

AICPA – GAO INDEPENDENCE RULES COMPARISON: NONAUDIT SERVICES

	AICPA	GAO
<p><u>Overarching Principle(s)</u></p> <p><u>Comments:</u> With respect to nonaudit services, the GAO rule is more restrictive than the AICPA rule as a result of a proscription from providing nonaudit services (except for routine advice/activities) in situations where those services are significant / material to the subject matter of the audit. In cases where the nonaudit service is not material/significant to the subject matter of the audit, specific safeguards, including a requirement for a separate engagement team to perform the service, are required.</p>	<p>The rule contains one overarching principle: (1) A member may not perform management functions or make management decisions for the attest client, the responsibility for which remains with the client's board of directors and management.</p> <p>In all situations, the member should establish an understanding with the client regarding the objectives of the engagement, the services to be performed, management's responsibilities, the member's responsibilities, and the limitations of the engagement. It is preferable that this understanding be documented in an engagement letter. In addition, the member should be satisfied that the client is in a position to have an informed judgment on the results of the other services and that the client understands its responsibility to—</p> <ol style="list-style-type: none"> 1. Designate a management-level individual or individuals to be responsible for overseeing the services being provided. 2. Evaluate the adequacy of the services performed and any findings that result. 3. Make management decisions, including accepting responsibility for the results of the other services. 4. Establish and maintain internal controls, including monitoring ongoing activities. 	<p>The rule contains two overarching principles: (1) audit organizations should not provide nonaudit services that involve performing management functions or making management decisions¹; and (2) audit organizations should not audit their own work or provide nonaudit services in situations where the nonaudit services are significant/material to the subject matter of audits.</p> <p>If the nonaudit service meets both principles, the audit organization must first comply with a list of safeguards in order to perform the nonaudit service. The safeguards are:</p> <ul style="list-style-type: none"> • The audit organization should preclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work related to the nonaudit service under the overarching principle that auditors cannot audit their own work.² • The audit organization should document its consideration of the nonaudit services including documentation for its rationale that providing the nonaudit services does not violate the two overarching principles. • Before performing nonaudit services, the audit organization should establish and document an understanding with the audited entity regarding the objectives, scope of work, and product or deliverables of the nonaudit service. The audit organization should also establish and document an understanding with management that management is responsible for the substantive outcomes of the work and, therefore, has a responsibility to be in a position

¹ Auditors can provide routine advice to the audited entity and management to assist them in activities such as establishing internal controls or implementing audit recommendations, can answer technical questions, and/or provide training. An auditor may also provide tools and methodologies, such as best practice guides, benchmarking studies, and internal control assessment methodologies that can be used by management. These are routine activities that would not require the audit organization to apply the safeguards.

²Personnel who provided the nonaudit service are permitted to convey the knowledge gained of the audited entity and its operations to the audit assignment team.

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		<p>in fact and appearance to make an informed judgment on the results of the nonaudit service and that the audited entity complies with the following:</p> <ol style="list-style-type: none"> 1. Designates a management-level individual to be responsible and accountable for overseeing the nonaudit service. 2. Establishes and monitors the performance of the nonaudit service to ensure that it meets management’s objectives. 3. Makes any decisions that involve management functions related to the nonaudit service and accepts full responsibility for such decisions. 4. Evaluates the adequacy of the services performed and any findings that result. <ul style="list-style-type: none"> • The audit organization is precluded from reducing the scope and extent of the audit work beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party. • The audit organization’s quality control systems for compliance with independence requirements should include policies and procedures to assure consideration of the effect on the ongoing, planned, and future audits when deciding whether to provide nonaudit services and a requirement to have the understanding with management of the audited entity documented. The understanding should be communicated to management in writing and can be included in the engagement letter. • For individual audits selected in the peer review, all related nonaudit services should be identified to the audit organization’s peer reviewer and the required audit documentation be made available for inclusion in the audit organization’s peer review. • In cases where certain nonaudit services by their nature impair the audit organizations ability to meet either or both of the overarching principles for certain types of audit work, the audit organization

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		<p>should communicate to management of the audited entity, before performing the nonaudit service, that the audit organization would not be able to perform subsequent audit work related to the subject matter of the nonaudit service.</p>
<p><u>Bookkeeping</u></p> <p><u>Comments:</u> GAO rules are more restrictive than those of the AICPA. While both organizations prohibit the performance of management functions, the AICPA would not consider maintaining or preparing the client’s general ledger or posting coded transactions to the general ledger to be a management function, rather they are ministerial in nature. In addition, any permitted bookkeeping services under the GAO rule must not be significant /material to the subject matter of the audit and must be performed by engagement personnel not involved in the audit.</p>	<p>Independence would <i>not</i> be considered to be impaired if the member—</p> <ul style="list-style-type: none"> • Records transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger; • Prepares financial statements based on information in the trial balance; • Posts client-approved entries to a client's trial balance; • Proposes standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client. <p>Such services are not considered management functions that violate the overarching principle.</p> <p>However, independence would be considered to be impaired if the member—</p> <ul style="list-style-type: none"> • Determines or changes journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval; • Authorizes or approves transactions; • Prepares source documents or originates data. • Makes changes to source documents without client approval. <p>Such services are considered management functions that violate the overarching principle.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization provided basic accounting assistance <i>provided that such services were deemed not to be significant/material to the subject matter of the audit</i> and are limited to services such as—</p> <ul style="list-style-type: none"> • Preparing draft financial statements that are based on management’s chart of accounts and trial balance and any adjusting, correcting, and closing entries that have been approved by management; • Preparing draft notes to the financial statements based on information determined and approved by management; • Preparing a trial balance based on management’s chart of accounts; • Maintaining depreciation schedules for which management has determined the method of depreciation, rate of depreciation, and salvage value of the asset; • Proposing adjusting and correcting entries that are identified during the audit as long as management makes the decisions on accepting these entries. <p>Independence would be considered to be impaired under all circumstance if the audit organization—</p> <ul style="list-style-type: none"> • Maintains or prepares the audited entity’s basic accounting records or maintain or take responsibility for basic financial or other records that the audit organization will audit; • Posts transactions (whether coded or not coded) to the entity’s financial records or to other records that subsequently provide data to the entity’s financial records.

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<p><u>Payroll Services</u></p> <p><u>Comments:</u> GAO rules are more restrictive than those of the AICPA. Specifically, any permitted payroll services under the GAO rule must not be significant /material to the subject matter of the audit and must be performed by engagement personnel not involved in the audit.</p>	<p>Independence would <i>not</i> be considered to be impaired if the member—</p> <ul style="list-style-type: none"> • Uses payroll time records provided and approved by the client, generates unsigned checks, or processes client's payroll; • Transmits 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; • Makes electronic payroll tax payments in accordance with U.S. Treasury Department <i>or comparable</i> guidelines provided the client has made arrangements for its financial institution to limit such payments to a named payee. <p>Such services are not considered management functions that violate the overarching principle.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization provided payroll services <i>provided that such services were deemed not to be significant / material to the subject matter of the audit</i> and are limited to services such as—</p> <ul style="list-style-type: none"> • Computing pay amounts for the entity's employees based on entity maintained and approved time records, salaries or pay rates, and deductions from pay; • Generating unsigned payroll checks; • Transmitting client approved payroll to a financial institution provided management has approved the transmission and limited the financial institution to make payments only to previously approved individuals.
<p><u>Appraisal and Valuation Services</u></p> <p><u>Comments:</u> GAO rules are more restrictive than those of the AICPA. Specifically, the GAO limits appraisal and valuation services to <i>reviewing</i> the work of the entity or a specialist employed by the entity. In addition, any permitted appraisal or valuation service under the GAO rule (e.g., valuing an entity's pension plan) must not be significant /material to the subject matter of the audit and must be performed by engagement personnel not involved in the audit.</p>	<p>Independence would <i>not</i> be considered to be impaired if the member—</p> <ul style="list-style-type: none"> • Tests the reasonableness of the value placed on an asset or liability included in a client's financial statements by preparing a separate valuation of that asset or liability; • Performs a valuation of a client's business when all significant matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on the results of the valuation. <p>Such services are not considered management functions that violate the overarching principle.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization provided appraisal or valuation services <i>provided that such services were deemed not to be significant/material to the subject matter of the audit</i> and are limited to services such as—</p> <ul style="list-style-type: none"> • Reviewing the work of the entity or a specialist employed by the entity where the entity or specialist provides the primary support for the balances recorded in financial statements or other information that will be audited; • Valuing an entity's pension, other post-employment benefit, or similar liabilities provided management has determined and taken responsibility for all significant assumptions and data.

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<p><u>Information Technology Services</u></p> <p><u>Comments:</u> GAO rules are more restrictive than those of the AICPA. Specifically, any permitted information technology services under the GAO rule must not be significant /material to the subject matter of the audit and must be performed by engagement personnel not involved in the audit.</p>	<p>Independence would <i>not</i> be considered to be impaired if the member—</p> <ul style="list-style-type: none"> • Designs, installs or integrates a client's information system, provided the client makes all management decisions; • Customizes a prepackaged accounting or information system, provided the client makes all management decisions; • Provides the initial training and instruction to client employees on a newly implemented information and control system. <p>Such services are not considered management functions that violate the overarching principle.</p> <p>A member would be prohibited from supervising client personnel in the daily operation of a client's information system. Such services are considered management functions that violate the overarching principle.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization provided advisory services on information technology <i>provided that such services were deemed not to be significant/material to the subject matter of the audit</i> and are limited to services such as—</p> <ul style="list-style-type: none"> • Advising on system design, system installation, and system security if management acknowledges responsibility for the design, installation, and internal control over the entity's system and does not rely on the auditor's work as the primary basis for determining <ol style="list-style-type: none"> (1) whether to implement a new system, (2) the adequacy of the new system design, (3) the adequacy of major design changes to an existing system, and (4) the adequacy of the system to comply with regulatory or other requirements. <p>The audit organization would be prohibited from operating or supervising the operation of the entity's information technology system.</p>
<p><u>Human Resources Services</u></p> <p><u>Comments:</u> GAO rules are more restrictive than those of the AICPA. Specifically, the GAO prohibits the audit organization from performing executive search and recruiting activities for the client. AICPA independence rules* would permit such activities provided the client makes all decisions.</p> <p>In addition, any permitted human resources services under the GAO rule must not be significant /material to the subject matter of the audit and must be performed by engagement personnel not involved in the audit.</p> <p>* SECPS membership requirements prohibit the provision of human resources services for audit clients of SECPS member firms.</p>	<p>Independence would <i>not</i> be considered to be impaired if the member—</p> <ul style="list-style-type: none"> • Recommends a position description or candidate specifications; • Solicits and performs screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience); • Participates in employee hiring or compensation discussions in an advisory capacity. <p>Such services are not considered management functions that violate the overarching principle.</p> <p>However, independence would be considered to be impaired if the member—</p> <ul style="list-style-type: none"> • Commits the client to employee compensation or benefits; • Hires or terminates client employees <p>Such services are considered management functions that violate the overarching principle.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization provided human resources services <i>provided that such services were deemed not to be significant/material to the subject matter of the audit</i> and are limited to services such as—</p> <ul style="list-style-type: none"> • Assisting management in its evaluation of potential candidates that are limited to activities such as— <ul style="list-style-type: none"> ➤ serving on an evaluation panel to review applications; ➤ interviewing candidates to provide input to management in arriving at a listing of best qualified applicants to be provided to management. <p>Independence would be considered to be impaired under all circumstance if the audit organization—</p> <ul style="list-style-type: none"> • Recommends a single individual for a specific position; • Conducts an executive search or a recruiting program for the audited entity.

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<p><u>Tax Services</u></p> <p><u>Comments:</u> GAO rules are more restrictive than those of the AICPA. Specifically, AICPA rules would permit the preparation of routine tax filings regardless of materiality/significance to the subject matter of the audit. In addition, AICPA rules would not require a separate engagement team to perform the service.</p>	<p>Independence would <i>not</i> be considered to be impaired if the member prepares routine tax filings for an attest client.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization prepared routine tax filings in accordance with federal tax laws and rules and regulations of the Internal Revenue Service and state and local tax authorities and any applicable laws, <i>provided that such services were deemed not to be significant / material to the subject matter of the audit.</i></p>
<p><u>Indirect Cost Proposals</u></p> <p><u>Comments:</u> AICPA would permit this service provided the overarching principle is complied with. In complying with GAO rules, should the audit organization determine that preparing indirect cost proposals is not material to the subject matter of the audit, a separate engagement team would be required to perform the service.</p>	<p>Not specifically addressed in the AICPA rules.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization prepared an entity’s indirect cost proposal³ or cost allocation plan provided management has taken responsibility for all significant assumptions and data and <i>such services were deemed not to be significant / material to the subject matter of the audit.</i></p>
<p><u>Other Nonaudit Services</u></p> <p>AICPA would permit this service provided the overarching principle is complied with.</p>	<p>Not specifically addressed in the AICPA rules.</p>	<p>Independence would <i>not</i> be considered to be impaired if the audit organization provided the following nonaudit services <i>provided that such services were deemed not to be significant/material to the subject matter of the audit—</i></p> <ul style="list-style-type: none"> • Gathering and reporting unverified external or third-party data to aid legislative and administrative decision-making. • Advising an entity regarding its performance of internal control self-assessments. • Assisting a legislative body by developing questions for use at a hearing.

³The Office of Management and Budget prohibits an auditor who prepared the entity’s indirect cost proposal from conducting the required audit when indirect costs recovered by the entity during the prior year exceeded \$1 million.