

December 11, 2006

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5669  
U.S. Department of Labor  
200 Constitution Avenue, NW.  
Washington, DC 20210

**Attn: Independence of Accountant RFI (RIN 1210-AB09)**

The American Institute of Certified Public Accountants (AICPA) is pleased to comment on the Department of Labor's (Department) request for information (RFI) concerning the advisability of amending Interpretive Bulletin 75-9 relating to guidelines on independence of accountants retained by employee benefit plans under section 103(a)(3)(A) of the Employee Retirement Income Security Act of 1974 (ERISA). The AICPA is the largest professional association of certified public accountants in the United States, with approximately 330,000 members in business, industry, public practice, government and education. These comments were prepared by the AICPA Professional Ethics Executive Committee (PEEC), which is the AICPA senior technical committee charged with the responsibility of interpreting and enforcing the AICPA Code of Professional Conduct, and the AICPA Employee Benefit Plan Expert Panel, which addresses emerging practice issues in employee benefit plan financial reporting, auditing, and audit quality issues.

We are pleased that the Department is considering revising its independence guidelines in an effort to modernize its rules. There have been significant changes in the audit profession and the employee benefit plan environment over the past thirty years since the Department issued Interpretive Bulletin 75-9 and, accordingly, as noted in the RFI, other bodies that establish audit independence standards—including the Securities and Exchange Commission, Government Accountability Office (GAO), and AICPA—have in recent years revised their independence rules.

AICPA member firms audit the vast majority of the over 70,000 plans required to have an annual audit under ERISA (ERISA audits). All AICPA member firms that audit employee benefit plans subject to the Employee Retirement Income Security Act (ERISA) must comply with the AICPA *Code of Professional Conduct*, including the independence rules therein, as well as the Department's independence rules. ERISA also requires that the accountant perform the plan's audit in accordance with generally accepted auditing standards (GAAS).

GAAS recognizes that, “*The profession has established, through the AICPA's Code of Professional Conduct, precepts to guard against the presumption of loss of independence...Insofar as these precepts have been incorporated in the profession's code, they have the force of professional law for the independent auditor.*”<sup>1</sup> Accordingly, through its GAAS requirement, we believe ERISA implicitly requires compliance with the AICPA independence standards when performing plan audits

The AICPA’s independence standards are based on the *Conceptual Framework for AICPA Independence Standards*<sup>2</sup> (“Conceptual Framework”) which was adopted in January 2006 after a formal due process, including public exposure and comments. The Conceptual Framework describes a risk-based approach to analyzing independence matters. Under this approach, an independent auditor’s relationship with a client is analyzed to determine whether it poses an unacceptable risk to the auditor’s independence. Risk is unacceptable if the relationship would compromise (or would be perceived as compromising by an informed third party having knowledge of all relevant information) the auditor’s professional judgment when rendering an attest service to the client. Key to that analysis is identifying and assessing the extent to which a threat to the auditor’s independence exists and, if it does, whether it can be effectively mitigated or eliminated. The PEEC has identified seven broad categories of threats that should always be evaluated when threats to independence are being identified and assessed. They are self-review, advocacy, adverse interest, familiarity, undue influence, financial self-interest, and management participation threats. Under the risk-based approach, safeguards (including prohibitions of certain relationships) are prescribed by the rules to eliminate the threats to independence or mitigate them to an acceptable level. If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

Auditor independence is a core tenet of the accounting profession. Since 1931, the AICPA has been issuing standards on auditor independence. The AICPA is dedicated to the independence standard-setting process and ensuring that adequate resources are available to carry out this and related activities. Through its Professional Ethics Executive Committee and staff, the AICPA devotes significant resources to independence activities, including evaluating existing standards, proposing new standards, and interpreting and enforcing those standards. The Professional Ethics Executive Committee comprises twenty members, including three public members and two members of state CPA licensing boards. The remaining members are in public practice and represent a cross-section of our membership (small, medium-size and large multi-national firms). We are firmly committed to working with the Department on auditor independence issues to ensure the quality and integrity of independent audits and the protection of the nation’s employee benefit system.

Below are our responses to the specific questions detailed in the RFI.

### *Specific comments*

**1. Should the Department adopt, in whole or in part, current rules or guidelines on accountant independence of the SEC, AICPA, GAO or other governmental or nongovernmental entity? If the Department were to adopt a specific organization’s**

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<sup>1</sup> See AU Section 220, *Independence* [AU 220.04] of the AICPA Professional Standards.

<sup>2</sup> See [http://www.aicpa.org/about/code/et\\_100.html](http://www.aicpa.org/about/code/et_100.html)

**rules or guidelines, what adjustments would be needed to reflect the audit requirements for or circumstances of employee benefit plans under ERISA?**

The Department should adopt an approach to establishing independence rules and guidelines that is based on a comprehensive framework and set of risk-based principles, and establish a process to ensure that such independence rules and guidelines continue to be interpreted and updated as may become necessary. We strongly encourage the Department to incorporate the AICPA's independence rules and conceptual framework as the foundation for its independence rules for ERISA audits. If the Department adopts the AICPA independence framework, the PEEC commits to work with the Department to address issues specifically related to ERISA audits and to resolve them within the framework of the AICPA independence standards. We recognize that there are some differences between the AICPA's independence rules and the Department's rules established specifically for ERISA audits, and we believe it is in our mutual best interest to minimize or eliminate those differences. The AICPA has a long history of successfully working with the Department in resolving issues of concern to both parties—most notably in the area of accounting and auditing matters—and is committed to devoting the necessary resources to work with the Department in addressing independence issues related to ERISA audits.

The AICPA strives for harmonization of the profession's independence rules with those of other interested parties, recognizing that there may be differences between public and nonpublic companies with respect to the nature and extent of the safeguards necessary to mitigate threats to independence. For example, while certain of the AICPA's independence rules related to nonaudit services are different from those of the SEC and GAO, our rules related to financial interests and employment relationships are comparable. AICPA rules are universally accepted and applied throughout the profession and the Department's adoption of the AICPA rules would result in greater harmonization of the profession's independence rules. A significant number of state boards of accountancy have either adopted or directly refer to the AICPA *Code of Professional Conduct* for purposes of their own independence rules. CPA practitioners who perform ERISA audits must already comply with the AICPA independence rules when performing ERISA audits.

**2. Should the Department modify, or otherwise provide guidance on, the prohibition in Interpretive Bulletin 75-9 on an independent accountant, his or her firm, or a member of the firm having a “direct financial interest” or a “material indirect financial interest” in a plan or plan sponsor? For example, should the Department issue guidance that clarifies whether, and under what circumstances, financial interests held by an accountant's family members are deemed to be held by the accountant or his or her accounting firm for independence purposes? If so, what familial relationships should trigger the imposition of ownership attribution rules? Should the ownership attribution rules apply to all members of the accounting firm retained to perform the audit of the plan or should it be restricted to individuals who work directly on the audit or may be able to influence the audit?**

The Department should adopt independence rules as they relate to the financial interests of the accountant's family members. AICPA independence rules address the financial and employment relationships of the immediate family members (spouse, spousal equivalent and dependents) of “covered members” (See [Appendix A](#) for relevant definitions and AICPA

independence rules applicable to family members, and our response to Question 6 below regarding the applicability of the financial interest restrictions to covered members). Our rules also address the financial and employment relationships of certain close relatives (parents, siblings, or non-dependent children) of a covered member. Our rules are comparable to those of the SEC and prohibit family relationships that pose a threat to the auditor's independence.

**3. Should the Department issue guidance on whether, and under what circumstances, employment of an accountant's family members by a plan or plan sponsor that is a client of the accountant or his or her accounting firm impairs the independence of the accountant or accounting firm?**

The Department should adopt the AICPA independence rules as they relate to the employment relationships of the accountant's family members. The AICPA rules address employment and certain other business relationships between an attest client and a covered member's immediate family and close relatives. The AICPA rules proscribe certain employment relationships between audit clients and a covered member's relatives, such as those employed in "key positions" at the client. (See [Appendix A](#) for relevant definitions and copy of AICPA independence rules for family members.) Our employment relationship rules are comparable to those of the SEC and prohibit employment relationships that pose a threat to the auditor's independence.

**4. Interpretive Bulletin 75-9 states that an accountant will not be considered independent with respect to a plan if the accountant or member of his or her accounting firm maintains financial records for the employee benefit plan. Should the Department define the term "financial records" and provide guidance on what activities would constitute "maintaining" financial records. If so, what definitions should apply?**

The term "financial records" is not used by other independence standard-setters and is not well understood by auditors. The Department should clearly describe the types of "bookkeeping" or "record keeping" activities that would impair independence. If the Department adopts the AICPA independence rules as we recommend, the PEEC commits to work with the Department to amend its current Interpretation 101-3 to specifically identify those services that would and would not impair independence with respect to ERISA audits. See our response to Question 7 below regarding nonaudit services.

**5. Should the Department define the terms "promoter," "underwriter," "investment advisor," "voting trustee," "director," "officer," and "employee of the plan or plan sponsor," as used in Interpretive Bulletin 75-9? Should the Department include and define additional disqualifying status positions in its independence guidelines? If so, what positions and how should they be defined?**

The terms promoter, underwriter, voting trustee, director, officer and employee of the plan or plan sponsor are terms that are used in the SEC rules as well as our rules without definition. We believe they are well understood within the profession and employee benefit plan industry and therefore definitions by the Department are unnecessary. We are not aware of any additional positions that should be included in a disqualifying status position; however, if the Department identifies any additional positions it should describe the authority and responsibilities entailed by the position as well as the position title.

Our rules specifically provide that independence is impaired if, at any time during the period covered by the financial statements or during the period of professional engagement, the firm or a partner or professional employee of the firm was simultaneously associated with the client as (1) a director, officer or employee, or in any capacity equivalent to that of a member of management, (2) promoter, underwriter, or voting trustee, or (3) trustee for any pension or profit-sharing trust of the client.

**6. Interpretive Bulletin 75-9 defines the term “member of an accounting firm” as all partners or shareholder employees in the firm and all professional employees participating in the audit or located in an office of the firm participating in a significant portion of the audit. Should the Department revise and update the definition of “member?” If so, how should the definition be revised and updated?**

We strongly recommend that Department revise its definition of “member of an accounting firm” for purposes of its financial relationship rules and adopt an approach consistent with that of the AICPA and SEC. In 2001, the AICPA and SEC “modernized” their independence rules and adopted an approach whereby only those individuals who participate on the audit engagement or can influence the engagement team and, as a result, the outcome of the engagement (covered members/persons) would be subject to the financial relationship restrictions set forth in the independence rules. The GAO embraced a similar approach as part of its independence rule-making in January 2002. (See [Appendix A](#) for the AICPA’s definition of “covered member.”)

In deliberating which individuals and entities should be subject to the financial-relationship restrictions in the independence rules, the PEEC concluded that individuals and entities in any of the following six categories should be covered members for purposes of applying independence rules because relationships between audit clients and those individuals pose significant threats to independence:

- An individual on the audit engagement team.
- An individual in a position to influence the audit engagement.
- A partner or manager who provides 10 or more hours of nonaudit services to the audit client.
- A partner in the office in which the lead audit engagement partner primarily practices in connection with the audit engagement
- The firm, including the firm’s employee benefit plans.
- Any entity whose operating, financial, or accounting policies can be controlled...by any of the individuals or entities described above or by two or more of those covered members acting together.

**7. What kinds of nonaudit services are accountants and accounting firms engaged to provide to the plans they audit or to the sponsor of plans they audit? Are there benefits for the plan or plan sponsor from entering into agreements to have the accountant or accounting firm provide nonaudit services and also perform the employee benefit plan audit? If so, what are the benefits? Should the Department issue guidance on the circumstances under which the performance of nonaudit services by accountants and accounting firms for the plan or plan sponsor would be treated as impairing an accountant’s independence for purposes of auditing and rendering an opinion on the**

**financial information required to be included in the plan’s annual report? If so, what should the guidance provide?**

The PEEC has devoted significant time and resources to strengthening Interpretation 101-3, *Performance of Nonattest Services*, which addresses independence and the provision of nonaudit services for an audit client (see [Appendix A](#) for a copy of the Interpretation). The underlying premise in Interpretation 101-3 is that an auditor should not perform management functions or make management decisions for an audit client, the responsibility for which remains with client management. Interpretation 101-3 requires the implementation of specific safeguards (“general requirements”) to mitigate management participation and self-review threats when performing nonaudit services for an audit client.

Before an auditor can agree to perform any nonaudit services for an audit client, the client must agree to perform the following functions with respect to the engagement:

- Make all management decisions and perform all management functions;
- Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- Evaluate the adequacy and results of the services performed;
- Accept responsibility for the results of the services; and
- Establish and maintain internal controls, including monitoring ongoing activities.

The Interpretation provides examples of specific activities that would and would not impair independence. Included in these examples are benefit plan administration services; however, the Interpretation recognizes that the Department’s independence regulations may be more restrictive than the AICPA standard (see footnote 10 of the Interpretation) and requires compliance with the Department’s regulations. As previously stated, if the Department adopts our rules as a base, the PEEC would commit to work with the Department to minimize or eliminate those differences.

Interpretation 101-3 permits auditors to perform certain non-audit services, provided safeguards are in place to mitigate the self-review and management participation threats. In addition, the Interpretation would permit an auditor to perform an actuarial valuation of a client's pension or post-employment benefit liabilities since such valuations do not require a significant degree of subjectivity and generally produce reasonably consistent results. The PEEC believes that the self-review threat is sufficiently mitigated because the results would be essentially the same whether the CPA firm’s actuary or another actuary performed the calculation. However, in performing such services, the general requirements of the interpretation must be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

We believe that it is in the public’s interest to allow an auditor to perform certain nonaudit services, such as assisting the plan in developing a set of reliable financial statements, advising the plan in developing sound internal controls over plan assets and accounting functions, and providing tax and regulatory compliance services, including preparing the plan’s Form 5500, Form 990 or other regulatory filings, and assisting in preparing the plan’s summary annual report. The auditor not only has in-depth knowledge of the client’s financial and operating activities, but also understands the client’s unique operating environment.

Many entities have limited resources, and if restricted from engaging their auditors to perform certain nonaudit services, plans would lose the efficiencies that are inherent in having one service provider.

We also believe it is appropriate to address the provision of nonaudit services performed for the plan sponsor and how such services may impact the plan's independence.

**8. Interpretive Bulletin 75-9 requires an auditor to be independent during the period of professional engagement to examine the financial statements being reported, at the date of the opinion, and during the period covered by the financial statements. Should the Department change the Interpretive Bulletin to remove or otherwise provide exceptions for “the period covered by the financial statements” requirement? For example, should the requirement be changed so that an accountant’s independence would be impaired by a material direct financial interest in the plan or plan sponsor during the period covered by the financial statements rather than any direct financial interest?**

Interpretive Bulletin 75-9 prohibits the auditor from having any direct or material indirect financial interest in the plan or plan sponsor during the period of professional engagement to examine the financial statements being reported, at the date of the opinion, and during the period covered by the financial statements. This differs from AICPA, SEC, and GAO rules, which permit an audit firm to audit the financial statements of an entity if the auditor had a financial interest in such entity, provided that the financial interest was disposed of prior to the period of the professional engagement (prior to signing the initial audit engagement letter or commencing audit procedures). Any threat to the auditor's independence is eliminated once the financial interest in the client is disposed of and, therefore, provided such disposition occurs prior to the performance of any audit procedures or formal agreement to perform the audit engagement, independence should not be considered impaired.

As a practical matter, the current requirements restrict the ability of plans to change auditors and often prevent the simultaneous change of auditors for the plan and the plan sponsor. We strongly recommend that the Department revise its independence rules to be consistent with other standard-setters as well as the AICPA in this area.

**9. Should there be special provisions in the Department’s independence guidelines for plans that have audit committees that hire and monitor an auditor’s independence, such as the audit committees described in the Sarbanes-Oxley Act applicable to public companies?**

No. We believe that most ERISA plans that are subject to independent audit do not have audit committees. Plan sponsors that have plans required to file Form 11-K with the SEC are already subject to Sarbanes-Oxley rules governing the role of their audit committee, including the responsibility for hiring the plan's independent auditor and approving all nonaudit services provided by the auditor.

**10. What types and level of fees, payments, and compensation are accountants and accounting firms receiving from plans they audit and sponsors of plans they audit for audit and nonaudit services provided to the plan? Should the Department issue guidance regarding whether receipt of particular types of fees, such as contingent fees and other fees and compensation received from parties other than the plan or plan sponsor, would be treated as impairing an accountant’s independence for purposes of**

**auditing and rendering an opinion on the financial information required to be included in the plan’s annual report?**

AICPA Rule 302, *Contingent Fees*, and Rule 503, *Commissions and Referral Fees*, would prohibit an accountant or accounting firm from accepting a contingent fee from an employee benefit plan audit client or from receiving a commission from a third party on behalf of such a client. In addition, the SEC and most state boards of accountancy prohibit such fee arrangements. Accordingly, we do not believe it is necessary for the Department to include such guidance in its independence rules.

**11. Should the Department define the term “firm” in Interpretive Bulletin 75-9 or otherwise issue guidance on the treatment of subsidiaries and affiliates of an accounting firm in evaluating the independence of an accounting firm and members of the firm? If so, what should the guidance provide regarding subsidiaries and affiliates in the evaluation of the independence of an accountant or accounting firm?**

The AICPA extends its independence rules to cover the firm’s employee benefit plans as well as any entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles for consolidation purposes) by the firm or members of the firm, individually or collectively. AICPA has also adopted detailed guidance addressing the applicability of the independence rules to members who practice in “alternative practice structures” (see Interpretation 101-14—*The effect of alternative practice structures on the applicability of independence rules*). In addition, the PEEC recently formed a task force to consider extending the definition of firm to cover those entities that are part of a larger structure and meet criteria to be considered part of a “network firm,” a notion recently incorporated into the Code of Ethics of the International Federation of Accountants.

Because firms continue to change and evolve, we encourage the Department to monitor these developments and work with the AICPA to issue guidance, if and when necessary. It should be noted that the SEC, as part of its 2003 independence rule-making, considered defining the term “affiliate of the accounting firm” and concluded that this proved to be “one of the most controversial aspects” of the proposed rule. The SEC ultimately decided not to adopt the definition of “affiliate of the accounting firm” on the basis that the definition as proposed “could have unintended consequences, and that varying criteria of affiliation could be appropriate depending on the regulatory context in which the issue of attribution arises.” We agree with the SEC’s conclusion that such affiliations should be considered in light of all relevant facts and circumstances.

**12. Should the Department’s independence guidance include an “appearance of independence” requirement in addition to the requirement that applies by reason of the ERISA requirement that the accountant perform the plan’s audit in accordance with GAAS?**

As noted in our response to Question 1 above, ERISA requires that the accountant perform the plan’s audit in accordance with GAAS. AU Section 220, *Independence* under GAAS recognizes that an auditor must be independent in fact and appearance: “*Independent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence.*” Therefore, the Department arguably already



incorporates the requirement that the accountant be independent in both fact and appearance. In addition, the *Conceptual Framework for AICPA Independence Standards* and the AICPA independence interpretations and rulings based on such framework, recognize that an auditor must be independent in both fact and appearance and the independence rules of the AICPA *Code of Professional Conduct* incorporate the “appearance of independence” requirement. Accordingly, we do not believe it is necessary for the Department to include a separate requirement with respect to the appearance of independence.

**13. Should the Department require accountants and accounting firms to have written policies and procedures on independence which apply when performing audits of employee benefit plans? If so, should the Department require those policies and procedures be disclosed to plan clients as part of the audit engagement?**

GAAS relates to the conduct of individual audit engagements, whereas quality control standards relate to the conduct of a firm’s audit practice taken as a whole. Thus, quality control standards are closely related to GAAS. We believe that the AICPA Auditing Standards Board’s proposed Statement on Quality Control Standards, *A Firm’s System of Quality Control*, when finalized, should satisfy any concerns the Department may have regarding written policies and procedures on independence. In addition, AICPA Statement on Auditing Standards No. 114, *The Auditor’s Communication With Those Charged With Governance*, provides auditors with on communicating with those charged with governance circumstances or relationships (for example, financial interests, business or family relationships, or nonaudit services provided or expected to be provided) that in the auditor's professional judgment may reasonably be thought to bear on independence, and that the auditor gave significant consideration to in reaching the conclusion that independence has not been impaired. Accordingly, we do not believe it is necessary for the Department to require separate disclosure of the policies and procedures to clients.

**14. Should the Department adopt formal procedures under which the Department will refer accountants to state licensing boards for discipline when the Department concludes an accountant has conducted an employee benefit plan audit without being independent?**

Yes. We believe it is appropriate for the Department to refer accountants to state boards of accountancy when it identifies violations of the independence rules and also continue to refer any such matters involving AICPA members to the AICPA Professional Ethics Division so that we can enforce our Code of Professional Conduct. The AICPA is interested in working with the Department to establish formal procedures in this area.

**15. Should accountants and accounting firms be required to make any standard disclosures to plan clients about the accountant’s and firm’s independence as part of the audit engagement? If so, what standard disclosures should be required?**

We do not believe that this type of disclosure would be beneficial in all cases and may carry certain cost/benefit implications depending on, for example, whether the client already has an active audit committee in place. Therefore, we believe any such disclosure should be left to the discretion of the auditor and client as to whether such communications should take place and, if so, under what circumstances.

We appreciate the opportunity to comment on the RFI. We are committed to working with the Department in addressing independence issues related to ERISA audits, and we would be pleased to meet with Department representatives to discuss our comments and recommendations.

Sincerely,



Bruce P. Webb  
Chair  
Professional Ethics Executive Committee



Marilee P. Lau  
Chair  
AICPA Employee Benefit Plans Expert Panel

cc: Mr. Ian Dingwall, Chief Accountant, Employee Benefit Security Administration  
Mr. Bradford Campbell, Acting Assistant Secretary, Employee Benefit Security Administration

**Selected Sections of the AICPA Code of Professional Conduct**

**ET Section 92.06**

**Covered member.** A covered member is—

- a. An individual on the attest engagement team;
- b. An **individual in a position to influence the attest engagement**;
- c. A partner or manager who provides nonattest services to the attest client beginning once he or she provides ten hours of nonattest services to the client within any fiscal year and ending on the later of the date (i) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) he or she no longer expects to provide ten or more hours of nonattest services to the attest client on a recurring basis;
- d. A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
- e. The firm, including the firm's employee benefit plans; or
- f. An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described in (a) through (e) or by two or more such individuals or entities if they act together.

**ET Section 92.13**

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

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

**ET Section 92.17**

**Key position.** A key position is a position in which an individual:

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

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

### **ET Section 101.02**

**101-1—Interpretation of Rule 101 [Note: Application to family members only. For full text of Interpretation 101-1, see [http://www.aicpa.org/about/code/et\\_101.html#et\\_101.02](http://www.aicpa.org/about/code/et_101.html#et_101.02)]**

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

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

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

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

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

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

Independence would be considered to be impaired if—

1. An individual participating on the attest engagement team has a **close relative** who had
  - a. A key position with the client, or
  - b. A financial interest in the client that
    - (i) Was material to the close relative and of which the individual has knowledge; or

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

### **Grandfathered Employment Relationships**

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

### **ET Section 101.05**

#### **101-3—Performance of nonattest services.**

Before a member or his or her firm ("member") performs nonattest services (for example, tax or consulting services) for an attest client, [in 5](#) the member should determine that the requirements described in this interpretation have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired.

### **Engagements Subject to Independence Rules of Certain Regulatory Bodies**

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the General Accounting Office [GAO], the Department of Labor [DOL], and state boards of accountancy) where a member performs nonattest services for an attest client and is required to be independent of the client under the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

### **General Requirements for Performing Nonattest Services**

1. The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.
2. The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
  - a. Make all management decisions and perform all management functions;

- b. Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- c. Evaluate the adequacy and results of the services performed;
- d. Accept responsibility for the results of the services; and
- e. Establish and maintain internal controls, including monitoring ongoing activities.

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.

3. Before performing nonattest services, the member should establish and document in writing [fn 6](#) his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:
  - a. Objectives of the engagement
  - b. Services to be performed
  - c. Client's acceptance of its responsibilities
  - d. Member's responsibilities
  - e. Any limitations of the engagement

The documentation requirement does not apply to:

- a. Nonattest services performed prior to January 1, 2005.
- b. Nonattest services performed prior to the client becoming an attest client. [fn 7](#)

General requirements 2 and 3 above do not apply to certain routine activities performed by the member such as providing advice and responding to the client's questions as part of the normal client-member relationship.

### **General Activities**

The following are some general activities that would impair a member's independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents, [fn 8](#) in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities
- Determining which recommendations of the member should be implemented

- Reporting to the board of directors on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent

### Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member's independence. These examples presume that the general requirements in the previous section "General Requirements for Performing Nonattest Services" have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

#### Impact on Independence of Performance of Nonattest Services

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Bookkeeping	<ul style="list-style-type: none"> <li>• Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger.</li> <li>• Prepare financial statements based on information in the trial balance.</li> <li>• Post client-approved entries to a client's trial balance.</li> <li>• Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.</li> <li>• Authorize or approve transactions.</li> <li>• Prepare source documents.</li> <li>• Make changes to source documents without client approval.</li> </ul>
Payroll and other disbursement	<ul style="list-style-type: none"> <li>• Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.</li> <li>• Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.</li> <li>• Make electronic payroll tax payments in accordance with U.S. Treasury Department or comparable guidelines provided the client has made arrangements for its financial institution to limit such payments to a named payee. <a href="#">fn 9</a></li> </ul>	<ul style="list-style-type: none"> <li>• Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.</li> <li>• Accept responsibility to sign or cosign client checks, even if only in emergency situations.</li> <li>• Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client.</li> <li>• Sign payroll tax return on behalf of client management.</li> <li>• Approve vendor invoices for payment</li> </ul>

Benefit plan administration  
[fn 10](#)

- Communicate summary plan data to plan trustee.
- Advise client management regarding the application or impact of provisions of the plan document.
- Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member's electronic medium, such as an interactive voice response system or Internet connection or other media.
- Prepare account valuations for plan participants using data collected through the member's electronic or other media.
- Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other medium.

Investment—  
advisory or  
management

- Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, etc.
- Perform recordkeeping and reporting of client's portfolio balances including providing a comparative analysis of the client's investments to third-party benchmarks.
- Review the manner in which a client's portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client's investment policy statement; (2) meeting the client's investment objectives; and (3) conforming to the client's stated investment styles.
- Transmit a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.

Corporate  
finance—  
consulting or  
advisory

- Assist in developing corporate strategies.
- Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria.
- Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.

- Make policy decisions on behalf of client management.
- When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence.
- Make disbursements on behalf of the plan.
- Have custody of assets of a plan.
- Serve a plan as a fiduciary as defined by ERISA.

- Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments.
- Execute a transaction to buy or sell a client's investment.
- Have custody of client assets, such as taking temporary possession of securities purchased by a client.

- Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.
- Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.
- Maintain custody of client



	<ul style="list-style-type: none"> <li>• Assist in drafting an offering document or memorandum.</li> <li>• Participate in transaction negotiations in an advisory capacity.</li> <li>• Be named as a financial adviser in a client's private placement memoranda or offering documents.</li> </ul>	securities.
Executive or employee search	<ul style="list-style-type: none"> <li>• Recommend a position description or candidate specifications.</li> <li>• Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).</li> <li>• Participate in employee hiring or compensation discussions in an advisory capacity.</li> </ul>	<ul style="list-style-type: none"> <li>• Commit the client to employee compensation or benefit arrangements.</li> <li>• Hire or terminate client employees.</li> </ul>
Business risk consulting	<ul style="list-style-type: none"> <li>• Provide assistance in assessing the client's business risks and control processes.</li> <li>• Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.</li> </ul>	<ul style="list-style-type: none"> <li>• Make or approve business risk decisions.</li> <li>• Present business risk considerations to the board or others on behalf of management.</li> </ul>
Information systems—design, installation or integration	<ul style="list-style-type: none"> <li>• Install or integrate a client's financial information system that was not designed or developed by the member (e.g., an off-the-shelf accounting package).</li> <li>• Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system.</li> <li>• Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records.</li> <li>• Provide training and instruction to client employees on an information and control system.</li> </ul>	<ul style="list-style-type: none"> <li>• Design or develop a client's financial information system.</li> <li>• Make other than insignificant modifications to source code underlying a client's existing financial information system.</li> <li>• Supervise client personnel in the daily operation of a client's information system.</li> <li>• Operate a client's local area network (LAN) system.</li> </ul>

### **Appraisal, Valuation, and Actuarial Services**

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.

Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of

subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence. <sup>fn 11</sup> However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

### **Internal Audit Assistance Services**

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as "internal audit outsourcing." In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational <sup>fn 12</sup> internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for establishing and maintaining the internal control system <sup>fn 13</sup> and directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

In addition to the general requirements of this interpretation, the member should ensure that client management:

- Designates an <sup>fn 14</sup> individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function;
- Determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services;
- Evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services; and
- 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 member.

The member should also be satisfied that the client's board of directors, audit committee, or other governing body is informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide the client's governing body a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member is responsible for performing the internal audit procedures in accordance with the terms of the engagement and reporting thereon. The performance of such procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.

The following are examples of activities (in addition to those listed in the "General Activities" section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions

- or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Determining which, if any, recommendations for improving the internal control system should be implemented
  - Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
  - Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
  - Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

## Transition

Independence would not be impaired as a result of the more restrictive requirements of interpretation 101-3, provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.

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### Footnotes:

[fn.5](#) A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* [AR section 100.19]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

[fn.6](#) A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202, *Compliance With Standards* [Rule 202.01], provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote revised, January 2005, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

[fn.7](#) However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client. [Footnote added, effective October 31, 2004, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

[fn.8](#) Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote

subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

[fn 9](#) Although this type of transaction may be considered by some to be similar to signing checks or disbursing funds, the Professional Ethics Executive Committee concluded that making electronic payroll tax payments under the specified criteria would not impair a member's independence. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September, 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

[fn 10](#) When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

[fn 11](#) Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

[fn 12](#) For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

[fn 13](#) As part of its responsibility to establish and maintain internal control, management monitors internal control to assess the quality of its performance over time. Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time and built into the normal recurring activities of an entity; they include regular management and supervisory activities, comparisons, reconciliations, and other routine actions. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

[fn 14](#) [Footnote deleted by the Professional Ethics Executive Committee, January 2005. Footnote renumbered by the revision of interpretation 101-1, April 2006.]