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United States Government Accountability Office  
Washington, DC 20548

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Lisa A. Snyder  
Director, Professional Ethics Division  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775

Subject: AICPA Professional Ethics Executive Committee's September 2012  
Exposure Draft entitled "*Omnibus Proposal ~ AICPA Professional Ethics Division  
~ Interpretations and Definitions.*"

This letter provides the U.S. Government Accountability Office's (GAO) comments on the AICPA Professional Ethics Executive Committee's (the PEEC) proposed revisions to the definitions of *practice of public accounting* (paragraph .29 of ET section 92, *Definitions* [AICPA, *Professional Standards*]) and *professional services* (paragraph .30 of ET section 92) and the related conforming changes in the AICPA *Code of Professional Conduct* (the Code). As noted below, while GAO generally agrees with the proposed revisions to definitions, we believe that the revision process provides an opportunity for the PEEC to consider additional changes that would enhance the ability of auditors in government to apply the Code's rules and standards. We are suggesting that the PEEC take this opportunity to revise the definition of *client* (ET 92.03); add explanatory language to the definition of *firm* (ET 92.10); and revise the list of safeguards implemented by the firm (ET 100-01.26).

### ***Proposed Revisions to Paragraphs .29-.30 of ET Section 92***

We agree that replacement of the term *practice of public accounting* with the term *public practice* would improve consistency with both the majority of AICPA's rules and with the International Ethics Standards Board for Accountants' Code of Ethics. We also agree with the PEEC's position that eliminating the word *accounting* from the term more clearly communicates the breadth of the term's meaning by not appearing to limit its application strictly to accounting services. However, we question the value of the parenthetical comment *also referred to as the practice of public accounting*. If, after making the proposed revisions, the phrase *the practice of public accounting* remains elsewhere in the Code, we suggest that the PEEC make conforming changes similar to those proposed for the sections of the Code selected for inclusion in the exposure draft.

## ***Additional Considerations***

***Definition of client (ET 92.03):*** We agree with the PEEC that the relationship between independent government auditors and those they audit needs to be addressed in a comprehensive definition of *client*. As written, subparagraph b of the definition includes important guidance for independent government auditors applying the standards and rules of the Code in the government environment. We believe, however, that the subparagraph should be expanded to include other circumstances under which an independent government auditor should consider the audited entity to be a “client” rather than an “employer” in keeping with the meaning of those words as described in the definition. For example, an auditor employed in the legislative branch of a state government who audits financial statements, the objective of which is to report on the executive branch’s financial position and activity, would likely more appropriately consider the executive branch to be a “client” for the purposes of applying the Code. In this light, we suggest the following revisions to the definition of *client* in ET 92:

**.03 Client.** A client is any person or entity, other than the member’s employer, that engages a member or a member’s firm to perform professional services or a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term “employer” does not include—

- a. Entities engaged in the practice of public accounting; or
- b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities is
  - i. ~~Is~~ Directly elected by voters of the government or component unit thereof with respect to which professional services are performed; or
  - ii. ~~Is~~ An individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; ~~or~~
  - iii. ~~Is~~ Appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body;
  - iv. Appointed by, accountable to, reports to, and can only be removed by a statutorily created governing body, the majority of whose members are independently elected or appointed and are outside the organization being audited;
  - v. At a level of government other than the one of which the audited entity is part (federal, state, or local); for example federal auditors auditing a state government program; or
  - vi. Placed within a different branch of government from that of the audited entity; for example, legislative auditors auditing an executive branch program.

**Definition of *firm*:** The definition of *firm* would be improved by an acknowledgment that the rules and standards contained in the Code may apply equally to auditors in independent government audit organizations. Examples of contexts in the Code and the proposed revisions to the Code in which the term *firm* is used but which express principles that apply equally to independent government auditors include the definitions of *client* and *manager* in ET 92.03 and .19 respectively; the proposed definition of *partner equivalent*; the safeguards in ET 100.01.26; and the discussion of independence in ET 101. Adding the following to the definition of *firm* would address this concern:

An independent government audit organization that adheres to the rules and standards of the Code may be considered a firm for the purposes of applying those rules and standards.

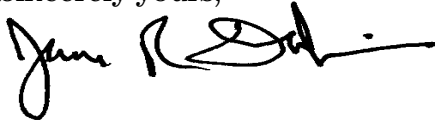
**Examples of safeguards implemented by the firm (ET 100.1.26):** In the context of independence, GAO views adequate safeguards as proactive steps taken by an audit organization to eliminate threats to independence or to reduce them to an acceptable level. This perspective is reflected in *Government Auditing Standards*, where the examples of safeguards include consultation with an independent third party and removal of a team member with interests or relationships that pose a threat to independence. We believe that examples like these emphasize the importance of active management of threats to independence. While we recognize the value of passive safeguards such as firm leadership that stresses the importance of independence and policies that empower staff to communicate independence issues, it is our view that they can augment but not take the place of active safeguards. From this perspective, examples of passive safeguards, without adequate explanation that in many cases such safeguards will not on their own eliminate threats to independence or reduce them to an acceptable level, can lead to misunderstandings by auditors that result in application of insufficient safeguards. We recommend that the PEEC revise the list of safeguards to identify those that are passive and therefore cannot be relied upon to eliminate or to reduce to an acceptable level any significant threats to auditor independence if they are not combined with active safeguards. Appropriate language could reflect that currently used to clarify the role of safeguards implemented by the attest client:

*Examples of safeguards implemented by the firm that would operate in combination with other safeguards*

We consider the safeguards listed in ET 100.01.26 *a* through *m*, *s*, *w*, *x*, and *y* to be passive safeguards.

We thank you for considering our comments on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact Jim Dalkin ((202) 512-3133, [dalkinj@gao.gov](mailto:dalkinj@gao.gov)) or Eric Holbrook ((202) 512-5232, [holbrooke@gao.gov](mailto:holbrooke@gao.gov)).

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 at the end.

James R. Dalkin  
Director  
Financial Management and Assurance