AUDIT CONDUCT NEWS

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CPAs in Business, Industry & Government and Auditor Independence

As a professional employed in business, industry, or government, you are not personally subject to the profession's independence rules, but if you deal with auditors from time to time, you should be familiar with the types of issues that may arise. Missteps, oversights, or innocent errors that impair your auditor's independence can seriously impact your organization, in some cases requiring a re-audit and exposing your employer to liability and negative press. A basic awareness of the types of financial interests and business and personal relationships that can affect independence may one day help you to avoid a sticky situation. In addition to being aware of potential independence issues, you can share certain information that supplements and enhances the data your auditor uses to comply with the independence rules and play a part in ensuring compliance.

These simple actions—being aware and providing organizational data to your auditor—benefit your organization and its constituents (such as shareholders, creditors, donors, or vendors) who have a vested interest in a strong, independent audit.

The Compliance Blues

Maintaining independence under today's standards is not easy. The rules and regulations are multi-tiered and complex and are issued and enforced by a patchwork of private, federal, state, international, and quasi-governmental bodies ranging from the American Institute of Certified Public Accountants (AICPA) to the state accountancy boards and federal agencies such as the Securities and Exchange Commission (SEC) and Department of Labor (DOL), among others. For example, auditors of public companies need to comply with the independence rules of the AICPA, the SEC, and the PCAOB - in addition to local state rules.

Information—A Valuable Commodity

Compliance with these rules can be tedious, requiring a truckload of detailed information about investments, employment, business relationships, loans, fee arrangements, and nonaudit services. The more complex your auditor's operations (e.g., the firm has many affiliates or practices in numerous locations), and the more complex your organization, the more information your auditors need to achieve and maintain compliance. For example, under SEC/PCAOB rules, auditors are not permitted to provide tax services to

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employees in financial reporting oversight roles of the company or its material affiliates. If your auditors are subject to these rules and provide tax services to your employees, they will likely request the names of the people in these roles. Your auditors can use this valuable information to update their internal data to reflect your employees' most recent status and validate their data against yours, which should help to minimize errors.

An Illustration

Assume Abel, CPAs audits the financial statements of Brown, Inc., a public company. Brown provides the following information to Abel:

- **The names of persons in financial reporting oversight roles in Brown, Inc. and its material affiliates and persons in accounting roles.** Abel, CPAs uses this information to verify compliance with various rules, including: (1) to ensure that no personal tax services are provided to Brown employees in financial reporting oversight roles; (2) to verify compliance with rules barring relatives of certain Abel professionals from serving in accounting or financial reporting oversight roles, and (3) to ensure that Brown employees joining Abel, CPA (and Abel employees taking jobs with Brown) satisfy all "cooling off" requirements.

- **A current and complete list of Brown, Inc. affiliates, including individuals (i.e., officers, directors, and significant shareholders) and entities (e.g., equity method investees, subsidiaries, and companies under common control with Brown).** The SEC and PCAOB rules require Abel to be independent not only of Brown but also of various affiliates so it is imperative that this information be comprehensive, accurate, and up-to-date.

- **A current list of Brown, Inc.'s shareholders, which highlights shareholders who have substantial investments in the company (i.e., five percent or more).** Abel, CPAs matches Brown's list against its internal list of personnel who are required to avoid financial interests in Brown (e.g., all partners in the office performing the audit) to ensure that none of these persons (including their immediate family members) is invested in Brown. For substantial investments, the prohibition extends to all of Abel's partners and professional employees and certain of their family members.

- **Nonaudit services provided by Abel, CPAs to Brown, Inc. and affiliates of Brown.** Ideally, Brown's management should provide a list of all nonaudit work Abel provided to Brown and its affiliates over the past year. Abel should monitor this information and match it against its own records to ensure that all requirements are being met, including that all services are being pre-approved by the audit committee in accordance with the rules.

About the Author & Publisher

Cathy Allen, founder of Audit Conduct, LLC, develops courses and customized training on professional ethics and auditor independence for CPA firms, professional organizations, and other stakeholders of the accounting profession. She also helps CPA firms enhance their quality controls over ethics and independence compliance.

Independence Resources

The following resources can help you get up-to-speed with independence and stay current with standard-setting and other developments:

To familiarize yourself with the standards that apply to your organization's attest services, see www.auditconduct.com/resources.php.

For resources about recent standard-setting and similar events, see www.auditconduct.com/events.php.