Retirement planning
- d.* Investment planning
- e.* Estate, gift, and wealth transfer planning
- f.* Elder planning
- g.* Charitable planning
- h.* Education planning
- i.* Tax planning

### **Applicability**

**.04** The statement applies when a member provides PFP services as defined in paragraph .12, and (Ref: par. .A2)

- a.* represents to the public or clients that the member provides PFP services,

- b. engages in activities that would require registration as an investment adviser under federal or state law,<sup>1</sup> or
- c. sells a product as a result of an engagement.

**.05** The statement does not supersede other applicable AICPA professional standards, such as (Ref: par. .A2–.A3, .A11)

- a. the Statement on Standards for Accounting and Review Services (SSARS) No. 6, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* (AR sec. 600), with regard to the compilation of personal financial statements;
- b. the Statements on Standards for Tax Services (SSTSs) with regard to tax services; and
- c. the Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* (VS sec. 100), with regard to valuation services.

## Objective

**.06** The statement provides authoritative guidance and establishes enforceable standards for members who provide PFP services to assist them in fulfilling their professional responsibilities.

## Authority of the Statement

**.07** The statement contains requirements designed to enable the member to meet the stated objective. It also includes related guidance in the form of application and other explanatory material that provides context relevant to a proper understanding of the statement and definitions.

**.08** The requirements of the statement are expressed using the word *should*. If a standard provides that a member "should" perform an action, then unless prevailing facts and circumstances dictate otherwise, this action is required. If a standard provides that a procedure or action is one that the member "should consider," the consideration of the procedure or action is required, whereas carrying out the specified procedure or action is not. The professional requirements of the statement are to be understood and applied in the context of the explanatory material that provides guidance for their application.

**.09** The "Application Material" section and other explanatory material provide further explanation of the requirements and guidance for carrying them out.

**.10** The words *may*, *might*, and *could*, among others, are used to describe actions and procedures that are recommended but not required. Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements.

**.11** The statement includes, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the statement. These are provided to assist with the consistent application and interpretation of the statement and are not intended to override definitions that may be established for other purposes, whether by law or regulation.

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<sup>1</sup> Reference The CPA's Guide to Investment Advisory Business Models published by AICPA.

## Definitions

.12 For purposes of the statement, the following terms have the meanings attributed:

**Personal financial planning services.** The process of identifying personal financial goals and resources, designing financial strategies, and making personalized recommendations that, when implemented, assist the client in achieving these goals. (Ref: par. .03)

**Personal financial planning engagement.** An engagement in which a member provides PFP services and the statement applies. (Ref: par. .03–.04)

**Implementation engagement.** A PFP engagement that involves assisting the client in taking action on recommendations developed during the PFP engagement.

**Monitoring engagement.** A PFP engagement that involves tracking and communicating the client's progress in achieving established PFP goals.

**Updating engagement.** A PFP engagement that involves revising the client's existing financial plan and financial planning recommendations as the member and client agree upon.

**Personalized recommendation.** Financial advice directing a client to take action based on the client's personal financial information disclosed to the member. (Ref: par. .03)

## Requirements

### General Professional Responsibilities

.13 The member should read the entire statement, including its application and other explanatory material, to understand its objective and apply its requirements properly.

.14 The proper application of the requirements established by the statement is expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the member should consider whether, due to the existence of particular matters or circumstances, procedures in addition to those required by the statement are needed to meet the stated objective.

.15 The member must comply with each requirement of the statement unless,

- a. in the circumstances of the engagement, the requirement is not relevant because it is conditional, and the condition does not exist.
- b. the member judges it necessary to depart from a requirement. In such circumstances, the member should perform alternative procedures to achieve the intent of that requirement and document the justification for that departure.

.16 The member should consider applicable interpretive publications when providing PFP services. (Ref: par. .A5)

### Independence and PFP Services

.17 If PFP services are performed for a client for which the member or member's firm also performs an attest engagement (defined by ET section 92, *Definitions*, of the AICPA Code of Professional Conduct), the member should meet the requirements of Interpretation No. 101-3, "Nonattest Services," under

Rule 101, *Independence* (ET sec. 101 par. .05), so as not to impair the member's independence with respect to the client.

## Responsibilities of Members in PFP Engagements

**.18** The member should comply with relevant ethical requirements. (Ref: par. .A7)

**.19** The member should possess a level of knowledge of PFP principles and theory, and a level of skill in the application of such principles, that will enable him or her to (Ref: par. .A8)

- a. identify client goals and objectives;
- b. gather and analyze relevant information;
- c. consider and apply appropriate planning approaches and methods; and
- d. use professional judgment when developing financial recommendations.

**.20** The member should evaluate whether any conflicts of interest exist with regard to the engagement as follows: (Ref: par. .A9–.A10)

- a. If the member determines conflicts of interest exist, the member should determine whether the engagement can be performed objectively.
- b. If the member determines the engagement can be performed objectively, the member should disclose all known conflicts of interest and obtain consent as required under Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and objectivity* (ET sec. 102 par. .03).
- c. If the member determines that the engagement cannot be performed objectively, the engagement should be terminated.

**.21** The member should comply with applicable federal, state, and other laws and regulations. The member should comply with professional standards applicable to the PFP engagement unless superseded by laws or regulations. When there is a conflict between the statement and laws or regulations, the laws or regulations will prevail unless less stringent than the statement. (Ref: par. .A11–.A12)

**.22** Prior to beginning the engagement, and throughout the engagement as circumstances dictate, the member should disclose in writing all compensation the member and the member's firm or affiliates will receive for services rendered or products sold (Ref: par. .A6). The disclosure should include

- a. the method of compensation, including the impact of indirect compensation;
- b. the amount of compensation;
- c. the time period over which compensation will be received; and
- d. the compensation, including noncash benefits, received by the member for referrals to other providers.

**.23** If compensation alternatives are offered, the member should disclose the differences in these alternatives in writing.

## Planning the PFP Engagement (Ref: par. .A14–.A15)

**.24** The member should document and communicate to the client the scope and nature of services to be provided and disclose the member's agreed upon

compensation for such services. This communication should be documented in the file and include descriptions of the following when applicable to the engagement:

- a.* Engagement objectives
- b.* Scope of services to be provided
- c.* Roles and responsibilities of the member, client, and other service providers
- d.* Timing of the engagement
- e.* Scope limitations and other constraints
- f.* Conflicts of interest (Ref: par. .20)
- g.* Responsibility, or lack thereof, for helping the client implement planning decisions
- h.* Responsibility, or lack thereof, for monitoring the client's progress in achieving goals
- i.* Responsibility, or lack thereof, for updating the plan and proposing new action

**.25** The member should evaluate the appropriateness of the original engagement as the engagement proceeds and document and communicate needed changes to the client.

**.26** If the member is aware of a service needed to complete the engagement and does not, or will not, provide that service, the member should limit the scope of the engagement accordingly and recommend that the client engage another service provider for that service in writing.

**.27** If the client declines to engage another service provider for services identified in paragraph .26, the member should consider whether this limitation impairs the ability to provide PFP services:

- a.* If the member determines that the ability to meet the standards established by the statement is impaired, the member should terminate the engagement in writing.
- b.* If the member determines that the ability to meet the standards established by the statement is not impaired, the member should communicate in writing that this limitation could affect the conclusions and recommendations developed in the engagement.

## Obtaining and Analyzing Information

**.28** The member should use professional judgment when obtaining and analyzing relevant information necessary to develop recommendations based on the stated engagement objectives.

**.29** If the member is unable to collect sufficient relevant information to establish a reasonable basis for recommendations, the engagement scope may be restricted to those matters for which sufficient information is available. This scope limitation should be communicated to the client in writing, including that this limitation should be taken into account in the assessment of conclusions and recommendations developed. (Ref: par. .A16)

**.30** If sufficient information does not exist to proceed as agreed, the member should terminate or modify the engagement through mutual agreement with the client. This engagement modification or termination should be communicated in writing.

**.31** When analyzing information obtained while performing the engagement, the member should

- a.* evaluate the reasonableness of estimates and assumptions that are significant to the plan;
- b.* use assumptions that are appropriate and consistent with each other; and
- c.* consider the interrelationship of various PFP activities (Ref: par. .03).

## **Developing and Communicating Recommendations (Ref: par. .A16–.A20)**

**.32** The member should establish a reasonable basis for PFP recommendations.

**.33** The member should develop recommendations derived from analyses of relevant information, client goals, and the client's overall financial circumstances. Even when an engagement addresses a limited number of personal financial goals, the member should consider the client's overall known financial circumstances.

**.34** The nature and extent of analyses and other procedures performed when establishing a basis for recommendations are affected by the scope and objectives of the engagement and should be documented.

**.35** The member should communicate to the client the assumptions and estimates that are significant to the recommendations. This should be documented and include the following:

- a.* A summary of the client's goals
- b.* Significant assumptions
- c.* Estimates
- d.* Recommendations
- e.* A description of limitations on the work performed
- f.* The recommendations in the engagement should contain qualifications to the recommendations if the effects of certain planning areas on the client's overall financial picture were not considered

## **Implementation Engagements (Ref: par. .A21–.A24)**

**.36** The member should document his or her understanding of the implementation engagement, including the roles and responsibilities of the member, the client, and other service providers. This documentation should include the following:

- a.* A summary of the planning decisions being implemented
- b.* A summary of recommended actions to be taken
- c.* A description of limitations on the work performed in the implementation engagement

**.37** The member should communicate in writing the level of responsibility, if any, for the following:

- a.* Selecting and acquiring products
- b.* Selecting service providers

- c.* Establishing selection criteria
  - d.* Coordinating or reviewing the delivery of services or products by other service providers
- .38** A member who is engaged to establish selection criteria should
  - a.* identify those criteria that are required to accomplish the client's objectives, subject to any constraints that result from the client's circumstances or as identified by the client.
  - b.* assist the client in evaluating the relative importance of criteria so that available alternatives can be compared.
- .39** A member who is engaged to participate in recommending products should
  - a.* gather information that establishes a reasonable basis for determining whether a product meets the selection criteria.
  - b.* communicate this evaluation in writing, along with product recommendations.
  - c.* disclose in writing any compensation received for recommending products.
- .40** A member who is engaged to assist the client in taking action on planning decisions developed in a PFP engagement in which the member did not participate should obtain an understanding of the planning decisions made.
- .41** All other relevant guidance under the statement relating to providing PFP services should be followed in an implementation engagement.

### **Monitoring and Updating Engagements (Ref: par. .A25–.A28)**

- .42** In a monitoring engagement, the member should document the nature and extent of the member's services, including
  - a.* the frequency and time period of measuring the client's progress toward reaching the stated goals.
  - b.* utilization of monitoring criteria that are appropriate to, and consistent with, the criteria used to establish the goals being monitored.
  - c.* the criteria that are important to the achievement of the financial planning goals being monitored.
  - d.* the member's evaluation of progress toward achieving the client's financial planning goals, including whether the client's existing financial plan and specific financial planning recommendations should be updated.
- .43** In an updating engagement, the member should document the nature and extent of the member's services, including
  - a.* the determination of whether the goals, objectives, information, and assumptions used as a basis for existing planning recommendations are still valid.
  - b.* the evaluation of the impact of revising recommendations on the client's ability to achieve other financial planning goals.
- .44** All other relevant guidance under the statement relating to providing PFP services should be followed in a monitoring or an updating engagement.

## Working With Other Service Providers

- .45** When referring another service provider to a client, the member should
- consider the professional qualifications of another service provider before referring the client to that service provider;
  - disclose, in writing, any compensation received for making such referrals; and
  - communicate, in writing, the extent to which the member will or will not evaluate the work performed by the service provider.

## Using Advice Provided By Other Service Providers

**.46** When the member uses the advice of another service provider when carrying out the PFP engagement, the member should understand the impact of the service provider's advice.

**.47** If the member has evaluated the advice of the other service provider, and

- if the member concurs with the other service provider's advice, the member need not communicate this concurrence to the client because concurrence is implied by its use, or
- if the member does not concur with the other service provider's advice, the member should communicate this non-concurrence to the client in writing.

## Application Material

### Scope

**.A1** ET section 202, *Compliance With Standards*, requires an AICPA member who performs a PFP engagement to comply with standards promulgated by the Personal Financial Planning Executive Committee (PFP EC). The PFP EC develops and issues standards in the form of statements through a process that includes deliberation in meetings open to the public, public exposure of statements, and a formal vote. The statements are codified in AICPA *Professional Standards*. (Ref: par. .02)

### Applicability (Ref: par. .03–.05)

**.A2** If any of the activities listed in paragraph .03 are provided as part of a PFP engagement, the activity is covered by the statement and should be considered in conjunction with the requirements set forth in the "Applicability" section (Ref: par. .04). In addition, depending on the nature of the service, other standards may apply (Ref: par. .05). For example, any personal income tax services provided as part of a PFP engagement are covered by the statement and are subject to the SSTSSs.

**.A3** Examples of activities not covered by the statement include the following: (Ref: par. .03–.05)

- Tax advice: Advising a client regarding his or her income tax matters or gift and estate tax matters when PFP services as defined in paragraph .03 are not provided. These services are, however, subject to the SSTSSs.



- b. Valuation services: Any engagement that would be considered a valuation service under SSVS No. 1 when PFP services as defined in paragraph .03 are not provided. These services are, however, subject to SSVS No. 1.
- c. Business succession planning
  - i. Planning to prepare for a vacancy in a key position resulting from a sudden departure, disability, or death and no advice is given to an individual.
  - ii. Planning to prepare for the sale to another firm and no advice is given to an individual.
- d. Educational discussions or presentations covering PFP
  - i. A workshop presented to a group of company employees on a PFP activity (Ref: par. .03) that does not include personalized recommendations.
  - ii. A discussion with an individual that covers one or more PFP activities (Ref: par. .03) that does not result in a personalized recommendation.
- e. Mechanical computations
  - i. Computation of the current income tax deduction for a client's contribution of assets to a charitable remainder trust.
  - ii. Computation of the current yield on a client's investment portfolio.
  - iii. Computation of the gift tax on a transfer of an asset.

**.A4** A member may identify and create an analysis of historical spending and income activity for a client as a purely mechanical computation, which would not be considered PFP services. However, extension of this analysis to future periods based on the judgment of the member that entails the use of assumptions and personalized recommendations regarding investing would be considered PFP services.

## General Professional Responsibilities

**.A5** Interpretive publications are not standards on PFP practice. Interpretive publications are recommendations on the application of the statement in specific circumstances. An interpretive publication is issued under the authority of the PFP EC after all members have been provided an opportunity to consider and comment on whether the interpretive publication is consistent with the statement. (Ref: par. .16)

## Responsibilities of Members in PFP Engagements (Ref: par. .18–.23)

**.A6** The member is required to comply with Rule 503, *Commissions and referral fees* (ET sec. 503 par. .01). (Ref: par. .22)

**.A7** The member is subject to relevant ethical requirements relating to PFP engagements (Ref: par. .18). Ethical requirements consist of the AICPA Code of Professional Conduct, rules of state boards of accountancy from which the member holds a license, and applicable regulatory agencies that are more stringent. The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- a. Responsibilities
- b. The public interest
- c. Integrity
- d. Objectivity and independence
- e. Due care
- f. Scope and nature of services

**.A8** Rule 201A, *Professional Competence* (ET sec. 201 par. .01), states that a member shall "undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence." (Ref: par. .19)

**.A9** Paragraph .01 of ET section 55, *Article IV—Objectivity and Independence*, states that objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free from conflicts of interest. (Ref: par. .20)

**.A10** The member is required to comply with AICPA's Code of Professional Conduct Interpretation No. 102-2. (Ref: par. .20)

**.A11** Laws, regulations, and professional standards applicable to engagements to perform PFP services include, but are not necessarily limited to, the following: (Ref: par. .21, .A5)

- a. Investment Advisers Act of 1940; see Securities and Exchange Commission Interpretive Release IA-1092
- b. Treasury Department Circular No. 230
- c. State boards of accountancy
- d. AICPA Code of Professional Conduct
- e. Statements on Standards for Tax Services (SSTSs)
- f. Statement on Standards for Valuation Services (SSVS) No. 1
- g. Statement on Standards for Consulting Services No. 1
- h. Statements on Standards for Accounting and Review Services (SSARS) No. 6
- i. Maintaining adequate data protection safeguards regarding a client's nonpublic personal information
- j. Maintaining client confidentiality in accordance with the applicable rules of professional conduct and federal and state laws and regulations

**.A12** Compliance with the AICPA Code of Professional Conduct depends primarily on the member's understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the rules. (Ref: par. .21)

**.A13** The member is not required to follow a standard format when communicating or documenting communication.

## Planning the Engagement (Ref: par. .24–.27)

**.A14** An understanding of the client may include understanding matters such as the client's family situation, commitment to the planning process, current cash flow and assets available, personal preferences, and relationships

with other professionals. This understanding may be obtained through comprehensive information gathering or may result from knowledge gained during a long-term relationship with the client.

**.A15** Additional services that require understanding and agreement by the client include the following:

- a. Implementing plan recommendations
- b. Monitoring the client's progress in achieving goals
- c. Updating recommendations

## **Developing and Communicating Recommendations (Ref: par. .32–.35)**

**.A16** Developing a reasonable basis for recommendations involves the following (Ref: par. .29):

- a. Collecting relevant quantitative and qualitative information. The nature and amount of information will depend on the scope and complexity of the engagement. This information may include, but is not limited to
  - i. the client's goals, existing financial situation, and available resources;
  - ii. nonfinancial factors, such as client attitudes, risk tolerance, family considerations, age, health, and life expectancy;
  - iii. external factors, such as estimates of inflation, taxes, economic conditions, legislative activity, investment markets, and interest rates; and
  - iv. reasonable estimates, projections, and assumptions furnished by the client, provided by other service providers, or developed by the member.
- b. Analyzing the client's current situation as it relates to the client's goals and objectives and identifying strengths and weaknesses of the existing financial situation.
- c. Formulating, evaluating, and recommending appropriate strategies for achieving the client's goals after due consideration of appropriate alternatives.

**.A17** The member's knowledge and experience also contribute to the basis for recommendations.

**.A18** PFP recommendations are suggested actions developed to help the client achieve personal financial goals.

**.A19** Recommendations are based on analyses and other procedures conducted prior to, and in preparation for, developing suggested actions.

**.A20** The member should help the client prioritize recommended tasks that are essential to enabling the client to act on planning decisions.

## **Implementation Engagements (Ref: par. .36–.41)**

**.A21** Implementation may include such activities as assisting the client in selecting other advisors, restructuring debt, obtaining new or updated estate documents, establishing cash reserves, preparing budgets, and selecting and acquiring specific investments and insurance products.

**.A22** In those situations in which the member may be functioning in a fiduciary or agency relationship, state law will control.

**.A23** The member may be engaged to assist the client in taking action on planning decisions, which may include the member doing one or more of the following:

- a. Taking responsibility for the selection and acquisition of products<sup>2</sup>
- b. Taking responsibility for the selection of service providers
- c. Establishing selection criteria
- d. Coordinating or reviewing the delivery of services or products by other service providers

**.A24** Implementation is typically completed when products are acquired or services are rendered based on the recommendations developed during the PFP engagement.

### **Monitoring and Updating Engagements (Ref: par. .42–.44)**

**.A25** A member may be engaged to assist the client in tracking progress in achieving established PFP goals or revising an existing personal financial plan, or both.

**.A26** The member may be specifically engaged by a client to provide monitoring services, updating services, or both. The member would typically have informed the client during a PFP engagement, in which planning recommendations are developed, that monitoring and updating are important elements of the financial planning process and that the member is not responsible for undertaking these services except by specific agreement with the client.

**.A27** Monitoring and updating engagements are typically undertaken after implementation of actions and recommendations developed during a PFP engagement. Monitoring and updating engagements may be either separate or combined engagements.

**.A28** Monitoring engagements vary in complexity, scope, and the nature and extent of assistance to be provided by the member. In other words, the member may undertake some or all of the monitoring services, coordinate or review monitoring services performed by other service providers, or monitor progress toward goals in a financial plan developed by other service providers.

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<sup>2</sup> Members advising clients on the selection or acquisition of products (such as investments or insurance policies) should determine whether they meet the qualifications and licensing requirements established by applicable federal and state laws.

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## CPE Section

# CONTINUING PROFESSIONAL EDUCATION

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These standards have been approved by the Joint AICPA/NASBA CPE Standards Committee and the Board of Directors of both the AICPA and NASBA. Effective implementation dates are as follows:

- July 1, 2012, for group programs and independent study
- July 1, 2012, for self-study programs in development as of December 31, 2011, being published for the first time, or both
- March 1, 2014, for self-study programs already in existence as of December 31, 2011

The old standards are in effect through June 30, 2012 (except for self-study programs already in existence as of December 31, 2011, for which they are effective until February 28, 2014) and can be found at [www.aicpa.org/CPEAndConferences/CPERequirements/Pages/CPERequirements.aspx](http://www.aicpa.org/CPEAndConferences/CPERequirements/Pages/CPERequirements.aspx).

Continuing Professional Education (CPE) is required for CPAs to maintain their professional competence and provide quality professional services. CPAs are responsible for complying with all applicable CPE requirements, rules, and regulations of state boards of accountancy, as well as those of membership associations and other professional organizations.

The Statement on Standards for CPE Programs (*Standards*) is published jointly by the AICPA and the National Association of State Boards of Accountancy (NASBA) to provide a framework for the development, presentation, measurement, and reporting of CPE programs. The standards were last revised in 2002.

In May 2010, NASBA and the CPE Advisory Committee provided a forum for an open and candid discussion of the *Standards*. A key outcome of the forum was to develop a task force to help review, analyze and implement suggestions and changes to the *Standards*.

The NASBA CPE Advisory Committee, with input from NASBA leadership, selected 13 task force participants. Careful consideration was given as to the composition of the task force to ensure that all facets of the CPE community were represented. The task force is comprised of CPE program sponsors; CPE Advisory Committee members; state board of accountancy members; state society members; educators; and a representative of the AICPA (provider side).

The task force developed its recommended revisions to the *Standards* and presented its recommendations to a Joint CPE Standards Committee made up of representatives from the AICPA and NASBA. The Joint CPE Standards Committee presented its recommendation to the respective AICPA and NASBA Boards of Directors. In August 2011, the *Standards* exposure draft was released for comment. The revisions to the *Standards* were approved by the AICPA Board of Directors and the NASBA Board of Directors in January 2012.

The *Standards* are intended to be an "evergreen" document. As questions arise related to implementation and application of the *Standards*, the questions will be presented to the CPE Standards Working Group whose composition will be

similar to that of the task force. The CPE Standards Working Group will meet quarterly and scheduled meeting dates will be posted on the NASBA website, LearningMarket.org. NASBA will communicate the findings of the CPE Standards Working Group to the specific CPE program sponsor. Authoritative interpretations will only be issued by the CPE Advisory Committee in limited cases when the matter is not addressed in the *Standards*, cannot be addressed specifically with the CPE program sponsor, or cannot be addressed in the Best Practices document. All interpretations issued by the CPE Advisory Committee will be reviewed and considered by the Joint AICPA/NASBA CPE Standards Committee upon the next revision of the *Standards*.

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## CPE Section 100

### *Preamble*

Revised, January 2012.

**.01** The right to use the title "Certified Public Accountant" (CPA) is regulated by each state's board of accountancy in the public interest and imposes a duty to maintain public confidence and current knowledge, skills, and abilities in all areas in which they provide services. CPAs must accept and fulfill their ethical responsibilities to the public and the profession regardless of their fields of employment.<sup>1</sup>

**.02** The profession of accountancy is characterized by an explosion of relevant knowledge, ongoing changes and expansion, and increasing complexity. Advancing technology, globalization of commerce, increasing specialization, proliferating regulations, and the complex nature of business transactions have created a dynamic environment that requires CPAs to continuously maintain and enhance their knowledge, skills, and abilities.

**.03** The continuing development of professional competence involves a program of lifelong educational activities. *Continuing Professional Education (CPE)* is the term used in these standards to describe the educational activities that assist CPAs in achieving and maintaining quality in professional services.

**.04** The following standards have been broadly stated in recognition of the diversity of practice and experience among CPAs. They establish a framework for the development, presentation, measurement, and reporting of CPE programs and thereby help to ensure that CPAs receive the quality CPE necessary to satisfy their obligations to serve the public interest. These standards may also apply to other professionals by virtue of employment or membership. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit.

**.05** Advances in technology, delivery and workplace arrangements may lead to innovative learning techniques. Learning theory may evolve to include more emphasis on outcome based learning. These standards anticipate innovation in CPE in response to these advances. Sponsors must ensure innovative learning techniques are in compliance with the standards. CPE program sponsors are encouraged to consult with the National Association of State Boards of Accountancy (NASBA) with questions related to compliance with the standards when utilizing innovative techniques.

**.06** These standards create a basic foundation for sound educational programs. Sponsors may wish to provide enhanced educational and evaluative techniques to all programs.

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<sup>1</sup> The term *CPAs* is used in these standards to identify all persons who are licensed or regulated by boards of accountancy.



## CPE Section 200

# General Guidelines for CPAs

Revised, January 2012.

## Professional Competence

**.01** All CPAs should participate in learning activities that maintain or improve their professional competence.<sup>1</sup>

**.02** Selection of learning activities should be a thoughtful, reflective process addressing the individual CPA's current and future professional plans, current knowledge and skills level, and desired or needed additional competence to meet future opportunities or professional responsibilities or both.

**.03** CPAs fields of employment do not limit the need for Continuing Professional Education (CPE). CPAs performing professional services need to have a broad range of knowledge, skills, and abilities. Thus, the concept of professional competence may be interpreted broadly. Accordingly, acceptable continuing education encompasses programs contributing to the development and maintenance of professional skills.

**.04** The fields of study represent the primary knowledge and skill areas needed by CPAs to perform professional services in all fields of employment.

**.05** To help guide their professional development, CPAs may find it useful to develop a learning plan. Learning plans are structured processes that help CPAs guide their professional development. They are dynamic instruments used to evaluate and document learning and professional competence development. They may be reviewed regularly and modified as CPAs' professional competence needs change. Plans include: a self-assessment of the gap between current and needed knowledge, skills, and abilities; a set of learning objectives arising from this assessment; and learning activities to be undertaken to fulfill the learning plan.

## CPE Compliance

**.06** CPAs must comply with all applicable CPE requirements.

**.07** CPAs are responsible for compliance with all applicable CPE requirements, rules, and regulations of state licensing bodies, other governmental entities, membership associations, and other professional organizations or bodies. CPAs should contact each appropriate entity to which they report to determine its specific requirements or any exceptions it may have to the standards presented herein.

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<sup>1</sup> The terms *should* and *must* are intended to convey specific meanings within the context of the *Joint AICPA/NASBA Statement on Standards for Continuing Professional Education Programs*. The term *must* is used in the standards applying to CPAs and Continuing Professional Education (CPE) program sponsors to convey that CPAs and CPE program sponsors are not permitted any departure from those specific standards. The term *should* is used in the standards applying to both CPAs and CPE program sponsors and is intended to convey that CPAs and CPE program sponsors are encouraged to follow such standards as written.

.08 Periodically, CPAs participate in learning activities which do not comply with all applicable CPE requirements, for example specialized industry programs offered through industry sponsors. If CPAs propose to claim credit for such learning activities, they must retain all relevant information regarding the program to provide documentation to state licensing bodies or all other professional organizations or bodies that the learning activity is equivalent to one which meets all these standards.

## CPE Credits Record Documentation

.09 CPAs are responsible for accurate reporting of the appropriate number of CPE credits earned and must retain appropriate documentation of their participation in learning activities.

.10 To protect the public interest, regulators require CPAs to document maintenance and enhancement of professional competence through periodic reporting of CPE. For convenience, measurement is expressed in CPE credits. However, the objective of CPE must always be maintenance/enhancement of professional competence, not attainment of credits. Compliance with regulatory and other requirements mandates that CPAs keep documentation of their participation in activities designed to maintain or improve professional competence. In the absence of legal or other requirements, a reasonable policy is to retain documentation for a minimum of five years from the end of the year in which the learning activities were completed.

.11 Participants must document their claims of CPE credit. Examples of acceptable evidence of completion include

- for group and independent study programs, a certificate or other verification supplied by the CPE program sponsor.
- for self-study programs, a certificate supplied by the CPE program sponsor after satisfactory completion of an examination.
- for instruction credit, appropriate supporting documentation that complies with the requirements of the respective state boards subject to the guidelines in "Standard 15 in Standards for CPE Program Measurement" section 300 par. .57).
- for a university or college course that is successfully completed for credit, a record or transcript of the grade the participant received.
- for university or college noncredit courses, a certificate of attendance issued by a representative of the university or college.
- for published articles, books, or CPE programs, (a) a copy of the publication (or in the case of a CPE program, course development documentation) that names the writer as author or contributor, (b) a statement from the writer supporting the number of CPE hours claimed, and (c) the name and contact information of the independent reviewer(s) or publisher.

## Reporting CPE Credits

.12 CPAs who complete sponsored learning activities that maintain or improve their professional competence must claim no more than the CPE credits recommended by CPE program sponsors subject to the state board regulations.

.13 CPAs may participate in a variety of sponsored learning activities, such as workshops, seminars and conferences, self-study courses, Internet-based programs, and independent study. While CPE program sponsors determine credits,

CPAs must claim credit only for activities through which they maintained or improved their professional competence. CPAs who participate in only part of a program must claim CPE credit only for the portion they attended or completed.

## Independent Study

**.14** CPAs may engage in independent study under the direction of a CPE program sponsor who has met the applicable standards for CPE program sponsors when the subject matter and level of study maintain or improve their professional competence.

**.15** Independent study is an educational process designed to permit a participant to learn a given subject under the guidance of a CPE program sponsor. Participants in an independent study program must

- enter into a written learning contract with a CPE program sponsor that must comply with the applicable standards for CPE program sponsors. A learning contract
  1. specifies the nature of the independent study program and the time frame over which it is to be completed, not to exceed 15 weeks.
  2. specifies that the output must be in the form of a written report that will be reviewed by the CPE program sponsor or a qualified person selected by the CPE program sponsor.
  3. outlines the maximum CPE credit that will be awarded for the independent study program, but limits credit to actual time spent.
- accept the written recommendation of the CPE program sponsor as to the number of credits to be earned upon successful completion of the proposed learning activities. CPE credits will be awarded only if
  1. all the requirements of the independent study as outlined in the learning contract are met,
  2. the CPE program sponsor reviews and signs the participant's report,
  3. the CPE program sponsor reports to the participant the actual credits earned, and
  4. the CPE program sponsor provides the participant with contact information.

The maximum credits to be recommended by an independent study CPE program sponsor must be agreed upon in advance and must be equated to the effort expended to improve professional competence. The credits cannot exceed the time devoted to the learning activities and may be less than the actual time involved.

- retain the necessary documentation to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.



## CPE Section 300

### *Standards for CPE Program Sponsors*

Revised, January 2012.

#### General Standards

**.01 Standard No. 1. Continuing Professional Education (CPE) program sponsors are responsible for compliance with all applicable standards and other CPE requirements.**

**.02 S1-01. CPE requirements of licensing bodies and others.** CPE program sponsors may have to meet specific CPE requirements of state licensing bodies, other governmental entities, membership associations, or other professional organizations or bodies. Professional guidance for CPE program sponsors is available from the National Association of State Boards of Accountancy (NASBA); state-specific guidance is available from the state boards of accountancy. CPE program sponsors should contact the appropriate entity to determine requirements.

#### Standards for CPE Program Development

**.03 Standard No. 2. Sponsored learning activities must be based on relevant learning objectives and outcomes that clearly articulate the knowledge, skills, and abilities that can be achieved by participants in the learning activities.**

**.04 S2-01. Program knowledge level.** Learning activities provided by CPE program sponsors for the benefit of CPAs must specify the knowledge level, content, and learning objectives so that potential participants can determine if the learning activities are appropriate to their professional competence development needs. Knowledge levels consist of basic, intermediate, advanced, update, and overview (see definitions in Glossary [section 400]).

**.05 Standard No. 3. CPE program sponsors must develop and execute learning activities in a manner consistent with the prerequisite education, experience, or advance preparation of participants.**

**.06 S3-01. Prerequisite education and experience.** To the extent it is possible to do so, CPE program sponsors should make every attempt to equate program content and level with the backgrounds of intended participants. All programs must clearly identify prerequisite education, experience, and/or advance preparation, if any, in precise language so that potential participants can readily ascertain whether they qualify for the program.

**.07 Standard No. 4. CPE program sponsors must use activities, materials, and delivery systems that are current, technically accurate, and effectively designed. All courses must contain the most recent publication, revision or review date. Courses must be revised as soon as feasible following changes to relative codes, laws, rulings, decisions, interpretations, and the like. Courses in subjects that undergo frequent changes must be reviewed by an individual with subject matter expertise at least once a year to verify the currency of the content. Other courses must be reviewed at least every two years.**

**.08 S4-01. Developed by a subject matter expert.** Learning activities must be developed by individuals or teams having expertise in the subject matter. Expertise may be demonstrated through practical experience or education.

**.09 Standard No. 5. CPE program sponsors of group and self-study programs must ensure learning activities are reviewed by qualified persons other than those who developed the programs to assure that the program is technically accurate and current and addresses the stated learning objectives.** These reviews must occur before the first presentation of these materials and again after each significant revision of the CPE programs. The participation of at least one CPA is required in the development of every program in accounting and auditing. The participation of a CPA, tax attorney, or IRS enrolled agent is required in the development of each program in the field of study of taxes. As long as this requirement is met at some point during the development process, a program would be in compliance. Whether to have this individual involved during the development or the review process is at the CPE program sponsor's discretion.

**.10 S5-01. Qualifications of reviewers.** Individuals or teams qualified in the subject matter must review programs. When it is impractical to review certain programs in advance, such as lectures given only once, greater reliance should be placed on the recognized professional competence of the instructors or presenters. Using independent reviewing organizations familiar with these standards may enhance quality assurance.

**.11 Standard No. 6. CPE program sponsors of independent study learning activities must be qualified in the subject matter.**

**.12 S6-01. Requirements of independent study sponsor.** A CPE program sponsor of independent study learning activities must have expertise in the specific subject area related to the independent study. The CPE program sponsor must also

- review, evaluate, approve, and sign the proposed independent study learning contract, including agreeing in advance on the number of credits to be recommended upon successful completion.
- review and sign the written report developed by the participant in independent study.
- retain the necessary documentation to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.

**.13 Standard No. 7. Group internet-based programs must employ learning methodologies that clearly define learning objectives, guide the participant through the learning process, and provide evidence of a participant's satisfactory completion of the program.**

**.14 S7-01. Live instructor during program presentation.** Group internet-based programs must have a live instructor while the program is being presented. Program participants must be able to interact with the live instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). Once a group internet-based program is recorded or archived for future presentation, it will continue to be considered a group internet-based program only where a live subject matter expert facilitates the recorded presentation. Any future presentations that do not include a live subject matter expert will be considered a self-study program and must meet all self-study delivery method requirements with the exception



of the basis for CPE credit. CPE credit for an archived group program will be equal to the CPE credit awarded to the original presentation.

**.15 Standard No. 8. Self-study programs must use learning methodologies that clearly define learning objectives, guide the participant through the learning process, and provide evidence of a participant's satisfactory completion of the program.**

**.16 S8-01. Guide participant through learning process.** To guide participants through a learning process, CPE program sponsors of self-study programs must elicit participant responses to test for understanding of the material. Learners must participate in activities during instruction to demonstrate achievement of learning objectives. Appropriate feedback must be provided. Achievement of learning objectives must be confirmed after the course through a final assessment.

**.17 S8-02. Use of review questions.** Review questions must be placed at the end of each learning activity throughout the program in sufficient intervals to allow the learner the opportunity to evaluate the material that needs to be re-studied. If objective type questions are used, at least three review questions per CPE credit must be included or two review questions if the program is marketed for one-half CPE credits.

**.18 S8-03. Evaluative and reinforcement feedback on review questions.** If the multiple choice method is used, evaluative feedback for each incorrect response must explain why each response is wrong and reinforcement feedback must be provided for correct responses. If rank order or matching questions are used, then it is permissible to provide single feedback to explain the correct response. Simulations and other innovative tools that guide participants through structured decisions could provide feedback at irregular intervals or at the end of the learning experience. In those situations, single feedback would be permissible. True/false questions are allowed as review questions but are not included in the number of review questions required per CPE credit. Forced choice questions, when used as part of an overall learning strategy, are allowed as review questions and can be counted in the number of review questions required per CPE credit. There is no minimum passing rate required for review questions.

**.19 S8-04. Final examination requirements.** To provide evidence of satisfactory completion of the course, CPE program sponsors of self-study programs must require participants to successfully complete a final examination with a minimum-passing grade of at least 70 percent before issuing CPE credit for the course. Examinations may contain questions of varying format (for example, multiple-choice, essay, and simulations). At least five questions/scored responses per CPE credit must be included on the final examination or three final exam questions if the program is marketed for one-half CPE credits. For example, the final examination for a five-credit course must include at least 25 questions. Alternatively, a five and one-half credit course must include at least 28 questions. Except in courses where recall of information is the learning strategy, duplicate review and final exam questions are not allowed. True/false questions are not permissible on the final examination in accordance with the implementation effective dates of these standards.

**.20 S8-05. Feedback on final examination.** Providing feedback on the final examination is at the discretion of the CPE program sponsor. If the CPE program sponsor chooses to provide feedback and utilizes a test bank, then the CPE program sponsor must ensure that the question test bank is of sufficient size to minimize overlap of questions on the final examination for the typical repeat test-taker. Feedback may comply with the feedback for review questions

as described in S8-03, or take the form of identifying correct and incorrect answers.

**.21** Does not utilize a test bank, whether or not feedback can be given depends on whether the learner passes the final examination, then

- on a failed examination, the CPE program sponsor may not provide feedback to the test-taker.
- on examinations passed successfully, CPE program sponsors may choose to provide participants with feedback. This feedback may comply with the type of feedback for review questions as described in S8-03, or take the form of identifying correct and incorrect answers.

**.22 S8-06. Program/course expiration date.** All courses must include an expiration date (the time by which the learner must complete the final examination). For individual courses, the expiration date is no longer than one year from the date of purchase or enrollment. For a series of courses to achieve an integrated learning plan, the expiration date may be longer.

**.23 S8-07. Based on materials developed for instructional use.** Self-study programs must be based on materials specifically developed for instructional use and not on third party materials. Self-study programs requiring only the reading of general professional literature, IRS publications, or reference manuals followed by a test will not be acceptable. However, the use of the publications and reference materials in self-study programs as supplements to the instructional materials could qualify if the self-study program complies with each of the CPE standards.

**.24** Instructional materials for self-study include teaching materials which are written for instructional educational purposes. These materials must demonstrate the expertise of the author(s). At a minimum, instructional materials must include the following items:

1. An overview of topics;
2. The ability to find information quickly;
3. The definition of key terms;
4. Instructions to participants;
5. Review questions with feedback; and
6. Final exam.

## Standards for CPE Program Presentation

**.25 Standard No. 9. CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. For CPE program sponsors whose courses are developed for sale or for external audiences (not internal training), CPE program sponsors must make the following information available in advance:**

- **Learning objectives.**
- **Instructional delivery methods.**
- **Recommended CPE credit and recommended field of study.**
- **Prerequisites.**
- **Program level.**
- **Advance preparation.**
- **Program description.**

- **Course registration requirements.**
- **Refund policy for courses sold for a fee/cancellation policy.**
- **Complaint resolution policy.**
- **Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits).**

**For CPE program sponsors whose courses are purchased or developed for internal training only, CPE program sponsors must make the following information available in advance:**

- **Learning objectives.**
- **Instructional delivery methods.**
- **Recommended CPE credit and recommended field of study.**
- **Prerequisites.**
- **Advance preparation.**
- **Program level (for optional internal courses only).**
- **Program description (for optional internal course only).**

**.26 S9-01. Disclose significant features of program in advance.** For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (such as through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with noneducational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration policies and procedures must be formalized, published, and made available to participants and include refund/cancellation policies as well as complaint resolution policies.

**.27 S9-02. Disclose advance preparation and prerequisites.** CPE program sponsors must distribute program materials in a timely manner and encourage participants to complete any advance preparation requirements. All programs must clearly identify prerequisite education, experience, and advance preparation requirements, if any, in the descriptive materials. Prerequisites, if any, must be written in precise language so that potential participants can readily ascertain whether they qualify for the program.

**.28 Standard No. 10. CPE program sponsors must ensure instructors are qualified with respect to both program content and instructional methods used.**

**.29 S10-01. Qualifications of instructors.** Instructors are key ingredients in the learning process for any group program. Therefore, it is imperative that CPE program sponsors exercise great care in selecting qualified instructors for all group programs. Qualified instructors are those who are capable, through training, education, or experience of communicating effectively and providing an environment conducive to learning. They must be competent and current in the subject matter, skilled in the use of the appropriate instructional methods and technology, and prepared in advance.

**.30 S10-02. Evaluation of instructors' performance.** CPE program sponsors should evaluate the instructor's performance at the conclusion of each program to determine the instructor's suitability to serve in the future.

**.31 Standard No. 11. CPE program sponsors must employ an effective means for evaluating learning activity quality with respect to content and presentation, as well as provide a mechanism for participants to assess whether learning objectives were met.**

**.32 S11-01. Required elements of evaluation.** The objectives of evaluation are to assess participant satisfaction with specific programs and to increase subsequent program effectiveness. Evaluations, whether written or electronic, must be solicited from participants and instructors for each program session, including self-study, to determine, among other things, whether

- stated learning objectives were met.
- stated prerequisite requirements were appropriate and sufficient.
- program materials were relevant and contributed to the achievement of the learning objectives.
- time allotted to the learning activity was appropriate.
- if applicable, individual instructors were effective.

**.33 S11-02. Evaluation results.** CPE program sponsors must periodically review evaluation results to assess program effectiveness and should inform developers and instructors of evaluation results.

**.34 Standard No. 12. CPE program sponsors must ensure instructional methods employed are appropriate for the learning activities.**

**.35 S12-01. Evaluate instructional method in context of program presentation.** CPE program sponsors must evaluate the instructional methods employed for the learning activities to determine if the delivery is appropriate and effective.

**.36 S12-02. Facilities and technology appropriateness.** Learning activities must be presented in a manner consistent with the descriptive and technical materials provided. Integral aspects in the learning environment that should be carefully monitored include the number of participants and the facilities and technologies employed in the delivery of the learning activity.

## Standards for CPE Program Measurement

**.37 Standard No. 13. Sponsored learning activities are measured by actual program length, with one 50-minute period equal to one CPE credit. Sponsors may recommend one-half CPE credits under the following scenarios:**

- **Group**—after the first credit has been earned.
- **Self-study**—one-half increments (equal to 25 minutes) are permitted.

**The CPA claiming CPE credits should refer to respective state board requirements regarding acceptability of one-half CPE credits.**

**.38 S13-01. Learning activities with individual segments.** For learning activities in which individual segments are less than 50 minutes, the sum of the segments would be considered one total program. For example, five 30-minute presentations would equal 150 minutes and would be counted as three CPE credits. When the total minutes of a sponsored learning activity are greater than 50, but not equally divisible by 50, the CPE credits granted must be rounded down to the nearest one-half credit, if one-half credits are awarded.

Thus, learning activities with segments totaling 140 minutes would be granted two and one-half CPE credits.

**.39 S13-02. Responsibility to monitor attendance.** While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must monitor group learning participation to assign the correct number of CPE credits.

**.40 S13-03. Monitoring mechanism for group internet-based programs.** In addition to meeting all other applicable group program standards and requirements, group internet-based programs must employ some type of monitoring mechanism to verify that participants are participating during the duration of the course. The monitoring mechanism must be of sufficient frequency and lack predictability to provide assurance that participants have been engaged throughout the program. If polling questions are used as a monitoring mechanism, at least three polling questions must be used per CPE credit hour. CPE program sponsors should verify with respective state boards on specific polling requirements.

**.41 S13-04. Small group viewing of group internet-based programs.** In situations where small groups view a group internet-based program such that one person logs into the program and asks questions on behalf of the group, documentation of attendance is required in order to award CPE credits to the group of participants. Participation in the group must be documented and verified by the small group facilitator or administrator in order to authenticate attendance for program duration.

**.42 S13-05. University or college credit course.** For university or college credit courses that meet these CPE Standards, each unit of college credit shall equal the following CPE credits:

- Semester System—15 credits
- Quarter System—10 credits

**.43 S13-06. University or college noncredit course.** For university or college noncredit courses that meet these CPE standards, CPE credit shall be awarded only for the actual classroom time spent in the noncredit course.

**.44 S13-07. Participant preparation time.** Credit is not granted to participants for preparation time.

**.45 S13-08. Committee or staff meetings qualification for CPE credits.** Only the portions of committee or staff meetings that are designed as programs of learning and comply with these standards qualify for CPE credit.

**.46 Standard No. 14. CPE credit for self-study learning activities must be based on one of the following educationally sound and defensible methods:**

**Method 1: Pilot test of the representative completion time.**

**Method 2: Computation using the prescribed word count formula.**

**.47 S14-01. Method 1—Sample group of pilot testers.** A sample of intended professional participants must be selected to test program materials in an environment and manner similar to that in which the program is to be presented. The sample group must consist of at least three qualified individuals who are independent of the program development group. For those courses whose target audience includes CPAs, the sample group must be licensed CPAs currently subject to state CPE requirements as defined by state board requirements and possess the appropriate level of knowledge before taking the program. For those sponsors who are subject to various regulatory requirements

that mandate a minimum number of CPE credits and offer courses to non-CPAs, those courses do not have to be pilot tested by licensed CPAs.

**.48 S14-02. Method 1—CPE credit based on representative completion time.** The sample does not have to ensure statistical validity; however, if the results of pilot testing are inconsistent, then the sample must be expanded or any inconsistent results eliminated. CPE credit must be recommended based on the representative completion time for the sample. Completion time includes the time spent taking the final examination and does not include the time spent completing the course evaluation. Pilot testers must not be informed about the length of time the program is expected to take to complete. If substantive changes are subsequently made to program materials, further pilot tests of the revised program materials must be conducted to affirm or amend, as appropriate, the representative completion time.

**.49 S14-03. Method 1—Requirement for re-pilot testing.** If, subsequent to course release, actual participant completion time warrants a change in CPE credit hours, re-pilot testing is required to substantiate a change in CPE credit prospectively.

**.50 S14-04. Method 1—Pilot testing when course is purchased from vendor or other developer.** CPE program sponsors may purchase courses from other vendors or course developers. For purchased courses where pilot tests were conducted and provided, CPE program sponsors must review results of the course developer's pilot test results to ensure that the results are appropriate. For purchased courses where no pilot tests were conducted or provided, CPE program sponsors must conduct pilot testing or perform the word count formula as prescribed in method 2.

**.51 S14-05. Method 2—Basis for prescribed word count formula.** The prescribed word count formula begins with a word count of the number of words contained in the text of the required reading of the self-study program and should exclude any material not critical to the achievement of the stated learning objectives for the program. Examples of information material that are not critical and therefore *excluded* from the word count are: course introduction; instructions to the learner; author/course developer biographies; table of contents; glossary; and appendices containing supplementary reference materials.

**.52** Again, only course content text that is critical to the achievement of stated learning objectives should be included in the word count formula. If an author/course developer determines, for example, that including the entire accounting rule or tax regulation is beneficial to the learner, the accounting rule or tax regulation should be included as an appendix to the course as supplementary reference material and excluded from the word count formula. Only pertinent paragraphs or sections of the accounting rule or tax regulation required for the achievement of stated learning objectives should be included in the actual text of the course and therefore included in the word count formula.

**.53** Review questions, exercises and final examination questions are considered separately in the calculation and should not be included in the word count.

**.54 S14-06. Method 2—Consideration of audio and video segments in word count formula.** If audio and video segments of a self-study program constitute additional learning for the participant (not narration of the text), then the actual audio/video duration time may be added to the time calculation as provided in the prescribed word count formula.

**.55 S14-07. Method 2—Calculation of CPE credit using the prescribed word count formula.** The word count for the text of the required reading of the program is divided by 180, the average reading speed of adults. The total number of review questions, exercises and final examination questions is multiplied by 1.85, which is the estimated average completion time per question. These two numbers plus actual audio/video duration time, if any, are then added together and the result divided by 50 to calculate the CPE credit for the self-study program. When the total minutes of a self-study program are not equally divisible by 50, the CPE credits granted must be rounded down to the nearest one-half credit.

$$[(\# \text{ of words}/180) + \text{actual audio/video duration time} + (\# \text{ of questions} \times 1.85)]/50 = \text{CPE credit}$$

**.56 S14-08. Method 2—Word count formula when course is purchased from vendor or other developer.** CPE program sponsors may purchase courses from other vendors or course developers. For purchased courses where the word count formula was calculated, CPE program sponsors must review the results of the course developer's word count formula calculation to ensure that results are appropriate. For purchased courses where the word count formula calculation was not performed or provided, CPE program sponsors must perform the word count formula calculation or conduct pilot testing as described in method 1.

**.57 Standard No. 15. Instructors or discussion leaders of learning activities may receive CPE credit for their preparation and presentation time to the extent the activities maintain or improve their professional competence and meet the requirements of these CPE standards.**

**.58 S15-01. Instructor CPE credit parameters.** Instructors, discussion leaders, or speakers who present a learning activity for the first time may receive CPE credit for actual preparation time up to two times the number of CPE credits to which participants would be entitled, in addition to the time for presentation, subject to regulations and maximums established by the state boards. For example, for learning activities in which participants could receive 8 CPE credits, instructors may receive up to 24 CPE credits (16 for preparation plus 8 for presentation). For repeat presentations, CPE credit can be claimed only if it can be demonstrated that the learning activity content was substantially changed and such change required significant additional study or research.

**.59 S15-02. Authoring and presenting a program.** The CPA claiming CPE credits should refer to respective state board requirements.

**.60 Standard No. 16. Writers of published articles, books, or CPE programs may receive CPE credit for their research and writing time to the extent it maintains or improves their professional competence.**

**.61 S16-01. Requirement for review from independent party.** Writing articles, books, or CPE programs for publication is a structured activity that involves a process of learning. For the writer to receive CPE credit, the article, book, or CPE program must be formally reviewed by an independent party. CPE credits should be claimed only upon publication.

**.62 S16-02. Authoring and presenting a program.** As a general rule, receiving CPE credits for authoring and presenting the same program should not be allowed. The CPA claiming CPE credits should refer to respective state board requirements.

**.63 Standard No. 17. CPE credits recommended by a CPE program sponsor of independent study must not exceed the time the participant devoted to complete the learning activities specified in the learning contract.**

**.64 S17-01. CPE credits agreed to in advance.** The maximum credits to be recommended by an independent study CPE program sponsor must be agreed upon in advance and must be equated to the effort expended to improve professional competence. The credits cannot exceed the time devoted to the learning activities and may be less than the actual time involved.

## Standards for CPE Program Reporting

**.65 Standard No. 18. CPE program sponsors must provide program participants at or after the conclusion of the program with documentation (electronic or paper) of their participation (certificate of completion), which includes the following:**

- **CPE program sponsor name and contact information**
- **Participant's name**
- **Course title**
- **Course field of study**
- **Date offered or completed**
- **If applicable, location**
- **Type of instructional/delivery method used**
- **Amount of CPE credit recommended**
- **Verification by CPE program sponsor representative**
- **Sponsor identification number or registration number, if required by the state boards**
- **NASBA time statement stating that CPE credits have been granted on a 50-minute hour**
- **Any other statements required by state boards**

**.66 S18-01. Entity to award CPE credits and acceptable documentation.** The CPE program sponsor is the individual or organization responsible for issuing the certificate of completion and maintaining the documentation required by these standards. The entity whose name appears on the certificate of completion is responsible for validating the CPE credits claimed by a participant. CPE program sponsors must provide participants with documentation (electronic or paper) to support their claims of CPE credit. Acceptable evidence of completion includes

- for group and independent study programs, a certificate or other verification supplied by the CPE program sponsor.
- for self-study programs, a certificate supplied by the CPE program sponsor after satisfactory completion of an examination.
- for instruction credit, appropriate supporting documentation that complies with the requirements of the respective state boards subject to the guidelines in Standard 15 in "Standards for CPE Program Measurement" (section 300 par. .57).
- for a university or college course that is successfully completed for credit, a record or transcript of the grade the participant received.



- for university or college noncredit courses, a certificate of attendance issued by a representative of the university or college.
- for published articles, books, or CPE programs, (1) a copy of the publication (or in the case of a CPE program, course development documentation) that names the writer as author or contributor, (2) a statement from the writer supporting the number of CPE hours claimed, and (3) the name and contact information of the independent reviewer(s) or publisher.

**.67 Standard No. 19. CPE program sponsors must retain adequate documentation (electronic or paper) for a minimum of five years to support their compliance with these standards and the reports that may be required of participants.**

**.68 S19-01. Required documentation elements.** Evidence of compliance with responsibilities set forth under these standards which is to be retained by CPE program sponsors includes, but is not limited to

- records of participation.
- dates and locations.
- instructor names and credentials.
- number of CPE credits earned by participants.
- results of program evaluations.

**.69** Information to be retained by developers includes copies of program materials, evidence that the program materials were developed and reviewed by qualified parties, and a record of how CPE credits were determined.

**.70 S19-02. Maintenance of documentation as basis for CPE credit for self-study programs.** For CPE program sponsors using method 1 (pilot tests) as the basis for CPE credit for self-study programs, appropriate pilot test records must be retained regarding the following:

- When the pilot test was conducted
- The intended participant population
- How the sample of pilot testers was selected
- Names and credentials and relevant experience of sample pilot test participants
- A summary of pilot test participants' actual completion time
- Statement from each pilot tester to confirm that the pilot tester is independent from the course development group and that the pilot tester was not informed in advance of the expected completion time

**.71** For CPE program sponsors using method 2 (word count formula) as the basis for CPE credit for self-study programs, the word count formula calculation as well as the supporting documentation for the data used in the word count formula (such as, word count; number of review questions, exercises and final examination questions; duration of audio or video segments, if applicable; and actual calculation) must be retained.

## Effective Dates

**.72** Unless otherwise established by state licensing bodies or other professional organizations, these standards are to be effective as follows:

1. For group programs and independent study—July 1, 2012.
  2. For self-study programs in development as of December 31, 2011, or being published for the first time, or both—July 1, 2012.
  3. For self-study programs already in existence as of December 31, 2011—March 1, 2014.
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## CPE Section 400

### Glossary

Revised, January 2012.

**.01 Advanced.** Program knowledge level most useful for individuals with mastery of the particular topic. This level focuses on the development of in-depth knowledge, a variety of skills, or a broader range of applications. Advanced level programs are often appropriate for seasoned professionals within organizations; however, they may also be beneficial for other professionals with specialized knowledge in a subject area.

**.02 Archived.** A learning activity through which a group program has been recorded for future use.

**.03 Basic.** Program knowledge level most beneficial to CPAs new to a skill or an attribute. These individuals are often at the staff or entry level in organizations, although such programs may also benefit a seasoned professional with limited exposure to the area.

**.04 Continuing Professional Education (CPE).** An integral part of the lifelong learning required to provide competent service to the public. The set of activities that enables CPAs to maintain and improve their professional competence.

**.05 CPE credit hour.** Fifty minutes of participation in a program of learning.

**.06 CPE program sponsor.** The individual or organization responsible for issuing the certificate of completion, and maintaining the documentation required by these standards. The term *CPE program sponsor* may include associations of CPAs, whether formal or informal, as well as employers who offer in-house programs.

**.07 Evaluative feedback.** Specific response to incorrect answers to questions in self-study programs.

**.08 Group internet-based program.** An educational process designed to permit a participant to learn a given subject through interaction with an instructor by using the Internet.

**.09 Group live program.** An educational process designed to permit a participant to learn a given subject through interaction with an instructor and other participants either in a classroom or conference setting.

**.10 Group program.** Any group live or group internet-based programs.

**.11 Independent study.** An educational process designed to permit a participant to learn a given subject under a learning contract with a CPE program sponsor.

**.12 Instructional methods.** Delivery strategies such as case studies, computer-assisted learning, lectures, group participation, programmed instruction, teleconferencing, use of audiovisual aids, or work groups employed in group, self-study, or independent study programs or other innovative programs.

**.13 Intermediate.** Program knowledge level that builds on a basic program, most appropriate for CPAs with detailed knowledge in an area. Such

persons are often at a mid-level within the organization, with operational or supervisory responsibilities.

**.14 Internet-based programs.** A learning activity through a group program or a self-study program that is designed to permit a participant to learn the given subject matter via the Internet. To qualify as either a group or self-study program, the Internet learning activity must meet the respective standards.

**.15 Learning activity.** An educational endeavor that maintains or improves professional competence.

**.16 Learning contract.** A written contract signed by an independent study participant and a qualified CPE program sponsor prior to the commencement of the independent study.

**.17 Learning objectives.** Specifications on what participants should accomplish in a learning activity. Learning objectives are useful to program developers in deciding appropriate instructional methods and allocating time to various subjects.

**.18 Overview.** Program knowledge level that provides a general review of a subject area from a broad perspective. These programs may be appropriate for professionals at all organizational levels.

**.19 Pilot test.** Sampling of at least three individuals independent of the development team and representative of the intended participants to measure the representative completion time as one method to determine the recommended CPE credit for self-study programs.

**.20 Professional competence.** Having requisite knowledge, skills, and abilities to provide quality services as defined by the technical and ethical standards of the profession. The expertise needed to undertake professional responsibilities and to serve the public interest.

**.21 Program of learning.** A collection of learning activities that are designed and intended as continuing education and that comply with these standards.

**.22 Reinforcement feedback.** Specific responses to correct answers to questions in self-study programs.

**.23 Self-study program.** An educational process designed to permit a participant to learn a given subject without involvement of an instructor.

**.24 Word count formula.** A method, detailed under S14-05 Method 2, to determine the recommended CPE credit for self-study programs that uses a formula including word count of learning material, number of questions and exercises, and duration of audio and video segments.

**.25 Update.** Program knowledge level that provides a general review of new developments. This level is for participants with a background in the subject area who desire to keep current.

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