

2000

# ABCs of independence : a basic primer for understanding AICPA independence standards; Audit risk alerts

American Institute of Certified Public Accountants

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## Recommended Citation

American Institute of Certified Public Accountants, "ABCs of independence : a basic primer for understanding AICPA independence standards; Audit risk alerts" (2000). *Industry Developments and Alerts*. 723.

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# The ABCs of Independence — 2000/01

A Basic Primer for Understanding  
AICPA Independence Standards

## Notice to Readers

This Audit Risk Alert is intended to provide CPA firm personnel with an introduction to certain independence rules and an update on recent activities affecting those rules. The AICPA staff has prepared this document. It has not been approved, disapproved, or otherwise acted on by any senior technical committee of the AICPA.

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Edited by  
*Accounting and Auditing Publications Staff*

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Independence is an attitude of mind, much deeper than the surface display of visible standards...Independence, both historically and philosophically, is the foundation of the public accounting profession and upon its maintenance depends the profession's strength and its stature.

—AICPA

First Statement on Independence, 1947



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# ***The ABCs of Independence—2000/01***

## **Introduction to Independence Matters**

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*Why is independence important? What is the purpose of this publication?*  
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The auditing profession developed from the needs of third-party investors and their desire for an objective opinion about the financial performance of the ventures they financed. Auditors provide that objective opinion. Independence is a prerequisite for objectivity, and that is why independence has been a cornerstone of the accounting profession since its inception.

Objectivity is largely a matter of *perception*. Because we need to ensure that third parties view us as objective, the independence rules seek to maintain independence in *appearance* as well as independence in fact.

You also should realize that the independence rules contemplate not only the independence of individual CPAs, but also the independence of the *entire firm*. Because of this focus on the accounting firm, firm members who do not perform audits and those who are not CPAs may in certain circumstances be required to comply with the independence rules.

This publication has been prepared to help you develop a broad-based understanding of the AICPA independence rules and to perform in good faith your responsibilities for complying with those rules. There are literally dozens of independence rules, rulings, and interpretations that have been enacted by a number of standard-setting organizations. This publication will not cover them all. Instead, we will present only those AICPA rules you are most likely to encounter in practice and they will be presented in a way that will promote your understanding of the fundamental concepts of independence...the ABCs, so to speak. This publication also will alert you to recent developments in auditor inde-

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pendence matters. This Alert only summarizes the independence rules discussed; therefore, when assessing your independence, you should refer directly to the applicable independence standards, interpretations, rules, or rulings because they may include additional details or topics relevant to your situation.

## Independence Rule-Makers

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*Who sets the independence standards? Which standards am I required to follow?*

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There are three main independence standard-setting bodies.

1. *The AICPA.* The AICPA independence rules are considered to be the fundamental rules of auditor independence. These rules must be followed whenever you perform a service that requires independence (for example, a financial statement audit or review). The AICPA independence rules can be found in the AICPA's Code of Professional Conduct, Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101). Interpretations and Rulings under rule 101 address a number of issues affecting independence.
2. *The Securities and Exchange Commission (SEC).* The SEC has adopted rules *in addition to* those promulgated by the AICPA. Often, the SEC rules tend to be more restrictive than the AICPA rules. The SEC rules apply to auditors of companies that are required to file financial statements with the SEC, generally publicly held registrants. The SEC independence policies are found in rule 2-01,<sup>1</sup> as amended, of regulation S-X, with additional guidance in section 600 of the *Codification of Financial Reporting Policies*, and many independence "no action letters" of the SEC staff.

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1. The Securities and Exchange Commission (SEC) has adopted significant revisions to rule 2-01 of regulation S-X. See the SEC Web site at [www.sec.gov/rules/final/33-7919.htm](http://www.sec.gov/rules/final/33-7919.htm) for the final rule revisions. See also appendix C of this Alert for an excerpt of the rule amendments.

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3. *The Independence Standards Board (ISB)*. The ISB was formed by the SEC and AICPA to address independence matters affecting audit firms of publicly held companies, and to develop a conceptual framework for auditor independence standards.

In addition to the three main independence standard-setting bodies, other organizations may set independence rules, including—

- State CPA societies
- State boards of accountancy
- Federal and state regulatory agencies

This Alert does not address the independence standards of these other bodies. Nevertheless, you must consider their standards where applicable, when assessing your firm's independence.

Determining which independence rules apply is *client-specific*. When your firm performs a service requiring independence for a non-public company, you must comply with the AICPA rules in addition to rules issued by the applicable state board, state society (if you are a member), or other regulatory body (for example, the Government Accounting Office). When the firm performs a service requiring independence for a public company, it must comply with the SEC and ISB rules in addition to the basic AICPA rules. Thus, it is possible that you will have to comply with different sets of independence rules, depending on whether the engagement in question is being performed for a private or public company.

### **Determining When the Independence Standards Apply**

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*Under what circumstances do the independence rules apply?*  
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Specific engagement performance standards determine whether you need to be independent to perform a certain engagement. According to these standards, an auditor should be independent when performing—

- Audits of financial statements.

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- Reviews of financial statements.
  - Engagements performed under the attestation standards, for example, agreed-upon procedures.

While compilation services do not require independence, Statement on Standards for Accounting and Review Services (SSARS) 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100), requires that a lack of independence be disclosed in the accountant's report.

The performance of tax and consulting services does *not* require independence. If your firm performs *only* tax and consulting services, the independence rules will not apply.

## **ISB Conceptual Framework**

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*Is there a conceptual framework for the independence rules?*

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The independence rules consist of a myriad of rules, rulings, and interpretations. Currently, a conceptual framework for these rules does not exist. The ISB is in the process of developing such a framework, which will help the ISB issue principle-based independence standards for auditors of public companies.

For the purposes of this Alert we offer the following summary to help provide a basis for the discussion that follows. The AICPA independence rules describe who must be independent from whom and the relationships that are presumed to impair independence.

- *Who must be independent.* Anyone who meets the definition of *member* or *member's firm* is required to be independent (see Interpretation No. 101-9, "The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence," of ET section 101, *Independence* [AICPA, *Professional Standards*, vol. 2, ET sec. 101.11]).
- *From whom is independence required.* Members must be independent of *restricted entities*. In general a restricted en-

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tity is any client for whom the firm performs services requiring independence.

- *Relationships that are presumed to impair independence.* The term *relationship* is used rather broadly in this context. It includes financial interests, certain family relationships, and other business relationships you might have with a client.

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### **Executive Summary—Introduction to Independence Matters**

- Independence is the cornerstone of the profession.
  - The independence rules address independence in appearance as well as in fact.
  - The independence rules generally address independence from a firmwide, not an engagement-specific, perspective.
  - The AICPA, SEC, and ISB are the primary independence standard-setting bodies.
  - In general, the independence rules describe who must be independent from whom and the relationships that are presumed to impair that independence.
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## **Definition of a Member**

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*Who must be independent? How do the independence rules vary according to one's position within the CPA firm?*  
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First, recognize that the independence rules are not necessarily limited to the firm's auditors or CPAs. The independence rules apply to anyone who meets the definition of a member (originally intended to refer only to a member of the AICPA, member now has a broader definition that includes non-AICPA members as well).

The definition of a member varies according to one's *level* within the firm. Entities affiliated with a restricted entity may also need to be considered. For example, differences exist between a manager and a staff professional. The independence rules do *not* vary according to one's functional classification. Thus, the indepen-

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dence rules that apply to a tax partner are the same as those that apply to an audit partner.

Under the independence rules (see Interpretation No. 101-9) you are a member if you are—

- A partner, proprietor, or shareholder of the firm. For simplicity, we will refer to these individuals as “partners” for the remainder of this Alert. Thus, partners must be independent of *all* the firm’s restricted entities, such as audit clients.
- An individual with a managerial position located in an office participating in a significant portion of an engagement requiring independence.
- Any individual participating in an engagement requiring independence (except those who perform only routing clerical functions, such as typing or photocopying).
- A former client employee or management. For example, suppose you work for a client or are on its board of directors and you decide to join the accounting firm as an owner or employee. You must, before becoming a member, eliminate any investments, activities, or other relationships you have with the client so as not to impair your new firm’s independence.

Because the independence rules vary according to your level in the firm you must be careful to evaluate your compliance whenever you receive a promotion. For example, suppose you joined the staff of Jones, CPA, a two-office firm.

- As a staff accountant, you would have to be independent whenever you participated on an engagement such as an audit. You would not have to be independent of clients for whom you were not part of the engagement team.
- If you became a manager for Jones, CPA, you would have to be independent of all the audit clients *in your office*, even those for which you did not provide services. You would not have to be independent of the audit clients of the other

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office if your office did not participate in a significant portion of their engagement.

- If you were then admitted to the partnership, you would have to be independent of all the audit clients in the *entire firm*, even those that were the clients of the other office in the firm.

The definition of member also includes your firm and any entities controlled by one or more members.

## **Family Relationships**

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### *How do my family relationships affect my independence?*

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The independence rules take into account the financial interests and employment of certain family members (see Interpretation No. 101-9). For example, you would not be considered independent of an entity owned by your spouse. In general, the independence rules relating to family relationships depend on the type of relationship and the position your family member holds at the client (or in some cases the materiality of their investment.)

- *Immediate family members.* Immediate family members consist of your spouse, cohabitant, and any dependents. The definition of member, as discussed earlier, extends to include your immediate family members. That is, if you meet the definition of a member with respect to a certain client, then so do your immediate family members.
- *Close relatives.* Specific rules exist that address the financial interests and employment of close relatives. Close relatives are—
  - Nondependent children, grandchildren, and stepchildren, and their respective spouses.
  - Siblings and their spouses.
  - Grandparents and parents, parents-in-law, and their respective spouses.

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## Financial Interests

**Immediate family members.** The independence rules that apply to you as a member also apply to your immediate family members. For example, your spouse's investments are treated as if you owned them—your financial interests are considered inseparable. This is true even if your spouse keeps securities in his or her own name or in a blind trust, separate and apart from you.

**Close relatives.** The financial interests of a close relative will impair your independence only if all of the following conditions are met:

1. The financial interest is material to the relative's net worth.
2. You know about this material financial interest.
3. You participate on the engagement.

## Employment of Family Members

The independence rules relating to the employment by restricted entities of family members depend on the position held by the family member. The independence rules address the following types of positions.

- **Positions of significant influence.** A position of significant influence is one that sets accounting, financial, or operating policy for the client. Typically, this definition envisions an executive officer, but the title held by the person is less important than the function he or she performs.
- **Audit-sensitive positions.** An audit-sensitive position is one whose activities are subject to significant internal accounting control, such as an accounting supervisor.

**Immediate family member.** Your independence is impaired under the following circumstances:

1. **Immediate family member holds a position of significant influence.** Independence is impaired if any one of the following conditions is met.
  - a. You participate in the engagement.



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- b. You are a partner in an office participating in a significant portion of the engagement.
  - c. You are any partner who has the ability to exercise influence over the engagement or has any involvement with the engagement.

2. *Immediate family member holds an audit-sensitive position.*  
Independence is impaired if you participate in the engagement, regardless of your position in the firm.

*Close relatives.* Your independence is impaired if you participate in an engagement and a close relative is employed by the client in an audit-sensitive position. Independence is also impaired if a close relative holds a position of significant influence and either—

- You provide services requiring independence to the client.
- You are a partner in an office participating in a significant portion of the engagement.

## **Former Partners**

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### *Can a former partner impair the firm's independence?*

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A former partner of the firm will be considered a member unless the following criteria have been met (see Interpretation No. 101-2, "Former Practitioners and Firm Independence," of ET section 101 [AICPA, *Professional Standards*, vol. 2, ET sec. 101.04]):

- Payments of amounts due (such as capital balance or retirement benefits) must be based on a fixed formula and cannot be material to the CPA firm.
- Dissociation from the CPA firm is critical in protecting the appearance of independence when the former partner accepts a position of significant influence with a client (such as a board membership or an executive position). The former partner should no longer participate in firm activities, and the firm should not provide him or her office space or related amenities.

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## Executive Summary—Definition of a Member

- Firm professionals who meet the definition of a member must be independent from restricted entities.
  - The definition of a member varies according to your level (for example, partner, manager, or staff) but not your functional classification (for example, audit, tax, or consulting).
  - The financial interests in and employment with restricted entities of certain family members may affect your independence.
  - Former partners of the firm must be sure to dissociate themselves from the firm, as specified by the independence standards, in order to avoid possible independence problems.
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## Definition of a Restricted Entity

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*From which clients is independence required?*  
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Assuming you meet the definition of a member, you are required to be independent of the firm’s “restricted entities.” A restricted entity is any client for whom your firm performs services requiring independence, and certain related entities. These services are—

1. Audits.
2. Reviews of financial statements.
3. Attestation engagements,<sup>2</sup> for example, agreed-upon procedures engagements or an examination or review of prospective financial information or an entity’s internal controls.

Services performed under the Statements on Standards for Tax Services or under the Standards for Consulting Services do not require independence.

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2. The independence rules are less restrictive for certain attest engagements. See Interpretation 101-11, “Independence and the Performance of Professional Services Under the Statements on Standards for Attestation Engagements and Statement of Auditing Standards No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement.*”

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## Financial Interests

*What financial interests are presumed to impair my independence?*

### Direct and Material Indirect Financial Interests

Owning a financial interest in a restricted entity may impair your independence or your firm's independence (see Interpretation No. 101-1, "Interpretation of Rule 101," of ET section 101, *Independence* [AICPA, *Professional Standards*, vol. 2, ET sec. 101.02]). A financial interest means an ownership interest in a business entity. Common stock and mutual fund shares are two of the more common forms of financial interests.

Your independence is considered to be impaired if you have or are committed to acquire either of the following:

1. *A direct financial interest in a restricted entity.* A direct financial interest is, as the name implies, your direct investment in an entity, for example, owning shares of stock. In general, the independence rules do not make exceptions for the type of investment vehicle you use to hold your direct investments. Direct investments held by a retirement plan (for example, a 401(k) plan), an investment club, or those held in a blind trust are still considered to be direct investments (see Ethics Rulings No. 66, "Member's Retirement or Savings Plan Has a Financial Interest in Client," of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [AICPA, *Professional Standards*, vol. 2, ET sec. 191.132-.133]; No. 36, "Participant in Investment Club," of ET section 191 [ET sec. 191.071-.072]; and No. 68, "Blind Trust," of ET section 191 [ET sec. 191.136-.137]). A general partnership interest is considered to be a direct investment (see Ethics Ruling No. 79, "Member's Investment in a Partnership That Invests in Member's Client," of ET section 191 [ET sec. 191.158-.159]).
2. *A material indirect financial interest in a restricted entity.* An indirect financial interest is one in which you have an

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interest in one entity, which, in turn, holds an interest in the restricted entity. For example, shares in a mutual fund are a common way in which you may hold an indirect investment in a restricted entity. A limited partnership interest is also considered to be an indirect investment (see Ethics Ruling No. 79). For indirect investments, there is a materiality threshold. In other words, you are permitted to have an indirect investment in a restricted entity as long as that investment is immaterial to you. The amount of your indirect investment is determined based on your ultimate investment in the restricted entity. For example, suppose you had \$100 invested in a mutual fund, and 1 percent of the mutual fund's total assets were invested in a restricted entity. The amount of your indirect investment in the restricted entity would be equal to  $\$100 \times 1\%$ , or \$1. To determine whether your indirect investment is material, you would compare it with your personal net worth.

### **Additional Rules for Certain Family Members**

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*Will investments held by my spouse's employee benefits plan impair my independence?*

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As described in the section "Family Relationships" in this Alert, the financial interests and employment of certain family members may affect your independence. In addition to those rules discussed in that previous section, the independence rules also include stipulations relating to a spouse's investment in a restricted entity either through an employer's benefit plan or employee stock option plan.

If you are a member, your spouse's or dependent's investments in a restricted entity through an employer's benefit plan (for example, a 401(k) plan) normally will impair your independence. However, an exception exists for a spouse's benefit plan (see Ethics Ruling No. 108, *Participation of Member or Spouse in Retirement, Savings, or Similar Plan Sponsored by, or That Invests In, Client* [AICPA, *Professional Standards*, vol. 2, ET sec. 191.216-.217]). Independence will *not* be impaired if all of the following conditions are met:

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1. The benefit plan is normally offered to all employees in equivalent employment positions.
  2. You do not participate in the engagement.
  3. You are not in a position to influence the engagement.

## Client Loans

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*May I obtain a loan from a client without impairing my independence?*  
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Loans to or from a client can impair your independence or your firm's independence. In general, loans from a restricted entity or from an officer, director, or principal stockholder of a restricted entity are *prohibited*.

However, there are several exceptions to this rule (see Interpretation No. 101-5, "Loans from Financial Institution Clients and Related Terminology," of ET section 101, *Independence* [AICPA, *Professional Standards*, vol. 2, ET sec. 101.07]). Assuming that you obtain the loan under normal lending procedures, terms, and requirements, the following loans from a *financial institution client* will not impair your independence:

1. *Permitted new loans.* Some new loans are permitted if they meet certain conditions. These loans are—
  - a. Car loans and leases that are collateralized by the car.
  - b. Credit card loans and cash advances of \$5,000 or less.
  - c. Loans that are fully collateralized by either the cash surrender value of an insurance policy or by cash deposits at the same financial institution.
2. *Grandfathered existing loans.* Some existing loans will not impair independence because they were obtained before certain events transpired. Grandfathered loans include: (a) home mortgages, (b) secured loans, or (c) unsecured loans that are not material. In order for these loans to not impair your independence, they must have been obtained at one of these dates:
  - Before January 1, 1992

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- Before you met the definition of a member
  - Before the entity became a restricted entity
  - Before the loan was sold to a client (by a nonclient) requiring independence

If the terms of the loan change in any manner after the above dates, then the loan will no longer be considered grandfathered. Additionally, you are required to keep the loan current.

### **Unpaid Fees**

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#### *How do a client's unpaid fees affect independence?*

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When a client has fees that have been past due for more than one year, that unpaid fee balance is treated as a loan (see Ethics Ruling No. 52, “Unpaid Fees,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [AICPA, *Professional Standards*, vol. 2, ET sec. 191.103-.104]). For example, if your firm issues a report on a client's current-year financial statements and your firm has not been paid fees, whether billed or unbilled, for *any* professional service for *more than one year* before the date of the current year's report, independence is considered impaired, even if the client has given you a note receivable for these fees.

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### **Executive Summary—Financial Interests**

- Your independence is presumed to be impaired whenever you hold a direct or material indirect financial interest in a restricted entity.
  - Investments held by your spouse's employee benefit plan will impair your independence unless certain conditions are met.
  - Loans from a client generally are prohibited; however, certain exceptions are allowed.
  - Your client's unpaid fees may impair your independence.
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## Nonattest Services

*Can I perform nonattest services for an attest client? What services can I perform without impairing my independence?*

The performance of nonattest services for a restricted entity may impair your firm's independence (see Interpretation No. 101-3, "Performance of Other Services," of ET section 101, *Independence* [AICPA, *Professional Standards*, vol. 2, ET sec. 101.05]). Whenever your firm is engaged to provide consulting or other nonattest services to a restricted entity, such as an audit client, you should carefully evaluate the scope of the engagement to make sure you remain independent.

The fundamental principle regarding nonattest services is that you must not perform management functions or make management decisions for a restricted entity. You can advise the client or make recommendations to the client, but ultimately, they are responsible for and must make all management decisions.

To make sure that this requirement is understood by both you and the client, the independence rules require you to make certain communications to your client whenever that client is a restricted entity of the firm. Before performing a nonattest engagement for a restricted entity, you are required to establish an understanding with the client regarding—

- The objectives of your engagement.
- The services you will perform.
- The responsibilities of the client's management.
- Your responsibilities.
- The limitations of the engagement.

Preferably, this understanding will be documented in an engagement letter.

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## **The Client's Responsibilities**

Whenever you provide nonattest services for a restricted entity, it is critical that client management understand their responsibilities and agree that they are not relying on you to make decisions for them. You should be satisfied that the client is in a position to have an informed judgment on the results of the nonattest services. Additionally, you should feel comfortable that the client understands its responsibilities to—

- Designate a management-level individual or individuals to oversee your engagement.
- Evaluate the adequacy of the services performed and any findings.
- Make management decisions, including accepting responsibility for the results of the engagement.
- Establish and maintain internal controls.

## **Activities That May Impair Independence**

The fundamental principle regarding the performance of nonattest services is that you not act in the capacity of management. The independence rules elaborate on that principle by listing some general activities that would be considered to impair your independence. These general activities include—

- Authorizing, executing, or consummating a transaction on behalf of a client.
- Preparing source documents or originating data (for example, purchase orders).
- Having custody of client assets.
- Supervising client employees in the performance of their normal recurring activities.

The independence rules also provide numerous specific examples of activities that will and will not impair your firm's indepen-



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dence. These specific examples, which are not intended to be all-inclusive, are categorized into the following types of services:

- Bookkeeping services
- Payroll and other disbursement services
- Benefit plan administration
- Investment advisory services
- Corporate finance consulting
- Appraisal and valuation services
- Executive or employee search services
- Business risk consulting
- Information systems design and installation

**Help Desk** – Ethics Interpretation No. 101-3 provides guidance on the performance of nonattest services for restricted entities. You should consult this Interpretation before considering any engagement to perform nonattest services. This Interpretation is updated periodically, so be sure to consult the most recent one. You can find Interpretation 101-3 in volume 2 of the AICPA *Professional Standards*. Current updates to the Interpretation are posted in the Ethics Team section of the AICPA Web site at [www.aicpa.org](http://www.aicpa.org).

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### **Executive Summary—Nonattest Services**

- You are prohibited from providing services through which you act in the capacity of management for an attest client. Interpretation 101-3 provides explicit guidance on the consulting and other services you may and may not perform for an attest client.
  - Whenever you perform consulting or other nonattest services for an attest client, you must be certain to clearly communicate with the client regarding the nature of the engagement and each party's responsibilities.
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## Fee Arrangements

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*What types of fee arrangements are prohibited for my attest clients?*  
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### Types of Prohibited Fees

Two types of fee arrangements are prohibited when the arrangement involves a client for whom you perform certain types of engagements (as described later in this section), even if the fee is not related to a service requiring independence. The two prohibited fee arrangements are—

1. *Contingent fees.* A contingent fee is an arrangement where (a) no fee is charged unless a specified result is attained or (b) the amount of the fee is otherwise dependent on the results of your services (see Rule 302, *Contingent Fees* [AICPA, *Professional Standards*, vol. 2, ET sec. 302.01]; and Ethics Ruling No. 25, *Commission and Contingent Fee Arrangements With Nonattest Clients*, of ET section 391, *Ethics Rulings on Responsibilities to Clients* [AICPA, *Professional Standards*, vol. 2, ET sec. 391.049]). Examples of contingent fees include the following:
  - Your firm receives a “finder’s fee” for helping a client locate a buyer for one of the client’s assets.
  - Your firm performs a consulting engagement to decrease a client’s operating costs. The fee is based on a percentage of the cost reduction that the client achieves as a result of your service.

In addition, you may not prepare an original or amended tax return or claim a tax refund for a contingent fee for any client.

Certain exceptions to the rules exist for the following items:

- Fees fixed by a court or other public authority
  - In tax matters, fees based on the results of judicial proceedings or the findings of governmental agencies
2. *Commissions.* A commission is any compensation paid to you or your firm for (a) recommending or referring a third

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party's product or service to a client or (b) recommending or referring a client's product or service to a third party (see Rule 503, *Commissions and Referral Fees* [AICPA, *Professional Standards*, vol. 2, ET sec. 503.01]; and Ethics Ruling No. 192, *Commission and Contingent Fee Arrangements With Nonattest Clients*, of ET section 591, *Ethics Rulings on Other Responsibilities and Practices* [AICPA, *Professional Standards*, vol. 2, ET sec. 591.383]). Examples of commissions include situations where you or your firm—

- Refers a client to a financial planning firm that pays you a commission for the referral.
- Sells accounting software to a client and receives a percentage of the sales price from a software company.
- Refers a non-client to an insurance company client, which pays you a percentage of any premiums subsequently received from the non-client.

An exception to the prohibition of commissions exists for referral fees that are related to recommending or referring the services of a CPA. Under the independence rules—

- You may receive a fee for referring the services of a CPA to any person or entity.
- If you are a CPA, you may pay a fee to obtain a client.

### **Circumstances Prohibiting Contingent Fees and Commissions**

You and your firm are prohibited from having a commission or contingent fee arrangement with a client whenever your firm also provides one of the following services:

- An audit of financial statements
- A review of financial statements
- Compiled financial statements when a third party will rely on the financial statements and you do not disclose a lack of independence
- An examination of prospective financial statements

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## Other Business Relationships

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*What other business relationships with a client will impair my independence?*  
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Any time you serve a client in a capacity that allows you to make management decisions or exercise authority over its business affairs, your firm's independence is considered impaired. Some of the more common business relationships that are prohibited include the following:

- Trustee of a trust that has or is committed to acquire a financial interest in a client
- Executor of an estate that has or is committed to acquire a financial interest in a client
- Director, officer, employee, or in any management capacity for a client
- Promoter or underwriter of a client's securities
- Voting trustee for a client
- Stock transfer or escrow agent for a client
- General counsel or equivalent for a client
- Trustee for a client's pension or profit-sharing trust

Certain exceptions to the rule exist that allow you to serve as an *honorary* trustee for a non-profit organization or on a client's *advisory board*, provided that certain other conditions are met.

## Maintaining Your Independence

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*What should I do to make sure I maintain my independence?*  
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Maintaining your independence is your responsibility. As part of its quality control system, the firm is required to address independence matters; however, ultimately it is up to you to follow firm policies and the independence rules.

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Many firms require you to certify your independence on a regular basis. The following are some suggestions that will help you to complete and sign that certification in good faith.

- *Gain an understanding of the independence rules and firm policies.* As a prerequisite to establishing and maintaining the independence of yourself and your firm, you must have a good, working understanding of the basic independence rules. At a minimum, you should be aware of the circumstances in which you and your immediate family meet the definition of a member and of the types of relationships you may have with the firm's clients that could impair independence. If you have any questions about independence matters, you should consult with someone in your firm who is knowledgeable about such matters, or you may seek the advice of the AICPA.

**Help Desk** – The AICPA recently released an interactive CD-ROM self-study course titled *Independence*. This course gives you an in-depth understanding of the AICPA, SEC, and ISB rules relating to independence and provides you with an opportunity to earn six hours of continuing professional education (CPE) credit. In addition, the AICPA *Plain English Guide to Independence* is available for download (free of charge) from the AICPA's Professional Ethics home page at [www.aicpa.org/members/div/ethics/plaineng.htm](http://www.aicpa.org/members/div/ethics/plaineng.htm). Assessing independence can be a complex and time-consuming undertaking. The AICPA can offer assistance. Call (888) 777-7077 to speak to a member of our Professional Ethics team with your questions relating to AICPA independence standards. You may also submit your question in an e-mail to [ethics@aicpa.org](mailto:ethics@aicpa.org).

- *Know when you meet the definition of a member.* The independence rules apply to all individuals who meet the definition of a member (see Interpretation No. 101-9). If you are to properly apply the independence rules, you must know when you meet that definition. The definition varies according to your level within your firm. Therefore, each time you are being considered for a promotion, it

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would be advisable for you to revisit the definition-of-a-member rules.

- *Consider your family relationships.* The investments and employment of certain family members may impair your independence if you are considered a member (see Interpretation No. 101-9). Know which of your family members meet the definition of “immediate family” and which ones meet the definition of “close relative.” Determine whether any of these relatives are employed by clients. If so, you need to distinguish between positions of “significant influence,” those that are “audit sensitive,” and others. The financial interests of your immediate family members are treated as if you own them. The rules regarding financial interests of close relatives are less restrictive.
- *Be familiar with the firm’s restricted entities.* Restricted entities are those for which the firm provides services requiring independence and certain affiliated entities. You should be aware of who these entities are. Many firms maintain a formal list or database of these clients. If yours is one of these firms, you should know how to access the list.
- *Maintain the integrity of the restricted entity list.* If you perform services requiring independence, then you need to make sure that those clients are identified as restricted entities of the firm. Certain entities that are related to your clients (for example, subsidiaries) also will be considered restricted entities, even if they are not clients of the firm.
- *Consult the restricted entity list regularly.* Get into the habit of referring to the firm’s restricted entity list whenever you are considering changes in circumstances that could affect your independence. For example, you should consult the restricted entity list *before*—
  - Acquiring a financial interest in an entity.
  - Entering into a business relationship.
  - Obtaining a loan.

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- Having an immediate family member change employment or assume new responsibilities at an existing job.
  - *Be aware of the rules relating to the performance of nonattest services.* CPA firms continue to expand the scope of the services they provide, going beyond the traditional attest services such as audits and reviews. If you provide nonattest services to restricted entities, you should be familiar with Ethics Interpretation No. 101-3 regarding the performance of nonattest services. You should be aware of the services that are permitted and prohibited under the ruling, as well as your responsibilities for establishing an understanding of the engagement with your client.
  - *Report any apparent violations.* If you become aware of any apparent violations of the independence rules, you should report these immediately to the person in your firm responsible for independence matters. If appropriate, corrective action should be taken promptly.

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### **Executive Summary—Maintaining Your Independence**

- Maintaining independence is—first and foremost—an individual responsibility.
  - You should have a good, working knowledge of the independence rules and firm policies regarding independence matters.
  - Know when you meet the definition of a member and which of your family members may affect your independence.
  - Regularly consult your firm’s list of restricted entities before a change in circumstance that may affect independence.
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## **Independence Quality Controls**

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*What policies and procedures should my firm establish to provide assurance that we maintain our independence when required?*  
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The AICPA Statement on Quality Control Standards (SQCS) No. 4, *System of Quality Control for a CPA Firm’s Accounting and*

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*Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 20.09), includes the following requirement:

Policies and procedures should be established to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances.

The professional standards do not describe how a firm should establish compliance with these requirements. However, in regards to independence matters, a CPA firm should consider the following.

- *Establish “plain English” independence policies and procedures.* Written policies and procedures are an important first step toward ensuring compliance with the independence rules. These policies should be written in a manner that is easy to read and understand.
- *Designate a partner-in-charge.* There are two reasons why a firm might wish to designate a partner in charge of independence matters. First, firm members who have questions about independence matters need to have someone to turn to for answers. It helps if they know there is one person in charge. Additionally, the independence rules are complicated and subject to change. A firm is more likely to have a good understanding of the independence rules when one person is specifically assigned the responsibility for monitoring and complying with the rules.
- *Communicate and train.* The firm’s independence policies and procedures must be communicated throughout the firm. Periodic training on these matters will help ensure understanding and compliance.
- *Maintain a list of restricted entities.* Firm personnel must be independent with respect to the firm’s restricted entities. It is important for the firm to maintain a database or list of all clients (and certain related entities) for whom the firm performs services requiring independence. Policies and procedures should exist for keeping the list current.



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- *Obtain written representations from firm personnel.* Many firms require their personnel to execute and return to the firm an independence representation in which the firm member affirms that he or she is independent with respect to the firm's restricted entities. Typically, these representations are completed annually.
  - *Resolve apparent independence violations.* The firm should have procedures for resolving apparent independence violations that are reported by firm personnel.

## Recent Developments

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### *What are the recent changes to the independence rules?*

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Auditor independence continues to draw the attention of those responsible for oversight of the profession. The year 2000 included many significant developments in independence matters, most notably in the area of nonattest services. Many of these developments resulted in new rules and interpretations; others are still in the planning stages.

## AICPA Independence Rule Changes

During the past year, the most significant changes to the AICPA independence rules included the following.

- *Performance of nonattest services.* In April 2000, the AICPA modified Ethics Interpretation No. 101-3, which provides guidance on the performance of nonattest services to restricted entities. See the section of this Alert titled "Nonattest Services" for a discussion of the new rule.
- *Previous employment.* A member or member's firm will not be in violation of the independence rules solely because he or she was formerly associated with the client, as long as the individual has dissociated himself or herself from the client (see Ethics Interpretation No. 101-9). In May 2000 the AICPA modified an ethics Interpretation to provide additional guidance on how a member should dissociate

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himself or herself from a former employer when that entity becomes a restricted entity of the firm.

- *Spouse's participation in an employee benefit plan.* The AICPA significantly revised its rules relating to independence and the participation by a member's spouse or dependent in a retirement plan sponsored by a client (see Ethics Ruling No. 108). See the section of this Alert titled "Additional Rules for Certain Family Members" for a discussion of the new rule.

## **Public-Company Independence Initiatives**

### **The SEC**

Auditors of public companies will have to comply with the independence standards issued by the SEC and the ISB, in addition to those of the AICPA. Conceptually, the SEC and ISB rules relating to independence are similar to the AICPA rules, but they do differ in certain specific ways, often by being more restrictive.

In November 2000 the SEC adopted amendments to its auditor independence requirements. Specifically, it amended Rule 2-01 of regulation S-X and Item 9 of Schedule 14A under the Securities Exchange Act of 1934. These amendments are intended to modernize the SEC's rules for determining whether an auditor is independent in light of—

- Investments by auditors or their family members in audit clients.
- Employment relationships between auditors or their family members and audit clients.
- The scope of services provided by audit firms to their audit clients.

Visit the SEC's Web site at [www.sec.gov/rules/final/33-7919.htm](http://www.sec.gov/rules/final/33-7919.htm) for the final rules. See appendix C of this Alert for an excerpt from the amendments to the SEC independence rules.

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## ISB

During the past year, the ISB issued two new independence standards:

1. ISB Standard No. 2, *Certain Independence Implications of Audits of Mutual Funds and Related Entities*. This standard addresses independence matters related to audit firms that audit mutual funds.
2. ISB Standard No. 3, *Employment with Audit Clients*. This standard addresses independence issues when CPA firm professionals join firm audit clients. The assumption is that the firm's independence may be impaired with respect to such clients because the former firm professional's knowledge of and relationships with the audit firm may adversely influence the quality or effectiveness of the audit. This assumption may be overcome if certain steps are taken to eliminate such a risk. This standard describes the safeguards that firms should implement under these circumstances.

The following Interpretations were issued by the ISB during 2000:

1. ISB Interpretation 00-1, *ISB No. 1 and Secondary Auditors*
2. ISB Interpretation 00-2, *An Amendment of Interpretation 00-1*

**Help Desk** —The full text of these standards and Interpretations, along with information about other ISB publications and exposure drafts, are posted on the ISB's Web site at [www.cpaindependence.org/pubs\\_db.php3](http://www.cpaindependence.org/pubs_db.php3).

## SEC Practice Section of the AICPA

The SEC Practice Section of the AICPA (SECPS) revised its membership rules to focus on quality control issues related to independence matters. The rules require member firms of the SECPS to, among other things—

- Establish independence policies.

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- Make their independence policies available to each professional.
  - Provide independence training to professionals at the time of employment and periodically thereafter.
  - Maintain a database to include all restricted entities.
  - Designate a partner responsible for overseeing the firm's independence matters and establish procedures to follow up on violations.
  - Require that the restricted entity list be reviewed by each professional before the individual acquires any security, obtains a loan, opens or modifies a brokerage account, or enters into business relationships.
  - Require each professional to sign an independence confirmation near the time of employment and annually thereafter.
  - Require each professional to report apparent violations and the related corrective action to be taken.

Only firms that are members of the SECPS need to comply with these rules; however, other firms may find the recommendations to be useful in promoting an awareness of and appreciation for the independence rules and in establishing policies to help ensure the independence of their professionals.

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### **Executive Summary—Recent Developments**

- Independence standard-setters have had a busy year, particularly on matters relating to the performance of nonattest services.
  - The SEC has adopted revisions to its rules on auditor independence that affect CPA firms, particularly in the area of nonattest services.
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## AICPA—At Your Service

*How can I order AICPA products? What other AICPA services may be of interest to me?*

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### **Order Department (Member Satisfaction)**

To order AICPA products, call (888) 777-7077; write to AICPA Order Department, CLA10, P.O. Box 2209, Jersey City, NJ 07303-2209; or fax (800) 362-5066. For best results, call Monday through Friday between 8:30 a.m. and 7:30 p.m. EST. Obtaining product information and placing online orders can be done at the AICPA's Web site, [www.aicpa.org](http://www.aicpa.org).

### **Independence Publications and Training**

The following new AICPA products provide guidance on independence matters:

- *Independence* CD-ROM, by Michael Ramos (Product No. 739035). This interactive CD-ROM course in independence reviews the AICPA independence rules (including the newly issued SECPS independence requirements), SEC regulations on independence, and ISB standards. Successful completion of the course qualifies for six hours of CPE credits. For further information, see [www.aicpa.org](http://www.aicpa.org).
- *Plain English Guide to Independence*. This guide provides a plain English explanation of basic independence rules. The Guide is available on the AICPA Web site only under the Ethics team section.

### **Ethics Hotline**

Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. Call (888) 777-7077.

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## Web Site

The AICPA has a home page on the World Wide Web. AICPA Online, the Web site ([www.aicpa.org](http://www.aicpa.org)), offers CPAs the unique opportunity to stay abreast of developments in accounting and auditing, including exposure drafts. The Ethics Team section contains recent developments relating to independence matters.

## New! Online CPE Offer!

The AICPA has launched a new online learning library, AICPA InfoBytes. An annual fee (\$95 for members and \$295 for non-members) will offer unlimited access to over 1,000 hours of on-line CPE in one- and two-hour segments. Register today as our guest at <http://infobytes.aicpaservices.org>.

## CD-ROM Library

The AICPA is currently offering a new CD-ROM product, titled *reSource: AICPA's Accounting and Auditing Literature*. This CD-ROM enables subscription access to the following AICPA Professional Literature products in a Windows format: *Professional Standards*, *Technical Practice Aids*, and *Audit and Accounting Guides* (available for purchase as a set, which includes all Guides and the related Audit Risk Alerts, or as individual publications). This dynamic product allows you to purchase the specific titles you need and includes hypertext links to references within and between all products. To order any publications included on the CD-ROM, call (888) 777-7077.

Practitioners Publishing Company (PPC) and the AICPA are currently offering publications issued by PPC, the AICPA, and the Financial Accounting Standards Board (FASB) on one CD-ROM disk, titled *The Practitioner's Library—Accounting and Auditing*. The FASB publications include *Original Pronouncements*, *Current Text*, *Emerging Issues Task Force Abstracts*, and *FASB Implementation Guides*; and the AICPA publications include *Professional Standards*, *Technical Practice Aids*, *Audit and Accounting Guides*, and *Peer Review Program Manual*. The disk also contains eighteen PPC engagement manuals. The disk may be customized

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so that purchasers pay for and receive only selected segments of the material. For more information about this product call (800) 323-8724.

***Further Assistance on Independence Matters***

As specific services and situations arise in practice, refer to the independence literature and consult with those responsible for independence in your firm. If you need further assistance researching your question, contact one of the following independence standard-setters for guidance:

- *AICPA*. The Web site address for information about the AICPA's standard-setting activities is [www.aicpa.org/members/div/ethics/index.htm](http://www.aicpa.org/members/div/ethics/index.htm). The AICPA Code of Professional Conduct is available at [www.aicpa.org/about/code/index.htm](http://www.aicpa.org/about/code/index.htm). For independence inquiries by phone call (888) 777-7077. Send e-mail inquiries to [ethics@aicpa.org](mailto:ethics@aicpa.org). Information on the independence quality control requirements of the AICPA SEC Practice Section is available at [www.aicpa.org/members/div/secps/inmerefinal.htm](http://www.aicpa.org/members/div/secps/inmerefinal.htm).
- *Independence Standards Board (ISB)*. The Web site address is [www.cpaindependence.org](http://www.cpaindependence.org) and lists ISB Standards, Interpretations, meeting notices, agendas, minutes, exposure drafts, and discussion memoranda. For independence inquiries call (212) 596-6133, fax (212) 596-6137, or e-mail the staff (form available on the ISB Web site).
- *Securities and Exchange Commission (SEC)*. For information on current rule-making visit the Web site, [www.sec.gov/rules/final/33-7919.htm](http://www.sec.gov/rules/final/33-7919.htm). Regulation S-X, Rule 2-01, *Qualifications of Accountants*,<sup>1</sup> is available at <http://auditorindependence.org/content/secrules.doc>. For

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1. Securities and Exchange Commission (SEC) rule-making and interpretative releases, SEC administrative decisions, SEC no-action letters, and other relevant materials, such as SEC and industry reports and studies, are available for sale through Commerce Clearing House at [www.cch.com](http://www.cch.com).



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independence inquiries, call (202) 942-4400 (most inquiries on independence are handled by the ISB).

Also, these selected federal agencies may serve as resources for further information:

- *Department of Labor (DOL)*. Obtain DOL Regulation 2509.75-9, *Interpretive Bulletin Relating to Guidelines on Independence of Accountant Retained by Employee Benefit Plan*, from the DOL at [http://www.dol.gov/dol/allcfr/PWBA/Title\\_29/Part\\_2509/29CFR2509.75-9.htm](http://www.dol.gov/dol/allcfr/PWBA/Title_29/Part_2509/29CFR2509.75-9.htm). Direct inquiries to the Office of the Chief Accountant Help Desk at (212) 219-8770.
- *General Accounting Office (GAO)*. Obtain the GAO Yellow Book requirements at: <http://www.gao.gov/govaud/yb-html/index.html>. Direct inquiries to the Project Manager for Government Auditing Standards at (202) 512-9535 or e-mail to [yellowbook@gao.gov](mailto:yellowbook@gao.gov).
- *Federal Deposit Insurance Corporation (FDIC)*. Obtain the FDIC regulations (12 CFR Part 363), *Annual Independent Audits and Reporting Requirements*, at <http://www.fdic.gov/regulations/laws/rules/2000-8500.html#2000part363>.

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## APPENDIX B

### ***References to Applicable Independence Standards Cited in This Alert***

The following list references you to the AICPA independence standards cited throughout this Alert.

#### **AICPA Ethics Interpretations**

- Interpretation No. 101-1, “Interpretation of Rule 101,” of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.02)
- Interpretation No. 101-2, “Former Practitioners and Firm Independence,” of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.04)
- Interpretation No. 101-3, “Performance of Other Services,” of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05)
- Interpretation No. 101-5, “Loans from Financial Institution Clients and Related Terminology,” of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.07)
- Interpretation No. 101-9, “The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence,” of ET section 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.11)

#### **Ethics Rules**

- Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101)

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- Rule 302, *Contingent Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 302.01)
  - Rule 503, *Commissions and Referral Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 503.01)

## **Ethics Rulings**

- Ethics Ruling No. 25, “Commission and Contingent Fee Arrangements with Nonattest Clients,” of ET section 391, *Ethics Rulings on Responsibilities to Clients* (AICPA, *Professional Standards*, vol. 2, ET sec. 391.049)
- Ethics Ruling No. 29, “Member as Bondholder,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, vol. 2, ET sec. 191.057-.058).
- Ethics Ruling No. 36, “Participant in Investment Club,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 191.071-.072)
- Ethics Ruling No. 52, “Unpaid Fees,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 191.103-.104)
- Ethics Ruling No. 66, “Member’s Retirement or Savings Plan Has Financial Interest in Client,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 191.132-.133)
- Ethics Ruling No. 68, “Blind Trust,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 191.136-.137)
- Ethics Ruling No. 79, “Member’s Investment in a Partnership That Invests in Member’s Client,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity*

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(AICPA, *Professional Standards*, vol. 2, ET sec. 191.158-.159)

- Ethics Ruling No. 108, “Participation of Member or Spouse in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 191.216-.217)
- Ethics Ruling No. 192, “Commission and Contingent Fee Arrangements with Nonattest Clients,” of ET section 591, *Ethics Rulings on Other Responsibilities and Practices* (AICPA, *Professional Standards*, vol. 2, ET sec. 591.383)

### **Statements on Quality Control Standards (SQCSs)**

- SQCS No. 4, *System of Quality Control for a CPA Firm’s Accounting and Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 20.09)

### **Statements on Standards for Accounting and Review Services (SSARSs)**

- SSARS 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100)

***SEC Amendments to Auditor Independence  
Rules***

This section has been adapted from the SEC 's final rule revisions on auditor independence. In general, the rules are effective February 5, 2001 (there are transition dates for certain situations). Visit the SEC's Web site at [www.sec.gov/rules/final/33-7919.htm](http://www.sec.gov/rules/final/33-7919.htm) for the complete rule revisions on auditor independence.

**X. Statutory Bases and Text of Amendments**

***Text of Amendments***

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

**PART 210 - FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975**

1. The heading for Part 210 is revised as set forth above.
2. The authority citation for Part 210 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 78c, 78j-1, 78l, 78m, 78n, 78o(d), 78q, 78u-5, 78w(a), 78ll, 78mm, 79e(b), 79j(a), 79n, 79t(a), 80a-8, 80a-20, 80a-29, 80a-30, 80a-37(a), 80b-3, 80b-11 unless otherwise noted.

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3. By amending § 210.2-01 by adding a Preliminary Note and paragraphs (d), (e) and (f) and revising paragraphs (b) and (c) to read as follows:

§ 210.2-01 Qualifications of accountants.

Preliminary Note to § 210.2-01

Rule 2-01 is designed to ensure that auditors are qualified and independent of their audit clients both in fact and in appearance. Accordingly, the rule sets forth restrictions on financial, employment, and business relationships between an accountant and an audit client and restrictions on an accountant providing certain non-audit services to an audit client.

Rule 2-01(b) sets forth the general standard of auditor independence. Paragraphs (c)(1) to (c)(5) reflect the application of the general standard to particular circumstances. The rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in paragraph 2-01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: (a) creates a mutual or conflicting interest between the accountant and the audit client; (b) places the accountant in the position of auditing his or her own work; (c) results in the accountant acting as management or an employee of the audit client; or (d) places the accountant in a position of being an advocate for the audit client.

These factors are general guidance only and their application may depend on particular facts and circumstances. For that reason, Rule 2-01 provides that, in determining whether an accountant is independent, the Commission will consider all relevant facts and circumstances. For the same reason, registrants and accountants are encouraged to consult with the Commission's Office of the Chief Accountant before entering into relationships, including relationships involving the provision of services, that are not explicitly described in the Rule.

(a) \* \* \*

(b) The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those

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relating to reports filed with the Commission.

(c) This paragraph sets forth a non-exclusive specification of circumstances inconsistent with paragraph (b) of this section.

(1) Financial relationships. An accountant is not independent if, at any point during the audit and professional engagement period, the accountant has a direct financial interest or a material indirect financial interest in the accountant's audit client, such as:

(i) Investments in audit clients. An accountant is not independent when:

(A) The accounting firm, any covered person in the firm, or any of his or her immediate family members, has any direct investment in an audit client, such as stocks, bonds, notes, options, or other securities. The term direct investment includes an investment in an audit client through an intermediary if:

(1) The accounting firm, covered person, or immediate family member, alone or together with other persons, supervises or participates in the intermediary's investment decisions or has control over the intermediary; or

(2) The intermediary is not a diversified management investment company, as defined by Section 5(b)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-5(b)(1), and has an investment in the audit client that amounts to 20% or more of the value of the intermediary's total investments.

(B) Any partner, principal, shareholder, or professional employee of the accounting firm, any of his or her immediate family members, any close family member of a covered person in the firm, or any group of the above persons has filed a Schedule 13D or 13G (17 CFR 240.13d-101 or 240.13d-102) with the Commission indicating beneficial ownership of more than five percent of an audit client's equity securities or controls an audit client, or a close family member of a partner, principal, or shareholder of the accounting firm controls an audit client.

(C) The accounting firm, any covered person in the firm, or any of his or her immediate family members, serves as voting trustee of a trust, or executor of an estate, containing the securities of an audit client, unless the accounting firm, covered person in the firm, or immediate family member has no authority to make investment decisions for the trust or estate.

(D) The accounting firm, any covered person in the firm, any of his or her immediate family members, or any group of the above persons has any material indirect investment in an audit client. For purposes of this paragraph, the term material indirect investment does not include ownership by any covered person

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in the firm, any of his or her immediate family members, or any group of the above persons of 5% or less of the outstanding shares of a diversified management investment company, as defined by Section 5(b)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-5(b)(1), that invests in an audit client.

(E) The accounting firm, any covered person in the firm, or any of his or her immediate family members:

(1) Has any direct or material indirect investment in an entity where:

(i) An audit client has an investment in that entity that is material to the audit client and has the ability to exercise significant influence over that entity; or

(ii) The entity has an investment in an audit client that is material to that entity and has the ability to exercise significant influence over that audit client;

(2) Has any material investment in an entity over which an audit client has the ability to exercise significant influence; or

(3) Has the ability to exercise significant influence over an entity that has the ability to exercise significant influence over an audit client.

(ii) Other financial interests in audit client. An accountant is not independent when the accounting firm, any covered person in the firm, or any of his or her immediate family members has:

(A) Loans/debtor-creditor relationship. Any loan (including any margin loan) to or from an audit client, or an audit client's officers, directors, or record or beneficial owners of more than ten percent of the audit client's equity securities, except for the following loans obtained from a financial institution under its normal lending procedures, terms, and requirements:

(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; and

(4) A mortgage loan collateralized by the borrower's primary residence provided the loan was not obtained while the covered person in the firm was a covered person.

(B) Savings and checking accounts. Any savings, checking, or similar account



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at a bank, savings and loan, or similar institution that is an audit client, if the account has a balance that exceeds the amount insured by the Federal Deposit Insurance Corporation or any similar insurer, except that an accounting firm account may have an uninsured balance provided that the likelihood of the bank, savings and loan, or similar institution experiencing financial difficulties is remote.

(C) Broker-dealer accounts. Brokerage or similar accounts maintained with a broker-dealer that is an audit client, if:

(1) Any such account includes any asset other than cash or securities (within the meaning of “security” provided in the Securities Investor Protection Act of 1970 (“SIPA”) (15 U.S.C. 78aaa et seq.));

(2) The value of assets in the accounts exceeds the amount that is subject to a Securities Investor Protection Corporation advance, for those accounts, under Section 9 of SIPA (15 U.S.C. 78fff-3); or

(3) With respect to non-U.S. accounts not subject to SIPA protection, the value of assets in the accounts exceeds the amount insured or protected by a program similar to SIPA.

(D) Futures commission merchant accounts. Any futures, commodity, or similar account maintained with a futures commission merchant that is an audit client.

(E) Credit cards. Any aggregate outstanding credit card balance owed to a lender that is an audit client that is not reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period.

(F) Insurance products. Any individual policy issued by an insurer that is an audit client unless:

(1) The policy was obtained at a time when the covered person in the firm was not a covered person in the firm; and

(2) The likelihood of the insurer becoming insolvent is remote.

(G) Investment companies. Any financial interest in an entity that is part of an investment company complex that includes an audit client.

(iii) Exceptions. Notwithstanding paragraphs (c)(1)(i) and (c)(1)(ii) of this section, an accountant will not be deemed not independent if:

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(A) **Inheritance and gift.** Any person acquires an unsolicited financial interest, such as through an unsolicited gift or inheritance, that would cause an accountant to be not independent under paragraph (c)(1)(i) or (c)(1)(ii) of this section, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the person has knowledge of and the right to dispose of the financial interest.

(B) **New audit engagement.** Any person has a financial interest that would cause an accountant to be not independent under paragraph (c)(1)(i) or (c)(1)(ii) of this section, and:

(1) The accountant did not audit the client's financial statements for the immediately preceding fiscal year; and

(2) The accountant is independent under paragraph (c)(1)(i) and (c)(1)(ii) of this section before the earlier of:

(i) Signing an initial engagement letter or other agreement to provide audit, review, or attest services to the audit client; or

(ii) Commencing any audit, review, or attest procedures (including planning the audit of the client's financial statements).

(C) **Employee compensation and benefit plans.** An immediate family member of a person who is a covered person in the firm only by virtue of paragraphs (f)(11)(iii) or (f)(11)(iv) of this section has a financial interest that would cause an accountant to be not independent under paragraph (c)(1)(i) or (c)(1)(ii) of this section, and the acquisition of the financial interest was an unavoidable consequence of participation in his or her employer's employee compensation or benefits program, provided that the financial interest, other than unexercised employee stock options, is disposed of as soon as practicable, but no later than 30 days after the person has the right to dispose of the financial interest.

(iv) **Audit clients' financial relationships.** An accountant is not independent when:

(A) **Investments by the audit client in the accounting firm.** An audit client has, or has agreed to acquire, any direct investment in the accounting firm, such as stocks, bonds, notes, options, or other securities, or the audit client's officers or directors are record or beneficial owners of more than 5% of the equity securities of the accounting firm.

(B) **Underwriting.** An accounting firm engages an audit client to act as an underwriter, broker-dealer, market-maker, promoter, or analyst with respect to securities issued by the accounting firm.

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(2) **Employment relationships.** An accountant is not independent if, at any point during the audit and professional engagement period, the accountant has an employment relationship with an audit client, such as:

(i) **Employment at audit client of accountant.** A current partner, principal, shareholder, or professional employee of the accounting firm is employed by the audit client or serves as a member of the board of directors or similar management or governing body of the audit client.

(ii) **Employment at audit client of certain relatives of accountant.** A close family member of a covered person in the firm is in an accounting role or financial reporting oversight role at an audit client, or was in such a role during any period covered by an audit for which the covered person in the firm is a covered person.

(iii) **Employment at audit client of former employee of accounting firm.** A former partner, principal, shareholder, or professional employee of an accounting firm is in an accounting role or financial reporting oversight role at an audit client, unless the individual:

(A) Does not influence the accounting firm's operations or financial policies;

(B) Has no capital balances in the accounting firm; and

(C) Has no financial arrangement with the accounting firm other than one providing for regular payment of a fixed dollar amount (which is not dependent on the revenues, profits, or earnings of the accounting firm):

(1) Pursuant to a fully funded retirement plan, rabbi trust, or, in jurisdictions in which a rabbi trust does not exist, a similar vehicle; or

(2) In the case of a former professional employee who was not a partner, principal, or shareholder of the accounting firm and who has been disassociated from the accounting firm for more than five years, that is immaterial to the former professional employee.

(iv) **Employment at accounting firm of former employee of audit client.** A former officer, director, or employee of an audit client becomes a partner, principal, shareholder, or professional employee of the accounting firm, unless the individual does not participate in, and is not in a position to influence, the audit of the financial statements of the audit client covering any period during which he or she was employed by or associated with that audit client.

(3) **Business relationships.** An accountant is not independent if, at any point during the audit and professional engagement period, the accounting firm or

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any covered person in the firm has any direct or material indirect business relationship with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client's officers, directors, or substantial stockholders. The relationships described in this paragraph do not include a relationship in which the accounting firm or covered person in the firm provides professional services to an audit client or is a consumer in the ordinary course of business.

(4) Non-audit services. An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client:

(i) Bookkeeping or other services related to the audit client's accounting records or financial statements.

(A) Any service involving:

- (1) Maintaining or preparing the audit client's accounting records;
- (2) Preparing the audit client's financial statements that are filed with the Commission or form the basis of financial statements filed with the Commission; or
- (3) Preparing or originating source data underlying the audit client's financial statements.

(B) Notwithstanding paragraph (c)(4)(i)(A) of this section, the accountant's independence will not be impaired when the accountant provides these services:

- (1) In emergency or other unusual situations, provided the accountant does not undertake any managerial actions or make any managerial decisions; or
- (2) For foreign divisions or subsidiaries of an audit client, provided that:
  - (i) The services are limited, routine, or ministerial;
  - (ii) It is impractical for the foreign division or subsidiary to make other arrangements;
  - (iii) The foreign division or subsidiary is not material to the consolidated financial statements;
  - (iv) The foreign division or subsidiary does not have employees capable or competent to perform the services;
  - (v) The services performed are consistent with local professional ethics rules;

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and

(vi) The fees for all such services collectively (for the entire group of companies) do not exceed the greater of 1% of the consolidated audit fee or \$10,000.

(ii) Financial information systems design and implementation.

(A) Directly or indirectly operating, or supervising the operation of, the audit client's information system or managing the audit client's local area network.

(B) Designing or implementing a hardware or software system that aggregates source data underlying the financial statements or generates information that is significant to the audit client's financial statements taken as a whole, unless:

(1) The audit client's management has acknowledged in writing to the accounting firm and the audit client's audit committee, or if there is no such committee then the board of directors, the audit client's responsibility to establish and maintain a system of internal accounting controls in compliance with Section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2));

(2) The audit client's management designates a competent employee or employees, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;

(3) The audit client's management makes all management decisions with respect to the design and implementation of the hardware or software system including, but not limited to, decisions concerning the systems to be evaluated and selected, the controls and system procedures to be implemented, the scope and timetable of system implementation, and the testing, training, and conversion plans;

(4) The audit client's management evaluates the adequacy and results of the design and implementation of the hardware or software system; and

(5) The audit client's management does not rely on the accountant's work as the primary basis for determining the adequacy of its internal controls and financial reporting systems.

(C) Nothing in this paragraph (c)(4)(ii) shall limit services an accountant performs in connection with the assessment, design, and implementation of internal accounting controls and risk management controls, provided the auditor does not act as an employee or perform management functions.

(iii) Appraisal or valuation services or fairness opinions.

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(A) Any appraisal service, valuation service, or any service involving a fairness opinion for an audit client, where it is reasonably likely that the results of these services, individually or in the aggregate, would be material to the financial statements, or where the results of these services will be audited by the accountant during an audit of the audit client's financial statements.

(B) Notwithstanding paragraph (c)(4)(iii)(A) of this section, the accountant's independence will not be impaired when:

(1) The accounting firm's valuation expert reviews the work of the audit client or a specialist employed by the audit client, and the audit client or the specialist provides the primary support for the balances recorded in the client's financial statements;

(2) The accounting firm's actuaries value an audit client's pension, other post-employment benefit, or similar liabilities, provided that the audit client has determined and taken responsibility for all significant assumptions and data;

(3) The valuation is performed in the context of the planning and implementation of a tax-planning strategy or for tax compliance services; or

(4) The valuation is for non-financial purposes where the results of the valuation do not affect the financial statements.

(iv) Actuarial services.

(A) Any actuarially-oriented advisory service involving the determination of insurance company policy reserves and related accounts for the audit client, unless:

(1) The audit client uses its own actuaries or third-party actuaries to provide management with the primary actuarial capabilities;

(2) Management accepts responsibility for any significant actuarial methods and assumptions; and

(3) The accountant's involvement is not continuous.

(B) Subject to complying with paragraph (c)(4)(iv)(A)(1) - (3) of this section, the accountant's independence will not be impaired if the accountant:

(1) Assists management to develop appropriate methods, assumptions, and amounts for policy and loss reserves and other actuarial items presented in financial reports based on the audit client's historical experience, current practice, and future plans;

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(2) Assists management in the conversion of financial statements from a statutory basis to one conforming with generally accepted accounting principles;

(3) Analyzes actuarial considerations and alternatives in federal income tax planning; or

(4) Assists management in the financial analysis of various matters, such as proposed new policies, new markets, business acquisitions, and reinsurance needs.

(v) Internal audit services. Either of:

(A) Internal audit services in an amount greater than 40% of the total hours expended on the audit client's internal audit activities in any one fiscal year, unless the audit client has less than \$200 million in total assets. (For purposes of this paragraph, the term internal audit services does not include operational internal audit services unrelated to the internal accounting controls, financial systems, or financial statements.); or

(B) Any internal audit services, or any operational internal audit services unrelated to the internal accounting controls, financial systems, or financial statements, for an audit client, unless:

(1) The audit client's management has acknowledged in writing to the accounting firm and the audit client's audit committee, or if there is no such committee then the board of directors, the audit client's responsibility to establish and maintain a system of internal accounting controls in compliance with Section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2));

(2) The audit client's management designates a competent employee or employees, preferably within senior management, to be responsible for the internal audit function;

(3) The audit client's management determines the scope, risk, and frequency of internal audit activities, including those to be performed by the accountant;

(4) The audit client's management evaluates the findings and results arising from the internal audit activities, including those performed by the accountant;

(5) The audit client's management evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the accountant; and

(6) The audit client's management does not rely on the accountant's work as the primary basis for determining the adequacy of its internal controls.

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(vi) Management functions. Acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.

(vii) Human resources.

(A) Searching for or seeking out prospective candidates for managerial, executive, or director positions;

(B) Engaging in psychological testing, or other formal testing or evaluation programs;

(C) Undertaking reference checks of prospective candidates for an executive or director position;

(D) Acting as a negotiator on the audit client's behalf, such as determining position, status or title, compensation, fringe benefits, or other conditions of employment; or

(E) Recommending, or advising the audit client to hire, a specific candidate for a specific job (except that an accounting firm may, upon request by the audit client, interview candidates and advise the audit client on the candidate's competence for financial accounting, administrative, or control positions).

(viii) Broker-dealer services. Acting as a broker-dealer, promoter, or underwriter, on behalf of an audit client, making investment decisions on behalf of the audit client or otherwise having discretionary authority over an audit client's investments, executing a transaction to buy or sell an audit client's investment, or having custody of assets of the audit client, such as taking temporary possession of securities purchased by the audit client.

(ix) Legal services. Providing any service to an audit client under circumstances in which the person providing the service must be admitted to practice before the courts of a United States jurisdiction.

(5) Contingent fees. An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides any service or product to an audit client for a contingent fee or a commission, or receives a contingent fee or commission from an audit client.

(d) Quality controls. An accounting firm's independence will not be impaired solely because a covered person in the firm is not independent of an audit client provided:



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- (1) The covered person did not know of the circumstances giving rise to the lack of independence;
  - (2) The covered person's lack of independence was corrected as promptly as possible under the relevant circumstances after the covered person or accounting firm became aware of it; and
  - (3) The accounting firm has a quality control system in place that provides reasonable assurance, taking into account the size and nature of the accounting firm's practice, that the accounting firm and its employees do not lack independence, and that covers at least all employees and associated entities of the accounting firm participating in the engagement, including employees and associated entities located outside of the United States.
  - (4) For an accounting firm that annually provides audit, review, or attest services to more than 500 companies with a class of securities registered with the Commission under Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), a quality control system will not provide such reasonable assurance unless it has at least the following features:
    - (i) Written independence policies and procedures;
    - (ii) With respect to partners and managerial employees, an automated system to identify their investments in securities that might impair the accountant's independence;
    - (iii) With respect to all professionals, a system that provides timely information about entities from which the accountant is required to maintain independence;
    - (iv) An annual or on-going firm-wide training program about auditor independence;
    - (v) An annual internal inspection and testing program to monitor adherence to independence requirements;
    - (vi) Notification to all accounting firm members, officers, directors, and employees of the name and title of the member of senior management responsible for compliance with auditor independence requirements;
    - (vii) Written policies and procedures requiring all partners and covered persons to report promptly to the accounting firm when they are engaged in employment negotiations with an audit client, and requiring the firm to remove immediately any such professional from that audit client's engagement and to review promptly all work the professional performed related to that audit client's engagement; and

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(viii) A disciplinary mechanism to ensure compliance with this section.

(e) Transition and grandfathering.

(1) Transition.

(i) Appraisal or valuation services or fairness opinions and internal audit services.

Until [insert date 18 months after the effective date of this section], providing to an audit client the non-audit services set forth in paragraphs (c)(4)(iii) and (c)(4)(v) of this section will not impair an accountant's independence with respect to the audit client if performing those services did not impair the accountant's independence under pre-existing requirements of the Commission, the Independence Standards Boards, or the accounting profession in the United States.

(ii) Other financial interests and employment relationships. Until [insert date 3 months after the effective date of this section], having the financial interests set forth in paragraph (c)(1)(ii) of this section or the employment relationships set forth in paragraph (c)(2) of this section will not impair an accountant's independence with respect to the audit client if having those financial interests or employment relationships did not impair the accountant's independence under pre-existing requirements of the Commission, the Independence Standards Board, or the accounting profession in the United States.

(iii) Quality controls. Until December 31, 2002, paragraph (d)(4) of this section shall not apply to offices of the accounting firm located outside of the United States.

(2) Grandfathering. Financial interests included in paragraphs (c)(1)(ii)(A) and (c)(1)(ii)(F) of this section and employment relationships included in paragraph (c)(2) of this section in existence on [insert date 3 months after the effective date of this section], and contracts for the provision of services described in paragraph (c)(4)(ii) of this section in existence on [insert the effective date of this section] will not be deemed to impair an accountant's independence if they did not impair the accountant's independence under pre-existing requirements of the Commission, the Independence Standards Board, or the accounting profession in the United States.

(3) Settling financial arrangements with former professionals. To the extent not required by pre-existing requirements of the Commission, the Independence Standards Board, or the accounting profession in the United States, the requirement in paragraph (c)(2)(iii) of this section to settle financial arrangements

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with former professionals applies to situations that arise after the effective date of this section.

(f) Definitions of terms. For purposes of this section:

(1) Accountant, as used in paragraphs (b) through (e) of this section, means a certified public accountant or public accountant performing services in connection with an engagement for which independence is required. References to the accountant include any accounting firm with which the certified public accountant or public accountant is affiliated.

(2) Accounting firm means an organization (whether it is a sole proprietorship, incorporated association, partnership, corporation, limited liability company, limited liability partnership, or other legal entity) that is engaged in the practice of public accounting and furnishes reports or other documents filed with the Commission or otherwise prepared under the securities laws, and all of the organization's departments, divisions, parents, subsidiaries, and associated entities, including those located outside of the United States. Accounting firm also includes the organization's pension, retirement, investment, or similar plans.

(3) Accounting role or financial reporting oversight role means a role in which a person is in a position to or does:

(i) Exercise more than minimal influence over the contents of the accounting records or anyone who prepares them; or

(ii) Exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, vice president of marketing, or any equivalent position.

(4) Affiliate of the audit client means:

(i) An entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client's parents and subsidiaries;

(ii) An entity over which the audit client has significant influence, unless the entity is not material to the audit client;

(iii) An entity that has significant influence over the audit client, unless the audit client is not material to the entity; and

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(iv) Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex.

(5) Audit and professional engagement period includes both:

(i) The period covered by any financial statements being audited or reviewed (the “audit period”); and

(ii) The period of the engagement to audit or review the audit client’s financial statements or to prepare a report filed with the Commission (the “professional engagement period”):

(A) The professional engagement period begins when the accountant either signs an initial engagement letter (or other agreement to review or audit a client’s financial statements) or begins audit, review, or attest procedures, whichever is earlier; and

(B) The professional engagement period ends when the audit client or the accountant notifies the Commission that the client is no longer that accountant’s audit client.

(iii) For audits of the financial statements of foreign private issuers, the “audit and professional engagement period” does not include periods ended prior to the first day of the last fiscal year before the foreign private issuer first filed, or was required to file, a registration statement or report with the Commission, provided there has been full compliance with home country independence standards in all prior periods covered by any registration statement or report filed with the Commission.

(6) Audit client means the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client, other than, for purposes of paragraph (c)(1)(i) of this section, entities that are affiliates of the audit client only by virtue of paragraph (f)(4)(ii) or (f)(4)(iii) of this section.

(7) Audit engagement team means all partners, principals, shareholders, and professional employees participating in an audit, review, or attestation engagement of an audit client, including those conducting concurring or second partner reviews and all persons who consult with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events.

(8) Chain of command means all persons who:

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(i) Supervise or have direct management responsibility for the audit, including at all successively senior levels through the accounting firm's chief executive;

(ii) Evaluate the performance or recommend the compensation of the audit engagement partner; or

(iii) Provide quality control or other oversight of the audit.

(9) Close family members means a person's spouse, spousal equivalent, parent, dependent, nondependent child, and sibling.

(10) Contingent fee means, except as stated in the next sentence, any fee established for the sale of a product or 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 product or service. Solely for the purposes of this section, a fee is not a "contingent fee" if it is 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. Fees may vary depending, for example, on the complexity of services rendered.

(11) Covered persons in the firm means the following partners, principals, shareholders, and employees of an accounting firm:

(i) The "audit engagement team;"

(ii) The "chain of command;"

(iii) Any other partner, principal, shareholder, or managerial employee of the accounting firm who has provided ten or more hours of non-audit services to the audit client for the period beginning on the date such services are provided and ending on the date the accounting firm signs the report on the financial statements for the fiscal year during which those services are provided, or who expects to provide ten or more hours of non-audit services to the audit client on a recurring basis; and

(iv) Any other partner, principal, or shareholder from an "office" of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.

(12) Group means two or more persons who act together for the purposes of acquiring, holding, voting, or disposing of securities of a registrant.

(13) Immediate family members means a person's spouse, spousal equivalent, and dependents.

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(14) Investment company complex.

(i) “Investment company complex” includes:

(A) An investment company and its investment adviser or sponsor;

(B) Any entity controlled by or controlling an investment adviser or sponsor in paragraph (f)(14)(i)(A) of this section, or any entity under common control with an investment adviser or sponsor in paragraph (f)(14)(i)(A) of this section if the entity:

(1) Is an investment adviser or sponsor; or

(2) Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any investment company, investment adviser, or sponsor; and

(C) Any investment company or entity that would be an investment company but for the exclusions provided by Section 3(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)) that has an investment adviser or sponsor included in this definition by either paragraph (f)(14)(i)(A) or (f)(14)(i)(B) of this section.

(ii) An investment adviser, for purposes of this definition, does not include a sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser.

(iii) Sponsor, for purposes of this definition, is an entity that establishes a unit investment trust.

(15) Office means a distinct sub-group within an accounting firm, whether distinguished along geographic or practice lines.

(16) Rabbi trust means an irrevocable trust whose assets are not accessible to the accounting firm until all benefit obligations have been met, but are subject to the claims of creditors in bankruptcy or insolvency.

**PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

4. The general authority citation for Part 240 is revised to read, in part, as follows:

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Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11, unless otherwise noted.

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5. By amending § 240.14a-101 to add paragraph (e) to Item 9 to read as follows:

§ 240.14a-101 Schedule 14A Information required in proxy statement.

\* \* \* \* \*

Item 9. Independent public accountants. \* \* \*

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(e)(1) Disclose, under the caption Audit Fees, the aggregate fees billed for professional services rendered for the audit of the registrant's annual financial statements for the most recent fiscal year and the reviews of the financial statements included in the registrant's Forms 10-Q (17 CFR 249.308a) or 10-QSB (17 CFR 249.308b) for that fiscal year.

(2) Disclose, under the caption Financial Information Systems Design and Implementation Fees, the aggregate fees billed for the professional services described in Paragraph (c)(4)(ii) of Rule 2-01 of Regulation S-X (17 CFR 210.2-01(c)(4)(ii)) rendered by the principal accountant for the most recent fiscal year. For purposes of this disclosure item, registrants that are investment companies must disclose fees billed for services rendered to the registrant, the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the adviser that provides services to the registrant.

(3) Disclose, under the caption All Other Fees, the aggregate fees billed for services rendered by the principal accountant, other than the services covered in paragraphs (e)(1) and (e)(2) of this section, for the most recent fiscal year. For purposes of this disclosure item, registrants that are investment companies must disclose fees billed for services rendered to the registrant, the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment

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adviser), and any entity controlling, controlled by, or under common control with the adviser that provides services to the registrant.

(4) Disclose whether the audit committee of the board of directors, or if there is no such committee then the board of directors, has considered whether the provision of the services covered in paragraphs (e)(2) and (e)(3) of this section is compatible with maintaining the principal accountant's independence.

(5) If greater than 50 percent, disclose the percentage of the hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees.



