

**STANDARDS FOR DETERMINING INDEPENDENCE IN
THE PRACTICE OF PUBLIC ACCOUNTANCY FOR CPAS
PRACTICING PUBLIC ACCOUNTANCY IN THE STATE OF FLORIDA**

(Words that appear in bold (initially) are defined in the definitions section at the end of this document.)

Section 101-1. Independence-General Provisions

Independence shall be considered to be impaired if:

- (1) During the **period of the professional engagement** a covered licensee:
 - (a) Had or was committed to acquire any direct or material indirect financial interest in the **client**.
 - (b) Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and
 1. The covered licensee had the authority to make (individually or with others) investment decisions for the trust or estate; or
 2. The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
 3. The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.
 - (c) Had a **joint closely held investment** that was material to the covered licensee.
 - (d) Except as specifically permitted in Section 101-5 herein, had any **loan** to or from the client, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests.
- (2) During the period of the professional engagement, a firm, a **partner** or professional employee of the **firm**, his or her **immediate family**, or any group of such persons acting together owned more than five percent of a client's outstanding equity securities or other ownership interests.
- (3) During the period covered by the **financial statements** or during the period of the professional engagement, a partner or professional employee of the firm was simultaneously associated with the client as a(n)
 - (a) Director, officer, or employee, or in any capacity equivalent to that of a member of management;
 - (b) Promoter, underwriter, or voting trustee; or
 - (c) Trustee for any pension or profit-sharing trust of the client.

Application of the Independence Rules to Covered Licensees Formerly Employed by a Client or Otherwise Associated With a Client

An individual who was formerly (i) employed by a client or (ii) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client would impair his or her firm's independence if the individual

- (1) Participated on the **attest engagement team** or was an **individual in a position to influence the attest engagement** for the client when the **attest engagement** covers any period that includes his or her former employment or association with that client; or
- (2) Was otherwise a covered licensee with respect to the client unless the individual first dissociates from the client by
 - (a) Terminating any relationships with the client described in Subsection 101-1(1)(c);
 - (b) Disposing of any direct or material indirect financial interest in the client;
 - (c) Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under Section 101-5.
 - (d) Ceasing to participate in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and

If a licensee participates in or receives benefits from a health and welfare plan (the "plan") sponsored by a client and that licensee is a covered licensee then that covered licensee's participation in a plan sponsored by a client

(e) Liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty² significant to the benefits is imposed upon liquidation or transfer.

Application of the Independence Rules to a Covered Licensee's Immediate Family

Except as stated in the following paragraph, a covered licensee's immediate family is subject to Rule 61H1-21.001 and these Standards.

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 licensee'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 licensees 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 this Rule the financial interests of the covered licensee 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.

Other Considerations

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. Licensees should consider whether personal and business relationships between the licensee and the client or an individual associated with the client would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the licensee's and the firm's independence.

Section 101-2. Employment or Association with Attest Clients

A firm's independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all of the following conditions are met:

would impair independence with respect to the client sponsor and the plan. However, if the covered licensee's participation in the plan, or benefits received thereunder, arises as a result of the permitted employment of the covered licensee's immediate family, independence would not be considered to be impaired provided that the plan is normally offered to all employees in equivalent employment positions.

²A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may be adjusted for inflation and interest may be paid on amounts due.

2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.

3. The former partner or professional employee does not participate in or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:

The individual provides consultation to the firm.

The firm provides the individual with an office and related amenities (for example, secretarial and telephone services).

The individual's name is included in the firm's office directory.

The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.

4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.

5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.

6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

Responsible members within the firm should implement procedures for compliance with the preceding conditions when firm professionals are employed or associated with attest clients.

With respect to conditions 4, 5 and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the positions he or she held at the firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure.³

Considering Employment or Association with the Client

When a member of the attest engagement team or an individual in a position to influence the attest engagement intends to seek or discuss potential employment or association with an attest client, or is in receipt of a specific offer of employment from an attest client, independence will be impaired with respect to the client unless the person promptly reports such consideration or offer to an appropriate person in the firm, and removes himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought. When a covered licensee becomes aware that a member of the attest engagement team or an individual in a position to influence the attest engagement is considering employment or association with a client, the covered licensee should notify an appropriate person in the firm.

The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as

³An inadvertent and isolated failure to meet conditions 4, 5 and 6, would not impair independence provided that the required procedures are performed promptly upon discovery of the failure to do so, and all other provisions of Section 101-2 are met.

required under Rule 61H1-21.002. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and individual involved.

Section 101-3. RESERVED Performance of nonattest services. Before a covered licensee or firm performs nonattest services for an attest client,⁴ the covered licensee shall determine that the requirements described in this section 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 covered licensee's independence would be impaired.

Engagements Subject to Independence Rules or Certain Regulatory Bodies.

This section 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], where a covered licensee performs nonattest services for a 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 section if so determined by the applicable regulatory body.

General Requirements for Performing Nonattest Services

(1) The covered licensee should not perform management functions or make management decisions for the attest client. However, the covered licensee 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 a competent employee, preferable 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 covered licensee 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 the competency of the client's designated employee, the covered licensee should be satisfied that such individual understands the services to be performed sufficiently to oversee them. In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with the necessary competence to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the covered licensee's or firm's provision of these services would impair independence.

(3) Before performing nonattest services, the covered licensee should establish and document in writings⁵ the licensee's or firm's understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:

- (a) Objective of the engagement
- (b) Services to be performed
- (c) Client's acceptance of its responsibilities
- (d) Covered licensee's or firm's responsibilities
- (e) Any limitations of the engagement

⁴A covered licensee who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the covered licensee or firm does not meet all of the conditions set out in this section when providing a nonattest service to that client (see Statement of Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements*

⁵An isolated and inadvertent failure to prepare the required documentation would not impair independence, provided that the licensee did establish the understanding with the client, the licensee documents the understanding promptly upon discovery of the failure to do so, and all other provisions of the interpretation are met.

The documentation requirement does not apply to certain routine activities performed by the covered licensee such as providing advice and responding to the client's technical questions as part of the normal client-covered licensee relationship.

General Activities

- The following are some general activities that would impair a covered licensee's or firm's independence:
- # Authorizing, executing, or consummating a transaction, otherwise exercising authority on behalf of a client, or having the authority to do so
 - # Preparing source documents,⁶ 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 covered licensee should be implemented
 - # Reporting to the board of directors on behalf of management
 - # Servicing 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 covered licensee's or firm's independence.

These examples presume that the general requirements in the previous subsection "**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 covered licensee.

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>

⁶Source 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.

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Bookkeeping	<p>Record transactions for which management</p> <p>Prepare financial statements</p> <p>Post client-approved entries to a client's trial balance.</p> <p>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 covered licensee is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</p>	<p>Determine or change journal entries, account codings or classifications for transactions, or other accounting records without obtaining client approval.</p> <p>Authorize or approve transactions.</p> <p>Prepare source documents.</p> <p>Make changes to source documents without client approval</p>
Payroll and other disbursements	<p>Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.</p> <p>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.</p> <p>Make electronic payroll tax payments in accordance with U.S. Treasury Department or comparable guidelines provided the client has made arrangements for its financial institutions to limit such payments to a named payee.</p>	<p>Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.</p> <p>Accept responsibility to sign or cosign client checks, even if only in emergency situations.</p> <p>Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client.</p> <p>Sign payroll tax return on behalf of client management.</p> <p>Approve vendor invoices for payment.</p>

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Benefit plan administration	<p>Communicate summary plan data to plan trustee</p> <p>Advise client management regarding the application or impact of provisions of the plan documented.</p> <p>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 covered licensee's or firm's electronic medium such as an interactive voice response system or Internet connection or other media.</p> <p>Prepare account valuations for plan participants using data collected through the covered licensee's or firm's electronic or other media.</p> <p>Prepare and transmit participant statements to plan participants based on data collected through the covered licensee's or firm's electronic or other medium.</p>	<p>Make policy decisions on behalf of client management.</p> <p>When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence.</p> <p>Make disbursements on behalf of the plan.</p> <p>Have custody of assets of a plan.</p> <p>Service a plan as a fiduciary as defined by ERISA.</p>

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
<p>Investment–advisory or management</p>	<p>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.,</p> <p>Perform recordkeeping and reporting of client's portfolio balances including providing a comparative analysis of the client's investments to third-party benchmarks.</p> <p>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.</p> <p>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.</p>	<p>Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments.</p> <p>Execute a transaction to buy or sell a client's investment.</p> <p>Have custody of client assets, such as taking temporary possession of securities purchased by a client.</p>
<p>Corporate finance–consulting or advisory</p>	<p>Assist in developing corporate strategies.</p> <p>Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria.</p> <p>Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.</p> <p>Assist in drafting an offering document or memorandum.</p> <p>Participate in transaction negotiations in an advisory capacity.</p> <p>Be named as a financial adviser in a client's private placement memoranda or offering documents.</p>	<p>Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.</p> <p>Act as a promoter, underwriter, brokerdealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.</p> <p>Maintain custody of client securities.</p>

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Executive or employee search	<p>Recommend a position description or candidate specifications.</p> <p>Solicit and perform screen of candidate and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).</p> <p>Participate in employee hiring or compensation discussions in an advisory capacity.</p>	<p>Commit the client to employee compensation or benefit arrangements.</p> <p>Hire or terminate client employees.</p>
Business risk consulting	<p>Provide assistance in assessing the client's business risks and control processes.</p> <p>Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.</p>	<p>Make or approve business risk decisions.</p> <p>Present business risk considerations to the Board or others on behalf of management.</p>
Information systems—design, installation or integration.	<p>Install or integrate a client's financial information that was not designed or developed by the covered licensee (e.g., an off-the-shelf accounting package)</p> <p>Design, develop, install or integrate a client's information system that is unrelated to the client's financial statements or accounting records.</p> <p>Assist in setting up the client's chart of accounts and financial information system that is unrelated to the client's financial statements or accounting records.</p> <p>Provide training and instruction to client employees on an information and control system.</p>	<p>Design or develop a client's financial information system..</p> <p>Make other than insignificant modifications to source code underlying a client's existing financial information system.</p> <p>Supervise client personnel in the daily operation of a client's information system.</p> <p>Operate a client's local area network (LAN) system.</p>

Appraisal, Valuation, and Actuarial Services

(1) Independence would be impaired if a covered licensee 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.

(2) 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.

⁷Although this type of transaction may be considered by some to be similar to signing checks or disbursing funds, making electronic payroll tax payments under the specified criteria would not impair a covered licensee's or firm's independence.

⁸When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed.

(3) 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.⁹ However, in performing such services, all other requirements of this section 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

(1) 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.

(2) Assisting the client in performing financial and operational¹⁰ internal audit activities would impair independence unless the covered licensee takes appropriate steps to ensure that the client understands its responsibility for establishing and maintaining the internal control system¹¹ and directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the covered licensee whereby the covered licensee in effect manages the internal audit activities of the client would impair independence.

(3) In addition, to the general requirements of this interpretation, the covered licensee should ensure the client management:

Designates a competent¹² individual or individuals, preferable within senior management, to be responsible for the internal audit functions;

Determines the scope risk and frequency of internal audit activities, including those to be performed by the covered licensee providing internal audit assistance services;

\$ Evaluates the findings and results arising from the internal audit activities, including those performed by the covered licensee 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 licensee.

(4) The covered licensee should also be satisfied that the client's board of directors, audit committee, or other governing body is informed about the covered licensee's or firm's and management's respective roles and

⁹Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings.

¹⁰For example, a covered licensee 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.

¹¹As 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. A licensee'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.

¹²A competent individual would have an understanding of internal audit activities sufficient to oversee the services performed by the covered licensee.

responsibilities in connection with the engagement. Such information should provide the client's governing body a basis for developing guidelines for management and the licensee to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

(5) The covered licensee 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 covered licensee. 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 covered licensee 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 covered licensee should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.

(6) 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 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 licensee 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.

(7) Services involving an extension of the procedures that are generally of the type considered to be extensions of the covered licensee's or firm'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 this Section, provided the provision of any such nonattest services are pursuant arrangements in existence on December 31, 2004, and are completed December 31, 2005, and the covered licensee was in compliance with the preexisting requirements of Rule 61H1-21.001.

Section 101-4. Honorary Directorships and Trusteeships of Not-for-profit Organization.

Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be considered to impair independence under rule 61H1-21.001, provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in

letterheads and externally circulated materials, he or she must be identified as an honorary director or honorary trustee.

Section 101-5. Permitted Loans

This section describes the conditions a covered licensee (or his or her **immediate family**) must meet in order to have any loan to or from the client, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests. Acceptable loans are termed "**Grandfathered Loans**" or "**Other Permitted Loans**."

Grandfathered Loans

Unsecured loans that are not material to the covered licensee's net worth, home mortgages¹³, and other secured loans¹⁴ are grandfathered if:

- (1) they were obtained from a **financial institution** under that institution's **normal lending procedures, terms, and requirements**.

¹³The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered licensee's net worth.

¹⁴See Footnote 4.

(2) after becoming a covered licensee they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement,¹⁵ and

(3) they were:

(a) obtained from the financial institution prior to its becoming a client requiring independence; or

(b) obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or

(c) were obtained prior to April 1, 2003 and met the requirements of previous provisions of Rule 61H1-21.001; or

(d) obtained after April 1, 2003 from a financial institution client requiring independence by a borrower prior to his or her becoming a covered licensee with respect to that client.

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.

For purposes of applying the grandfathered loans provision when the covered licensee is a partner in a partnership:

a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered licensee who is a partner in the partnership on the basis of their legal liability as a limited or general partner if:

the covered licensee's interest in the limited partnership, either individually or combined with the interest of one or more covered licensees, exceeds 50 percent of the total limited partnership interest; or

the covered licensee, either individually or together with one or more covered licensees, can control the general partnership.

even if no amount of a partnership loan is ascribed to the covered licensee(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described below.

Other Permitted Loans

This provision permits only the following new loans to be obtained from a financial institution client for which independence is required. These loans must be obtained under the institution's normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms.

- (1) Automobile loans and leases collateralized by the automobile.
- (2) Loans fully collateralized by the cash surrender value of an insurance policy.
- (3) Loans fully collateralized by cash deposits at the same financial institution (e.g., "passbook loans").
- (4) Credit cards and cash advances where the aggregate outstanding balance on the current statement is reduced to \$10,000 or less by the payment due date.

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.

Section 101-6. The Effect of Actual or Threatened Litigation on Independence.

In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

Litigation between client and licensee

The relationship between the management of the client and a covered licensee must be characterized by complete candor and full disclosure regarding all aspects of the client's business operations. In addition, there must be an absence of bias on the part of the covered licensee so that he or she can exercise professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against a covered licensee, the covered licensee.

¹⁵Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants.

and the client's management may be placed in adversarial positions in which the management's willingness to make complete disclosures and the covered licensee's objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the covered licensee and the covered licensee's client or its management are in threatened or actual positions of material adverse interests by reason of threatened or actual litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.
2. The commencement of litigation by the covered licensee against the present management alleging management fraud or deceit would be considered to impair independence.
3. An expressed intention by the present management to commence litigation against the covered licensee alleging deficiencies in audit work for the client would be considered to impair independence if the covered licensee concludes that it is probable that such a claim will be filed.
4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered licensee's firm¹⁶ or to the client company¹⁷ would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

Litigation by security holders

A covered licensee may also become involved in litigation ("primary litigation") in which the covered licensee and the client or its management are defendants. Such litigation may arise, for example, when one or more stockholders bring a stockholders' derivative action or a so-called "class action" against the client or its management, its officers, directors, underwriters and covered licensees under the securities laws. Such primary litigation in itself would not alter fundamental relationships between the client or its management and the covered licensee and therefore would not be deemed to have an adverse impact on independence. These situations should be examined carefully, however, since the potential for adverse interests may exist if cross-claims are filed against the covered licensee alleging that the covered licensee is responsible for any deficiencies or if the covered licensee alleges fraud or deceit by the present management as a defense. In assessing the extent to which independence may be impaired under these conditions, the covered licensee should consider the following additional guidelines:

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered licensee in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered licensee's firm¹⁸ or to the client.
2. The assertion of cross-claims against the covered licensee by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.
3. If any of the persons who file cross-claims against the covered licensee are also officers or directors of other clients of the covered licensee, independence with respect to such other clients would not generally be considered to be impaired.

Other third-party litigation

¹⁶Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered licensee should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment.

¹⁷See Footnote 7.

¹⁸See Footnote 7.

Another type of third-party litigation against the covered licensee may be commenced by a lending institution, other creditor, security holder, or insurance company who alleges reliance on financial statements of the client with which the covered licensee is associated as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may commence litigation (under subrogation rights) against the covered licensee in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered licensee and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered licensee alleges, in his defense, fraud, or deceit by the present management.

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered licensee ("the plaintiff client"), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered licensee's firm¹⁹ or to the plaintiff client.

Effects of impairment of independence

If the covered licensee believes that the circumstances would lead a reasonable person having knowledge of the facts to conclude that the actual or intended litigation poses an unacceptable threat to independence, the covered licensee shall either (a) disengage himself or herself, or (b) disclaim an opinion because of lack of independence. Such disengagement may take the form of resignation or cessation of any attest engagement then in progress pending resolution of the issue between the parties.

Termination of impairment

The conditions giving rise to a lack of independence are generally eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between the covered licensee and client. The covered licensee should carefully review the conditions of such resolution to determine that all impairments to the covered licensee's objectivity have been removed.

101-7. RESERVED

101-8. Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships with a Covered Licensee's Client.

Introduction

Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in other rulings [See Appendix 3].

The Following Definitions are to be used in only in Section 101-8 (all other definitions are contained at the end of the Standards).

The following specifically identified terms are used in Section 101-8 as indicated:

1. Client. The term client means the person or entity with whose financial statements a covered licensee is associated.
2. Investor. The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.
3. Investee. The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

Interpretation

Where a nonclient **investee** is material to a client **investor**, any direct or material indirect financial interest of a covered licensee in the nonclient investee would be considered to impair independence with respect to the client investor. If the nonclient investee is immaterial to the client investor, a covered licensee's material investment in the nonclient investee would cause an impairment of independence.

Where a client investee is material to nonclient investor, any direct or material indirect financial interest of a covered licensee in the nonclient investor would be considered to impair independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a covered licensee's financial interest in

¹⁹See Footnote 7.

the nonclient investor allows the covered licensee to exercise significant influence over the actions of the nonclient investor, independence would be considered to be impaired.

Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered licensee should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.

In general, in brother-sister common control situations, an immaterial financial interest of a covered licensee in the nonclient investee would not impair independence with respect to the client investee, provided the covered licensee could not exercise significant influence over the nonclient investor. However, if a covered licensee's financial interest in a nonclient investee is material, the covered licensee could be influenced by the nonclient investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered licensee in the nonclient investor would not impair the independence of the covered licensee with respect to the client investor, provided that the covered licensee could not exercise significant influence over the nonclient investor.

If a covered licensee does not and could not reasonably be expected to have knowledge of the financial interests or relationship described in this Section, independence would not be considered to be impaired under this Section.

Section 101-9. RESERVED

Section 101-10. The Effect on Independence of Relationships with Entities Included in the Governmental Financial Statements.²⁰

For purposes of this Section, a financial reporting entity's basic financial statements, issued in conformity with generally accepted accounting principles in the United States of America, include the government-wide financial statements (consisting of the entity's governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures, jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

Auditor of Financial Reporting Entity

A covered licensee issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity, as defined in the preceding paragraph of this Section. However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a licensee to be independent of that organization.

However, the covered licensee and his or her immediate family shall not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

Auditor of a Major Fund, Nonmajor Fund, Internal Service Fund, Fiduciary Fund, or Component Unit of the Financial Reporting Entity or Other Entity That Should Be Disclosed in the Notes to the Basic Financial

²⁰Except for a financial reporting entity's general purpose financial statements, which is defined within the text of this interpretation, certain terminology used throughout the interpretation is specifically defined by the Governmental Accounting Standards Board.

Statements

A covered licensee who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, must be independent with respect to those financial statements that the covered licensee is reporting upon. The covered licensee is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered licensee and his or her immediate family should not hold a key position within the primary government. For purposes of this Section, a covered licensee and immediate family member would not be considered employed by the primary government if the exceptions provided for in the definition of a **client** are met.

Section 101-11. RESERVED

Section 101-12. Independence and Cooperative Arrangements with Clients.

Independence will be considered to be impaired if, during the period of a professional engagement, a licensee or his or her firm had any cooperative arrangement with the client that was material to the licensee's firm or to the client.

Cooperative Arrangement – A cooperative arrangement exists when a licensee's firm and a client jointly participate in a business activity. The following are examples, which are not all inclusive, of cooperative arrangements:

1. Prime/subcontractor arrangements to provide services or products to a third party
2. Joint ventures to develop or market products or services
3. Arrangements to combine one or more services or products of the firm with one or more services or products of the client and market the package with references to both parties
4. Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the client's products or services, or the client acts as the distributor or marketer of the products or services of the firm

Nevertheless, joint participation with a client in a business activity does not ordinarily constitute a cooperative arrangement when all the following conditions are present:

\$ The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.

\$ The firm assumes no responsibility for the activities or results of the client, and vice versa.

\$ Neither party has the authority to act as the representative or agent of the other party.

In addition, the licensee's firm should consider the requirements of section 473.319 and section 473.3205.

101-13 RESERVED.

101-14 RESERVED.