

Preserving Independence

Navigating the AICPA's Revised Code of
Professional Conduct

Presented by Mark Dauberman, CPA

Accounting Day – May 13, 2019

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Independence

Organization and Structure

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 - Part 1 – Applicable to Members in Public Practice
 - Part 2 – Applicable to Members in Business
 - Part 3 – Applicable to Other Members

Preface – Applicable to All Members

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- 1.600 – Advertising and Other Forms of Solicitation
- 1.700 – Confidential Information
- 1.800 – Form of Organization and Name
 - 1.810 – Form of Organization and Related Practice Issues
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Part 2 – Applicable to Members in Business

- 2.000 – Introduction
- 2.100 – Integrity and Objectivity
 - 2.110 – Conflicts of Interest
 - 2.120 – Gifts and Entertainment
 - 2.130 – Preparing and Reporting Information
 - 2.160 – Educational Services
 - 2.170 – Pressure to Breach the Rules

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Part 3 – Applicable to Other Members

- 3.000 – Introduction
- 3.400 – Acts Discreditable

Financial Statement Preparation and Cash-to-Accrual Conversion

- Considered nonattest service
 - Subject to general requirements for performance of nonattest services
 - No longer considered part of normal audit process

Ethics Quiz

Is Independence Impaired as a Result of Performing
Nonattest Services?

#1

- The CPA records journal entries while performing monthly bookkeeping services without obtaining client approval.
- Would independence be impaired?

- Yes
- To maintain independence:
 - Client must review and approve journal entries
 - CPA should be satisfied that client understands:
 - Nature of journal entries
 - Impact of entries on the financial statements

#2

- During the course of providing monthly bookkeeping services, the CPA receives invoices from the client, indicating approval for payment and identifying the appropriate general ledger accounts to record the transaction.
- The CPA prepares the client's checks for payment of those invoices, records the transactions in the client's general ledger system and returns the checks to the client for approval and signature. The CPA does not have signature authority over the client's checking account.
- Would independence be impaired?

- No
- Management must:
 - Determine and approve account classifications
 - Approve invoices for payment
 - Sign prepared checks

#3

- A client records all disbursements in its checkbook and identifies the type of expense, such as telephone or rent, on the checkbook stubs.
- During the course of providing monthly bookkeeping services, the CPA assigns the general ledger account numbers based on the type of expense indicated by the client and records these payments in the client's accounting system.
- Would independence be impaired?

- No
- The CPA would not be considered to be coding transactions

#4

- A CPA is engaged to perform an audit, review, or compilation of a client's financial statements. During the course of the audit, review, or compilation, the CPA proposes audit adjustments to the financial statements. Examples of these entries include the current tax accrual and deferred tax assets or liabilities and the amount of depreciation and amortization necessary for the current year.
- The client reviews these entries and understands the impact on its financial statements and records the adjustments identified by the CPA.
- Would the proposal of such entries constitute a nonattest bookkeeping service subject to the general requirements for the performance of nonattest services?

- No
- Proposing journal entries as a result of a CPA's audit, review, or compilation services is a normal part of these engagements and would not be considered a nonattest service

#5

- A CPA is engaged to perform an audit for a client who records all transactions on a cash basis in its general ledger. During the audit process, the CPA identifies all appropriate journal entries required to convert the client's general ledger to an accrual basis and prepares the financial statements, including footnotes, on the accrual basis in order to conform with GAAP.
- The client reviews the entries and financial statements, including all footnote disclosures, and understands the impact these entries have on the financial statements. As part of the management representation letter, the client acknowledges responsibility for the financial statements and footnotes.

- Would these services be considered nonattest bookkeeping services subject to the general requirements for the performance of nonattest services?

- No
- The CPA should use judgment as to what is part of the normal audit process
 - Client's books and records must be substantially complete in order for CPA to perform an audit
 - An engagement to bring client books and records current would be a nonattest service
 - Performing bookkeeping and preparing monthly complied financial statements is also a nonattest service

#6

- The CPA performs year end tax planning and prepares the tax returns for an attest client.
- Would these services be considered nonattest services and subject to the general requirements for the performance of nonattest services?

- Yes
- Tax services are nonattest services

#7

- The CPA prepares a bank reconciliation of a client's bank account in connection with monthly bookkeeping services. The client reviews and approves the bank reconciliation.
- Would independence be impaired?

- No
- The client:
 - Reviews and approves the bank reconciliation
 - Understands the services sufficiently to oversee them

#8

- The general requirements for the performance of nonattest services requires that the CPA should establish and document in writing his or her understanding with the client regarding the a) objectives of the engagement; b) services to be performed; c) client's acceptance of its responsibilities; d) CPA's responsibilities; and e) any limitations of the engagement.
- Would the CPA be in compliance with this requirement if such was documented in: an engagement letter; the audit planning memo; or in a memo of understanding maintained in the member's billing files?

- Yes
- Requirement is for documentation of understanding without specifying method
 - Lack of documentation does not impair independence
 - Does represent violation of Rule 202 of the Code of Professional Conduct,
Compliance with Standards

#9

- A CPA provides only nonattest services to a client for the year ending December 31, 20X1. In 20X2, the CPA is asked to perform an audit of the client's year-end 20X1 financial statements.
- Would the CPA be in violation of the general requirements for the performance of nonattest services because the firm did not comply with the documentation requirement with respect to the nonattest services performed in 20X1?

- No
- Documentation requirement does not apply to nonattest services performed before the client became an attest client
- Upon acceptance of attest engagement, CPA should document compliance with other requirements during period covered by the financial statements

#10

- A CPA performing bookkeeping services records adjusting and reclassification journal entries and compiles preliminary financial statements. The CPA delivers the financial statements and compilation report to the client and provides the client copies of the general ledger, journals and journal entries, which contain a description of the nature of each entry.
- The CPA asks the client to review the journal entries and then asks whether the client has any questions about any of the entries.
- Would the general requirements for the performance of nonattest services?

- Yes
- CPA must be satisfied that client understands the nature and impact of the journal entries

#11

- Must the CPA document the client's review of the journal entries?

- No
- Documentation of the client's review of the journal entries is not required
- The CPA may wish document the review
 - Name of client representative
 - Date of review

#12

- The general requirement for the performance of nonattest services require that the client designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the nonattest services.
- Which individuals at the client can serve in the capacity?

- Will depend on nature of client's organization and of nonattest engagement
 - Owner managed entities
 - Owner
 - Controller
 - Bookkeeper
 - For larger organization or more complex service, likely a member of senior management
 - Must understand service adequately to oversee
 - Does not need ability to perform or re-perform service

#13

- A CPA's clients consist of very small businesses with informal control environments and an insufficient number of employees to achieve a proper segregation of duties.
- How can such clients establish and maintain internal controls as required under the general responsibilities for the performance of nonattest services?

- The client is required to accept responsibility for designing, implementing, and maintaining internal control and for performing ongoing evaluations of internal control as part of monitoring activities
- CPA may not
 - Authorize, execute, or consummate transactions
 - Maintain custody of client assets
 - Supervise client employees or make management decisions

- The client must establish and maintain internal control related to the CPA's services
- Often supervisory controls
- If CPA reconciles bank account, client should review and approve reconciliations

#14

- A CPA provides temporary “controllershship services” and various types of other temporary accounting services for clients during client maternity leaves, illness, and sudden departures.
- Do these activities impair independence?

- The services are subject to the independence rule
 - Controller type activities that involve assuming management responsibilities and supervision of employees would impair independence
 - Temporary accounting and other services do not if performed in compliance with the general requirements for the performance of nonattest services
 - Duration or regularity of services might impair appearance of independence
 - Having title of controller would impair independence

#15

- The general requirements for the performance of nonattest services do not allow the CPA to assume management responsibilities for the attest client.
- What are some examples of management responsibilities?

- Management responsibilities involve:
 - Leading and directing an entity
 - Making significant decisions regarding the acquisition, deployment, and control of resources

- Examples include:
 - Setting policies or strategic direction for the client
 - Directing or accepting responsibility for the actions of the client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards
 - Authorizing, executing, or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
 - Preparing source documents, in electronic or other form evidencing the occurrence of a transaction

- Having custody of client assets
- Deciding which recommendations of the CPA or other third parties to implement or prioritize
- Reporting to those in charge of governance on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel, or its equivalent
- Accepting responsibility for the management of a client's project

- Accepting responsibility for the preparation and fair presentation of the client's financial statements in accordance with the applicable financial reporting framework
- Accepting responsibility for designing, implementing, or maintaining internal control
- Performing ongoing evaluations of the client's internal control as part of its monitoring activities

Independence and the Performance of Nonattest Services

Understanding and Applying the Independence
Requirements to Nonattest Services

Do's and Don'ts

- Guidelines established for
 - Advisory Services
 - Appraisal, Valuation, and Actuarial Services
 - Benefit Plan Administration
 - Bookkeeping, Payroll, and Other Disbursements
 - Business Risk Consulting
 - Corporate Finance Consulting

- Executive or Employee Recruiting
- Forensic Accounting
- Information Systems Design, Implementation, or Integration
- Internal Audit
- Investment Advisory or Management
- Tax Services

General Requirements for the Performance of Nonattest Services

- Requirements must be met when performing nonattest services for attest clients
- Independence would be impaired if not met
 - During period of professional engagement
 - During period covered by financial statements

- Independence would not be impaired if services that would impair independence
 - Provided prior to period of professional engagement
 - Nonattest services related to periods prior to those covered by the financial statements
 - The financial services for the period to which the services applied were audited by another firm or reviewed or audited in the case of a review engagement

- Communications between CPA and client during performance of attest services do not impair independence
 - Selection and application of accounting standards or policies and disclosure requirements
 - Appropriateness of client's methods
 - Adjusting journal entries prepared or proposed by the CPA
 - Form or content of financial statements

- Considered normal part of attest engagement
- CPA should exercise judgment regarding extent of involvement
 - May constitute performing separate service
 - Subject to general requirements for the performance of nonattest services

Other Independence Requirements

- May be subject to separate or additional independence requirements of authoritative regulatory bodies
 - SEC
 - GAO
 - DOL
 - PCAOB

General Requirements for the Performance of Nonattest Services

- **#1 – Client Must Agree**
 - Assume all management responsibilities
 - Designating an appropriate individual to oversee the service
 - Evaluate the adequacy of the services performed
 - Accept responsibility for the results of the services

- **#2 – Accountant may not assume management responsibilities**

- Leading and directing an entity
- Making significant decisions regarding acquisition, deployment, and control of resources

- Examples include:
 - Setting policies or strategic direction for the client
 - Directing or accepting responsibility for the actions of the client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards
 - Authorizing, executing, or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so

- Preparing source documents, in electronic or other form evidencing the occurrence of a transaction
- Having custody of client assets
- Deciding which recommendations of the CPA or other third parties to implement or prioritize
- Reporting to those in charge of governance on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel, or its equivalent

- Accepting responsibility for the management of a client's project
- Accepting responsibility for the preparation and fair presentation of the client's financial statements in accordance with the applicable financial reporting framework
- Accepting responsibility for designing, implementing, or maintaining internal control
- Performing ongoing evaluations of the client's internal control as part of its monitoring activities

- **#3 – Establish and Document an Understanding**

- Before performing nonattest service
- Should cover
 - Objectives of engagement
 - Services to be performed
 - Client's acceptance of responsibilities
 - CPA's responsibilities
 - Limitations of engagement

Evaluating Independence

Applying a Risk-Based Approach

Identify Threats to Independence

- May be at acceptable level
 - Independence not considered impaired
 - Safeguards are not required to be considered

- Threats may not be at acceptable level
 - Existing safeguards may be sufficient to eliminate or reduce to an acceptable level
 - Additional safeguards, not yet in existence, may be implemented
 - Safeguards are considered sufficient when a threat to independence is not reasonably expected to compromise professional judgment
- If safeguards, existing & potential, are not sufficient to reduce risk to an acceptable level, independence is impaired

Seven Identified Threats to Independence

- Adverse Interest
- Advocacy
- Familiarity
- Management Participation
- Self-Interest
- Self Review
- Undue Influence

Adverse Interest

- Client's interests conflict with those of accountant
- May result from current or anticipated litigation between client and accountant

Advocacy

- Threat exists when accountant's actions effectively promote client's interests or position.
 - Promoting client's securities in an initial public offering
 - Representing a client in US tax court
- Does not exist as a result of testing as a fact witness or defending the results of professional services performed for the client

Familiarity

- May result from
 - Close and long standing relationship with client
 - Familiarity with those performing nonattest services for client, or their reputations

- May result from other relationships
 - Spouse or close friend of engagement team member in key position with client
 - Partner or equivalent providing attest services for client for extended period
 - Performance of insufficient audit or review procedures due to reliance on nonattest services performed by third party
 - Firm member having recently been an officer or director of the client

Management Participation

- Accountant assumes role of management or assumes management responsibility
 - Service as director or officer of client
 - Establishing and maintaining internal controls
 - Hiring, supervising, or terminating employees

Self Interest

- Potential for benefit as a result of financial interest or other financial relationship with client
 - Direct or material indirect interest in client
 - Loan from client, officer, director, or owner
 - Heavy reliance by accountant on fees from client
 - Material business arrangement or joint venture with client

Self Review

- Applies when evidence for attest engagement result from performance of nonattest services
- Potential for accepting information without evaluation

Undue Influence

- Attempts by management to influence accountant
 - Threat to replace accountant as a result of disagreement
 - Pressure to limit engagement to reduce fees
 - Potentially significant gifts from client to accountant

Safeguards

- Eliminate or reduce threats
- May include:
 - Prohibitions against actions or circumstances creating threats
 - Procedures designed to counter threats
- Considered effective if they reduce threats to an acceptable level

Factors Affecting Effectiveness of Safeguards

- Circumstances surrounding situation
- Proper identification of threats
- Appropriate design of safeguards
- Who applies safeguard, who is subject to it, and consistency with which it is applied

Safeguards Imposed by Profession, Legislation, or Regulation

- Education, training, and continuing professional education
- Professional standards, external reviews, monitoring, and disciplinary processes
- Legislation governing independence
- Requirements related to competency and experience

Safeguards Based on Client Characteristics and Policies

- Skill, knowledge, & experience of client personnel
- Tone at the top emphasizing fair reporting

- Client governance designed for appropriate decision making, oversight, and communication related to the accountant's services
- Policies limiting use of accountant for nonattest services

Safeguards Implemented by Firm

- Leadership stressing importance of independence
- Use of partners and others not involved in attest services for nonattest services
- Training and timely communication of firm policies
- Appropriate oversight of quality control

- Disciplinary policies encouraging compliance
- Discussing independence with client's audit committee
- Disclosure of services provided and related fees to audit committee
- Use of independent parties to review work done for attest client
- Consulting with interested third parties
- Rotation of senior attest engagement personnel

- Use of another firm for nonattest services
- Removing individuals from attest engagement team posing threats through a financial or other relationship
- Client acceptance and continuance policies

- Policies and procedures designed to
 - Implement and monitor quality control
 - Identify and evaluate threats
 - Identify and apply safeguards
 - Monitor compliance with independence policies
 - Identifying interests or relationships posing potential threats
 - Monitoring firm reliance on fees from a single client
 - Identifying clients that firm should maintain independence from

- Providing assurance that attest engagement personnel do not assume management responsibilities
- Prevent association with clients representing unacceptable threats to independence
- Preclude compensation to partners based on sales of nonattest services to attest clients

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- Information Systems Design, Implementation, or Integration
- Internal Audit
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- Tax Services

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 - During period covered by financial statements

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Other Independence Requirements

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 - GAO
 - DOL
 - PCAOB

General Requirements for the Performance of Nonattest Services

- **#1 – Client Must Agree**
 - Assume all management responsibilities
 - Designating an appropriate individual to oversee the service
 - Evaluate the adequacy of the services performed
 - Accept responsibility for the results of the services

- **#2 – Accountant may not assume management responsibilities**

- Leading and directing an entity
- Making significant decisions regarding acquisition, deployment, and control of resources

- Examples include:
 - Setting policies or strategic direction for the client
 - Directing or accepting responsibility for the actions of the client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards
 - Authorizing, executing, or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so

- Preparing source documents, in electronic or other form evidencing the occurrence of a transaction
- Having custody of client assets
- Deciding which recommendations of the CPA or other third parties to implement or prioritize
- Reporting to those in charge of governance on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel, or its equivalent

- Accepting responsibility for the management of a client's project
- Accepting responsibility for the preparation and fair presentation of the client's financial statements in accordance with the applicable financial reporting framework
- Accepting responsibility for designing, implementing, or maintaining internal control
- Performing ongoing evaluations of the client's internal control as part of its monitoring activities

- **#3 – Establish and Document an Understanding**

- Before performing nonattest service
- Should cover
 - Objectives of engagement
 - Services to be performed
 - Client's acceptance of responsibilities
 - CPA's responsibilities
 - Limitations of engagement

Evaluating Independence

Applying a Risk-Based Approach

Identify Threats to Independence

- May be at acceptable level
 - Independence not considered impaired
 - Safeguards are not required to be considered

- Threats may not be at acceptable level
 - Existing safeguards may be sufficient to eliminate or reduce to an acceptable level
 - Additional safeguards, not yet in existence, may be implemented
 - Safeguards are considered sufficient when a threat to independence is not reasonably expected to compromise professional judgment
- If safeguards, existing & potential, are not sufficient to reduce risk to an acceptable level, independence is impaired

Seven Identified Threats to Independence

- Adverse Interest
- Advocacy
- Familiarity
- Management Participation
- Self-Interest
- Self Review
- Undue Influence

Adverse Interest

- Client's interests conflict with those of accountant
- May result from current or anticipated litigation between client and accountant

Advocacy

- Threat exists when accountant's actions effectively promote client's interests or position.
 - Promoting client's securities in an initial public offering
 - Representing a client in US tax court
- Does not exist as a result of testing as a fact witness or defending the results of professional services performed for the client

Familiarity

- May result from
 - Close and long standing relationship with client
 - Familiarity with those performing nonattest services for client, or their reputations

- May result from other relationships
 - Spouse or close friend of engagement team member in key position with client
 - Partner or equivalent providing attest services for client for extended period
 - Performance of insufficient audit or review procedures due to reliance on nonattest services performed by third party
 - Firm member having recently been an officer or director of the client

Management Participation

- Accountant assumes role of management or assumes management responsibility
 - Service as director or officer of client
 - Establishing and maintaining internal controls
 - Hiring, supervising, or terminating employees

Self Interest

- Potential for benefit as a result of financial interest or other financial relationship with client
 - Direct or material indirect interest in client
 - Loan from client, officer, director, or owner
 - Heavy reliance by accountant on fees from client
 - Material business arrangement or joint venture with client

Self Review

- Applies when evidence for attest engagement result from performance of nonattest services
- Potential for accepting information without evaluation

Undue Influence

- Attempts by management to influence accountant
 - Threat to replace accountant as a result of disagreement
 - Pressure to limit engagement to reduce fees
 - Potentially significant gifts from client to accountant

Safeguards

- Eliminate or reduce threats
- May include:
 - Prohibitions against actions or circumstances creating threats
 - Procedures designed to counter threats
- Considered effective if they reduce threats to an acceptable level

Factors Affecting Effectiveness of Safeguards

- Circumstances surrounding situation
- Proper identification of threats
- Appropriate design of safeguards
- Who applies safeguard, who is subject to it, and consistency with which it is applied

Safeguards Imposed by Profession, Legislation, or Regulation

- Education, training, and continuing professional education
- Professional standards, external reviews, monitoring, and disciplinary processes
- Legislation governing independence
- Requirements related to competency and experience

Safeguards Based on Client Characteristics and Policies

- Skill, knowledge, & experience of client personnel
- Tone at the top emphasizing fair reporting

- Client governance designed for appropriate decision making, oversight, and communication related to the accountant's services
- Policies limiting use of accountant for nonattest services

Safeguards Implemented by Firm

- Leadership stressing importance of independence
- Use of partners and others not involved in attest services for nonattest services
- Training and timely communication of firm policies
- Appropriate oversight of quality control

- Disciplinary policies encouraging compliance
- Discussing independence with client's audit committee
- Disclosure of services provided and related fees to audit committee
- Use of independent parties to review work done for attest client
- Consulting with interested third parties
- Rotation of senior attest engagement personnel

- Use of another firm for nonattest services
- Removing individuals from attest engagement team posing threats through a financial or other relationship
- Client acceptance and continuance policies

- Policies and procedures designed to
 - Implement and monitor quality control
 - Identify and evaluate threats
 - Identify and apply safeguards
 - Monitor compliance with independence policies
 - Identifying interests or relationships posing potential threats
 - Monitoring firm reliance on fees from a single client
 - Identifying clients that firm should maintain independence from

- Providing assurance that attest engagement personnel do not assume management responsibilities
- Prevent association with clients representing unacceptable threats to independence
- Preclude compensation to partners based on sales of nonattest services to attest clients