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United States Government Accountability Office
Washington, DC 20548

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Subject: Proposed Revised Interpretations

This letter provides the U.S. Government Accountability Office's (GAO) comments on the AICPA Professional Ethics Executive Committee's (PEEC) proposed revisions to Interpretation No. 101-3, "Nonattest Services," under Rule 101, *Independence*. GAO is commenting on PEEC's proposed revisions to language in Interpretation No. 101-3 on the effect on independence of providing nonattest services, including financial statement preparation and cash-to-accrual conversion and internal audit assistance services. GAO is not commenting on the proposed new interpretations under Rules 501 and 502 or the proposed deletions of ethics rulings that are included in the exposure draft. As noted below, while GAO generally agrees with the proposed Interpretation No. 101-3, we have concerns related to the proposed language addressing special conditions under which independence would not be impaired, the proposed discussion of cumulative threats to independence, and the placement of the section on monitoring of internal control in the internal audit assistance section of the Interpretation.

Requests for Specific Comments

With respect to the revisions to the "Activities Related to Attest Services" section, the PEEC has asked respondents to indicate whether they believe a two-year transition period or an implementation date aligned with the effective date of the revised SSARS is appropriate. We believe that the proposed revisions to ET 101-3 will in some cases result in significant improvement in practice. Consequently, it is our view that the revisions should be adopted as soon as is practical and we support the earlier of the two proposed dates – likely the effective date of the revised SSARS. We agree with the proposal to permit early implementation. Permitting early implementation allows members to adopt one consistent set of policies and procedures to comply with the PEEC's guidance on independence for all engagements during the transition period.

Other Comments on Proposed Revisions

General Nonattest Services

The current exposure draft contains the following revised version of language introduced in the February 28, 2011 *Omnibus* exposure draft indicating conditions under which independence would not be impaired even if the requirements of the Interpretation have not been met:

“In cases where the requirements of this interpretation have not been met during the period of the professional engagement or the period covered by the financial statements, the member’s independence would be impaired, except as noted in the following paragraph.

A member’s independence would not be impaired if the member performed nonattest services that would have impaired independence during the period covered by the financial statements, provided that

- a. the nonattest services were provided prior to the period of the professional engagement.;
- b. the nonattest services related to periods prior to the period covered by the financial statements.;
- c. the financial statements for the period to which the nonattest services relate were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm).”

While we agree that the conditions indicated would lessen the risk that provision of some nonaudit services would pose to the auditor’s independence, we disagree that the outlined circumstances alone are sufficient to mitigate any threat of impairment. We believe that the auditor should assess threats to independence and the effectiveness of any safeguards applied to determine whether the circumstances result in an independence impairment. In addition, we believe that the Interpretation should make clear that all the conditions in the paragraph, as revised for our comments, should be met. The Interpretation could meet both these objectives with, for example, the addition of a fourth condition, preceded by an “and” at the end of condition “c” as follows:

“...reviewed or audited by another firm), and

d. after due consideration of the combined effect of conditions a, b, and c, the member determines that the impact of any resulting participation in the audited entity’s management does not impair independence.”

Cumulative Effect of Threats to Independence

We believe that PEEC's proposed provision highlighting the possible increased significance of cumulative threats to independence adds an important consideration to the Code's independence discussion. In our view, though, the importance of consideration of cumulative threats is not limited to assessments of nonattest services. It is possible that threats unrelated to nonaudit services, such as familiarity or undue influence threats, that are not significant individually could be significant in aggregate. While we realize that the proposed revisions are to the nonattest services section of the Code, we suggest that PEEC consider adding language on treatment of cumulative threats to independence that would address independence assessments generally.

Financial Statement Preparation and Cash-to-Accrual Conversions

GAO strongly supports PEEC's proposal to consider financial statement preparation and cash-to-accrual conversions performed by a member for an attest client to be nonattest services subject to the requirements of Interpretation No. 101-3. We believe that provision of these very common services to entities that the audit organization will subsequently audit almost always poses significant self-review and management participation threats to auditor independence. Requiring auditors to consider financial statement preparation and related services in the context of the Interpretation No. 101-3 General Requirements and all other guidance that applies to nonattest services would result in important enhancements to auditor independence, both in fact and in appearance. The change would also improve consistency in PEEC's message to the public on independence: currently, the *Frequently Asked Questions* cited in the explanation attached to the exposure draft does not agree with the table in Interpretation No. 101-3, which lists financial statement preparation as a type of nonattest service.

We also agree with PEEC's thoughts on the timing of implementation and the advisability of permitting early implementation. The comments in the explanation on implementation timing give due consideration to the significant issues that many practitioners will need to address if the proposed revision is adopted.

Internal Audit Assistance Services

We agree with PEEC that inherent management participation threats associated with separate evaluations of an audited entity's internal control justifies the attention given in the proposal. In our view, the proposed language on internal control monitoring is appropriate. However, we do not believe that the guidance would be better aligned if incorporated into the *Internal Audit Assistance Services* section as PEEC currently proposes. We are concerned that this placement could result in confusion for auditors who do not view such activity as internal audit assistance. We recommend that PEEC consider including the language on internal control monitoring in the *Management Responsibilities* section as proposed in the February 28, 2011 exposure draft. If PEEC determines that the proposed location in *Internal Audit Services* is appropriate, we suggest that a reference be added to the

Management Responsibilities section to direct auditors who may be performing separate evaluations to the proper section.

We thank you for considering our comments on these important issues.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

James R. Dalkin
Director
Financial Management and Assurance