

Auditor independence education materials: The importance of being independent

Case Study 1: Can we propose?

Developed in conjunction with the University of Illinois Center for Professional Responsibility in Business and Society.

Instructions and Table of Contents

Instructions

In this case study, you are Tanisha Williams, a senior manager at the international public accounting firm, Meridien, LLP (“Meridien”). You have been asked to run an “independence check” for a potential new audit client to Meridien, Bond Financial Services, Inc. Your task is to determine whether Meridien is independent of Bond and if Meridien may propose on the audit of Bond.

Below is a table of contents for Case Study 1. Please read the Briefing Documents, Appendix A, and the Case Facts and Background prior to answering any questions.

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Independence literature relating to this case study:

1. Securities and Exchange Commission’s (SEC) Independence Rules
 - » Rule 2-01 of Regulation S-X (Article 2 — Qualifications and Reports of Accountants (Reg. §210.2-01) <http://www.law.uc.edu/CCL/regS-X/SX2-01.html>.
2. Public Company Accounting Oversight Board (PCAOB) Independence Rules
 - » 3521, *Contingent Fees*, and Rule 3501 (c)(ii) — Definition of *Contingent Fee*, and 3501(a)(iii) - Definition of *Audit and Professional Engagement Period*. (http://www.pcaobus.com/Rules/Docket_017/2005-07-26_Release_2005-014.pdf.)
 - » Rule 3522, *Tax Transactions* (http://www.pcaobus.com/Rules/Docket_017/2005-07-26_Release_2005-014.pdf).
 - » Interim Independence Standard, ET Section 191 — *Ethics Rulings on Independence, Integrity, and Objectivity of the AICPA Code of Professional Conduct; Ruling No. 52*. (http://www.pcaobus.com/Standards/Interim_Standards/Ethics/index_et_nomenu.asp?section=191).
3. AICPA *Code of Professional Conduct*
 - » Section 101-3, *Performance of Non-Attest Services (Revised)* (http://www.aicpa.org/about/code/et_101.html#et_101.05)
 - » Section 101-11, Modified application of Rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements (http://www.aicpa.org/about/code/et_101.html#et_101.13)

Briefing Documents

The company/client

Name: Bond Financial Services, Inc. (“Bond”)

Location of headquarters: Boston, Massachusetts

Type of business: Bond is a financial services firm, which provides capital market services, brokerage, investment banking and advisory services, wealth management, asset management, insurance, and other related financial services.

Ownership structure: Publicly owned corporation (since 1998); registered with the Securities and Exchange Commission (SEC); issuer of securities.

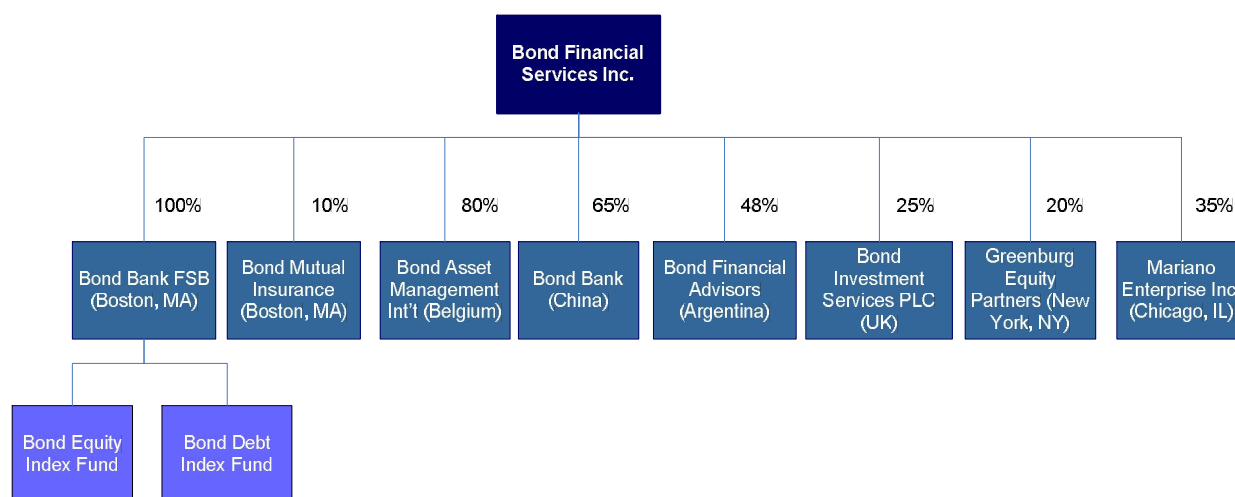
Number of employees (worldwide): 4,275

Bond employees: Charles Adams, Chief Financial Officer
Dennis Moscati, Chief Operations Officer
Bruce Weaver, Internal Audit Director

Bond Audit Committee members: Salvatore Marconi, Chair
Mary Armstrong, Member
Laverne Santiago, Member

Other: Net revenues for the fiscal year ended December 31, 20X3, were \$2.6 billion, which represent an increase of 3% over the prior year. Compared to its peers, Bond has a very strong balance sheet and most financial analysts expect solid growth into 20X4. All of the Bond companies are financially sound; the debt securities of Bond and its **affiliates** are A rated or above.

Entities associated with bond:



The public accounting firm

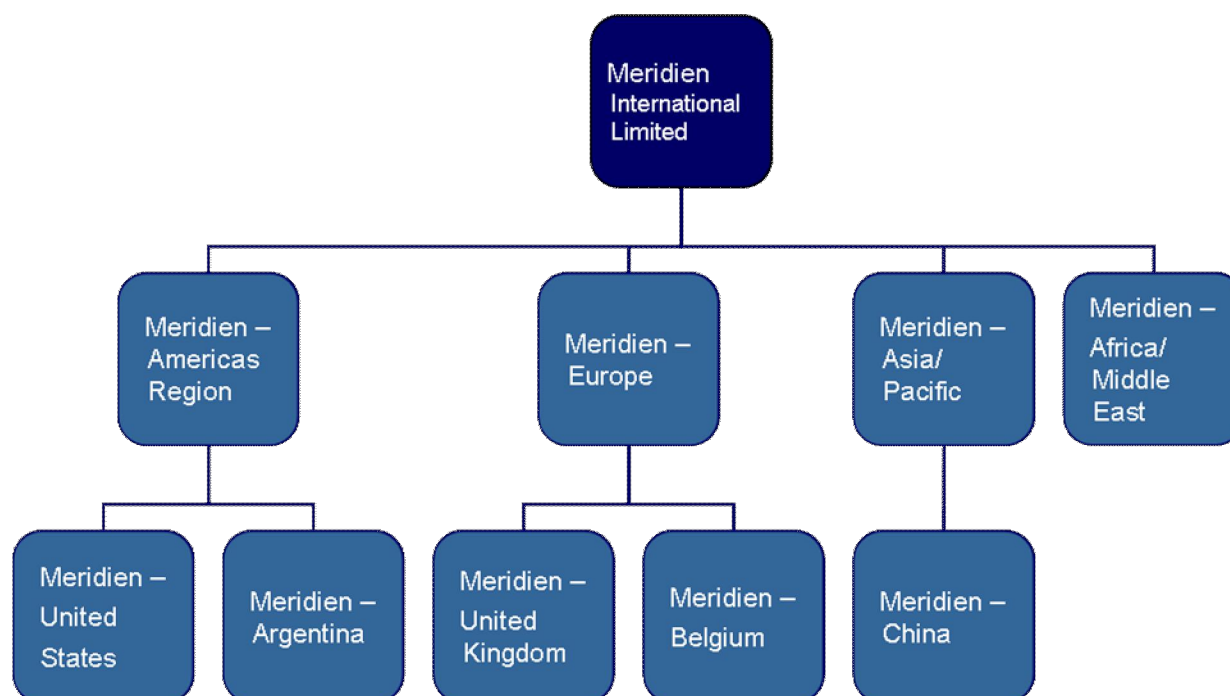
Name: Meridien, LLP (“Meridien”) is a public accounting firm registered with the Public Company Accounting Oversight Board (PCAOB).

Location of headquarters: New York, New York

Meridien professionals: Barbara Cortez, Audit Partner
 Tanisha Williams, Audit Senior Manager
 Jeff Smith, Audit Manager
 Frank Shepard, Tax Partner
 John LaPelle, Tax Associate
 Rod Mitchell, Independence Office Consultant

Independence Policy: [Link to Meridien Independence Policy](#)

Ownership structure: Meridien is a Delaware limited liability partnership that belongs to a network of member firms of Meridien International Limited, each of which is a separate and independent legal entity. The member firms of Meridien International Limited are made up of member firms located in over 50 countries. Meridien International Limited does not provide any professional services to clients; rather, it helps coordinate the activities of the member firms. The member firms provide professional services (such as audit, tax, and consulting services) to clients. Unless stated otherwise, “Meridien” or the “firm” means the Meridien member firm located in the United States. The Meridien member firms involved in the case studies appear in the bottom row of the organizational chart below:



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Case Facts and Background

Charles Adams, the Chief Financial Officer (CFO) of Bond Financial Services, Inc. (“Bond”), contacts Barbara Cortez, an audit partner at Meridien, LLP (“Meridien”) to request a **proposal** to perform an integrated audit of Bond’s financial statements for the year ended December 31, 20X4. Barbara organizes a small team to draft the audit **proposal**, including senior manager, Tanisha Williams.

Monday, July 15, 20X4 — 9:00 AM

Tanisha is sitting at her desk when her phone rings. Barbara informs her of the new potential audit client.

“I want you to run the **independence check**,” Barbara says. “Make sure we address all the independence requirements so we can issue a **proposal** to perform the audit of Bond’s December 31, 20X4 financial statements. You can do this, right?”

“Of course,” Tanisha says. “This would be a terrific win. Bond Financial is a solid, well-respected firm here in Boston.”

Barbara interjects, “I know the U.S. firm does a fair amount of tax work for the company... but outside of the U.S., I am not aware of any services Meridien has performed for them. They have limited international operations... so I am hoping it will not be too difficult to determine whether we have any relationships with Bond or its **affiliates** that would impair our independence.” Pausing, she adds, “We are looking to have a decision on whether we can propose by the end of the week.”

“Okay, I’ll get right on this... my goal will be to provide you the results of the **independence check** no later than 3 p.m. Friday.”

“Thanks, Tanisha. I knew I could depend on you,” says Barbara.

“Sure thing — I’ll keep you posted,” replies Tanisha as she hangs up the phone. Quickly, she logs into the Meridien intranet, links over to the firm’s independence page, and downloads a copy of the International “**Independence Check**” Form. After gathering the necessary information, Tanisha enters the name of the prospective audit client and other requested information, including the company’s **affiliates**. She sends the form to Meridien’s Independence Office, which will help Tanisha identify any relationships that may impair the firm’s independence.

See completed **independence check** form attached:

[Link to 1.1 Independence Check Form](#)

Monday, July 15, 20X4 — 12:30 PM

Upon receiving Tanisha’s e-mail with the independence check form attached, the Independence Office sends an e-mail to all of the Meridien member firms. The e-mail, which appears below, is addressed to persons responsible for independence compliance matters in their respective locations:

From: IndependenceOffice@MeridienUS

To: Independence Compliance Directors

Cc:

Subject: URGENT: Independence Check — Bond Financial Services, Inc.

Bond Financial Services, Inc. (a U.S.-domiciled company that is registered with the SEC) is accepting audit proposals for the period ending December 31, 20X4.

Please indicate whether your firm has had any relationships with Bond or its affiliates that may impair Meridien's independence. If you are not aware of any relationships, please reply to this e-mail indicating that there are none to your knowledge. If you have information to report, please include a detailed description of each relationship Meridien has with Bond and include a copy of the engagement letter if applicable. Please be advised that the Independence Office and/or the proposal team may request additional information regarding any reported matters.

As Meridien has been asked to propose on this audit by the end of this week (July 19), please reply to this e-mail as soon as possible, but no later than July 18.

Wednesday, July 17, 20X4 — 12:00 PM

During the week, Tanisha receives three responses from Meridien member firms that have identified possible conflicts. Please review the responses in the attachment below:

[Link to 1.2 Member Firm E-mails](#)

Thursday, July 18, 20X4 — 12:00PM

Tanisha has evaluated these potential conflicts and is now preparing a memorandum to send to Barbara. In drafting the memo, she also considers the following additional information, which she just received:

- From Meridien — China: the engagement team has decided not to pursue the Information Technology (IT) design and implementation work.
- From Meridien — Argentina: Bond Financial Advisors has decided to initiate litigation in the matter relating to Bond's royalty payments and would like Meridien Argentina to advocate its position as an expert witness.

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Suggested Questions

Simple – Rules based (SR)

SR1.1) Which of the companies listed in Section 3 of the [Independence Check Form \(document 1.1\)](#) would be considered “affiliates” of Bond? Why or why not? Please review [Meridien’s Independence Policy](#) for the definition of an affiliate.

SR1.2) Was the fee arrangement between Meridien-UK and Bond Investment Services, Plc. a contingent fee? Would the fee arrangement impact independence as it relates to the proposed 20X4 audit? Discuss the basis for your conclusion.

SR1.3) Given the timing of Meridien-Belgium’s engagement with Bond Asset Management International, would independence be considered impaired with respect to the 20X4 audit? Why or why not?

SR1.4) Assume Meridien performed nonaudit services for Bond, which were completed on August 10, 20X3. However, as of July 20X4, Bond has not paid the invoice for the services provided. If engaged as the auditor, Meridien would issue its audit report on Bond’s 20X4 financial statements on or about March 15, 20X5. If Meridien has still not been paid for the nonaudit services by the time it is ready to issue its audit report on the 20X4 financial statements, would its independence be considered impaired?

Complex – Rules based (CR)

CR1.1) The Preliminary Note in SEC Rule 2-01 of Regulation S-X states that, “In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: (a) creates a mutual or conflicting interest between the accountant and the audit client; (b) places the accountant in the position of auditing his or her own work; (c) results in the accountant acting as management or an employee of the audit client; or (d) places the accountant in a position of being an advocate for the audit client. These factors are general guidance only and their application may depend on particular facts and circumstances.”

Describe a situation you believe would illustrate each of these items and whether or not you agree that these situations impair an accounting firm’s independence.

CR1.2) If you were asked to gather the information requested in Section 3 of the independence check form regarding affiliated legal entities where would you expect to find the information?

CR1.3) Regardless of the timing the services were performed, determine whether each service described in the [Member Firm E-mails at 1.2](#) are permitted under [SEC Regulations S-X, Rule 2-01 \(see below\)](#). If service is not permitted under the SEC rules, state why and cite the applicable rule. If you are uncertain about whether a particular service is permitted under the SEC rules, state what additional information you would request from the engagement team to help you come to a conclusion?

[Link to Excerpt of SEC Regulation S-X, Rule 2-01](#)

CR1.4) Do you believe the scope of services described in Meridien’s [U.S. Tax Engagement Letter](#) included in the [1.1 Independence Check Form](#) is consistent with the independence requirements described in the AICPA *Code of Professional Conduct* Section 101-3? Discuss the basis of your answer.

CR1.5) Discuss how Bond management’s willingness and ability to meet its management responsibilities as outlined in the [UK tax engagement letter at 1.4](#) and in the AICPA *Code of Professional Conduct* Section 101-3 impacts Meridien’s independence.

CR1.6) Draft a memorandum to Barbara Cortez, noting all of the potential conflicts identified during the independence check process and whether Meridien can provide audit services to Bond for the year ending December 31, 20X4.

Conceptual (C)

C1.1) Why do you think independence rules apply *only* to audits and other attest services? That is, what is it about the nature of attest services that should require the accounting firm to be independent? Should independence also be required of nonaudit services? Why or why not?

C1.2) Imagine you received responses to all of the independence check inquiries by Friday, 3 p.m. except one. If the missing response left you uncertain as to the interests or relationships between Meridien and Bond that existed in 20X4, what would you do? What if instead, the missing information related to interests and relationships existing in 20X3? Would your answer change? If so, how and why?

C1.3) Comment on the breadth of the rules addressed in SEC Rule 2-01(c)(4) and (5). Do you consider the rules sufficient to protect the public (i.e., by ensuring that auditors are independent of their audit clients)? Why or why not?

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Request for Cross-Border Independence Check — Outbound From the U.S. Member Firm to Other Member Firms

| | | | |
|----------------------------|----------------|---------------------|--------------------|
| From: Independence Office | | | |
| Requesting Partner: | Barbara Cortez | Prepared by: | Tanisha Williams |
| Member Firm: | U.S. | E-mail: | twilliams@meridien |
| Office: | Boston | Phone: | 617-3X5-8190 |
| Date: | July 15, 20X4 | Fax: | N/A |

1. Identify the Entities Involved — Provide Names and Locations

Identify **each entity and/or person** for which you are requesting a conflict check or an independence check. Identify the location where each entity is believed to be headquartered. If a complex ownership structure is involved, attach an organization chart. For private entities, please include their web site addresses.

Bond Financial Services Inc. ("Bond") — Boston, Massachusetts

Entities associated with Bond:

- 1) Bond Bank, FSB — Boston, MA
- 2) Bond Mutual Insurance — Boston, MA
- 3) Bond Asset Management International — Brussels, Belgium
- 4) Bond Bank — Shenyang, China
- 5) Bond Financial Advisors — Buenos Aires, Argentina
- 6) Bond Investment Services, Plc. — London, UK
- 7) Greenburg Equity Partners — New York, NY
- 8) Mariano Enterprises, Inc. — Chicago, IL
- 9) Bond Equity Index Fund — Boston, MA (sponsored by Bond Bank, FSB)
- 10) Bond Debt Index Fund — Boston, MA (sponsored by Bond Bank, FSB)

2. Describe Any Known Relationships or Potential Conflicts —

For each Entity listed in Item 1, are you aware of any existing audit relationship with such entity, or of any other relationship that may be in conflict with your proposal?

- No.
 Yes.

We are aware of the following tax services being performed for Bond in the United States. See draft engagement letter attached. Services appear to be permitted.

[Link to 1.3 U.S. Tax Engagement Letter](#)

3. Describe the Relationship of Each Entity to the Potential Audit Client —

For each entity listed in Item 1, describe the Entity's relationship with the potential audit client .

Bond Financial Services, Inc. will be the audit client.

- 1) Bond Bank, FSB (U.S.) — 100% owned subsidiary
- 2) Bond Mutual Insurance (U.S.) — 10% owned subsidiary
- 3) Bond Asset Management International (Belgium) — 80 % owned subsidiary
- 4) Bond Bank (China) — 65% owned subsidiary
- 5) Bond Financial Advisors (Argentina) — 48% owned subsidiary; Bond principals have 8/10 seats on board of directors; not material to Bond
- 6) Bond Investment Services, Plc. (UK) — 25% owned subsidiary; material to Bond
- 7) Greenburg Equity Partners (U.S.) — 20% interest in the company; investment is material to Bond
- 8) Mariano Enterprises, Inc. (U.S.) — 35% interest in the company; investment not material to Bond
- 9) Bond Equity Index Fund — sponsored by Bond Bank, FSB
- 10) Bond Debt Index Fund — sponsored by Bond Bank, FSB

4. Describe the Opportunity —

a. Provide a summary of the requested services.

Bond Financial Services is requesting bids from accounting firms to audit the financial statements and the effectiveness of the company's internal control over financial reporting for the fiscal year ending December 31, 20X4. These services will include the following:

- Expressing an opinion on the fairness of the presentation of the company's financial statements for the year ended December 31, 20X4, in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"), in all material respects.
- Expressing an opinion on the effectiveness of the company's internal control over financial reporting as of December 31, 20X4, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.
- Performing reviews of Bond's interim financial reports for the remaining quarters in the year ended December 31, 20X4, prepared for submission to the SEC. The objective of a review of interim financial information is to provide a basis for communicating whether Meridien is aware of any material modifications that should be made to the interim financial information for it to conform to generally accepted accounting principles. In conjunction with each quarterly review, Meridien would perform quarterly procedures to provide it a basis for determining whether the firm is aware of any material modifications that, in the Meridien's judgment, should be made to the disclosures about changes in internal control over financial reporting that have materially affected or are reasonably likely to materially affect the company's internal control over financial reporting for such disclosures to be accurate and to comply with Section 302 of the Sarbanes-Oxley Act of 2002 and related SEC rules and regulations.

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U.S. tax engagement letter: Tax compliance and advisory services (excerpt)

June 8, 20X2

Charles Nell, VP — Taxation
Bond Financial Services, Inc.
25 Tewilliger St.
Boston, MA 02102

Dear Mr. Nell:

Meridien, LLP (“Meridien”) is pleased to have been selected to provide certain tax compliance and advisory services to Bond Financial Services, Inc. (“Bond” or the “Company”)

The purpose of this engagement letter is to confirm the terms of our engagement to provide the requested tax compliance and advisory services described below:

SCOPE OF SERVICES

- We will assist the Company’s Tax Director with annual tax compliance (e.g., prepare and sign as preparer the U.S. Corporate Income Tax Return, Form 1120, for the Company beginning with the tax year ended December 31, 20X2) and other tax returns or other documents required in each of the Company’s domestic and foreign tax jurisdictions.
- Upon completion of each tax return, a draft version of the return will be provided to the Tax Director for review and approval. The tax return will be signed and filed by the appropriate member of Company management.
- We will provide assistance with tax matters to the Tax Director and his staff, including representation before the IRS, as requested. We will also advise and assist the Tax Director and his staff with tax strategies, as requested. The Tax Director and other members of the Company’s management are responsible for acting on any advice we provide, including approving and implementing any proposed tax strategies.

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E-mail #1 - Bond Asset Management International (Belgium)

-----Original Message-----

From: Edwin Tamman [mailto:ETamman@MeridienBEL]

Sent: Wednesday, July 17, 20X4 7:22 AM

To: IndependenceOffice@MeridienUS

Cc:

Subject: Outsourcing Engagement: Bond Asset Management International

Bond Asset Management hired us in June 20X2, to host, maintain, and monitor their IT systems, platforms, and networks. Specifically, its servers were installed by us at a Meridien IT hosting facility. Ongoing monitoring and server functionality was performed by us throughout their 20X3 fiscal year. Included below is an excerpt of our engagement letter. Ultimately, Bond Asset Management began performing these functions itself and began hosting and maintaining its own IT systems, platforms, and networks at their own sites.

We completed the engagement in December 20X3.

Please contact me if any additional information is needed.

Best Regards,
Edwin Tamman
Consulting Principal
Brussels, Belgium

Excerpt of Engagement Letter: Outsourcing Engagement

SCOPE OF SERVICES

We will install your servers at an off-site Meridien IT Hosting facility.

The Meridien IT Hosting facility will have all appropriate safeguards to ensure your servers are protected and secure.

We will provide ongoing monitoring of your systems and networks and ensure server functionality.

The Meridien IT Hosting facility will provide backups of all data and information to a remote server and can be made available to management upon request.

E-mail #2 - Bond Financial Advisors (Argentina)

-----Original Message-----

From: Giraldo Garcia [mailto:GGarcia@MeridienARG]

Sent: Tuesday, July 16, 20X4 11:02 AM

To: IndependenceOffice@MeridienUS

Cc:

Subject: Agreed-Upon Procedures: Bond Financial Advisors

Two months ago, Bond Financial Advisors engaged us to perform agreed upon procedures with regards to a royalty agreement that they have with a publisher. Last year, a few of Bond's top people served as subject matter experts and helped author an investment guide that has sold over 100,000 copies. For months, Bond has questioned the amount of royalties they have received from the publisher. Ultimately, they decided to engage Meridien Argentina and exercise their right to verify that the royalty calculation used by FinanceNow Publications, the publisher, agrees with the calculation established in the royalty agreement. We will also verify the actual amount of copies sold by the publisher.

We do not believe we have been placed in a position of advocating the client's position but rather just providing verification of amounts and compliance with the royalty calculation contained in the agreement. We will be performing procedures set forth by Bond and using evidential matter obtained from FinanceNow Publications. At this time no decision has been made by Bond management on whether to pursue a lawsuit or to use us as an expert witness to advocate their position. Please see an excerpt of our engagement letter below. We welcome your thoughts and those of the Independence Office.

Regards,
Giraldo Garcia
Consulting Partner
Meridien-Argentina

Excerpt of Engagement Letter: Agreed Upon Procedures

SCOPE OF SERVICES

We will undertake a review of the royalty calculation used by FinanceNow Publications, and compare it to the calculation contained in the royalty agreement.

We will review FinanceNow Publications' sales system to verify that the number of copies sold used in their royalty calculation agrees to the number in their sales system.

Once we have reviewed the calculation used by the publisher and verified the number of copies sold, we will provide you a report of the procedures we performed and our findings.

Furthermore, we will provide documentation of the process and any other pertinent information that supports our findings in a written report, e.g., a description of the project objectives, summaries of the procedures performed, and findings from the performance of the procedures.

E-mail #3 – Bond Bank (China)

-----Original Message-----

From: Tina Caputo [mailto:Tcaputo@MeridienCHINA]

Sent: Tuesday, July 16, 20X4 8:02 AM

To: IndependenceOffice@MeridienUS

Cc:

Subject: Services Performed for Bond Bank (China) — IT Design and Implementation

This engagement is only in the discussion phase. The client would like us to design and implement a system that facilitates its compliance with local banking regulations. The system would have no bearing on the financial statements or internal controls over financial reporting. Our understanding is that this service would be consistent with the SEC's independence rules.

Please advise if our understanding is incorrect.

Tina Caputo
Senior Manager
Information Technology Assurance

E-mail #4 – Bond Investment Services, Plc

-----Original Message-----

From: Terrence Tork [mailto:TTork@MeridenUK]

Sent: Monday, July 15, 2008 7:02 PM

To: IndependenceOffice@MeridenUS

Cc: DAllison@MeridenUK

Subject: Independence Check — Bond Financial Services, Inc.

In regards to your request, attached please find a copy of an engagement letter, which fully describes the services and fee arrangement between our firm and Bond Investment Services, Plc. for tax advisory services we performed last year.

Once you have reviewed the letter, please feel free to contact me with any questions. Dean Allison (copied on this e-mail) is also available to discuss the arrangement.

Kind Regards,
Terrence Tork
Partner

[Link to 1.4 UK Tax Engagement Letter](#)

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Meridien

April 16, 20X3

Mr. Keith Cane
Director of Finance
Bond Investment Services, Plc.
400 Chestnut Road
London, UK NW3

Dear Mr. Cane:

We appreciate the opportunity for Meridien UK LLP (“Meridien,” “us,” or “we”) to work with Bond Investment Services, Plc. (“Bond,” “you,” or “Client”) to analyze your operations to determine whether future tax savings may be achieved. This engagement letter confirms the services to be provided and sets forth the terms and conditions for this engagement.

We will commence our tax study in May 20X3, and with your cooperation (described later in this document), and we anticipate issuing our final report to you on or about August 15, 20X3.

Research

We will begin with an information gathering process, involving the tax group at Bond. We will need to review the corporate structure of Bond Financial Services, Inc. (the “Parent Company”) and Bond. We will also review the current financial and tax position of Bond, including, but not limited to, income generated in the UK by Bond as a proportion of consolidated income of the Parent Company, corporate income, and any UK tax relief and incentives currently being received by Bond.

Deliverable

Our findings will be based on our research, combined with information and key financial assumptions provided by Bond.

The deliverable result of our work will be a report, in Microsoft® PowerPoint format, describing our findings and their implications, and presenting potential action plans for Bond management to take to achieve tax savings, if such savings are identified in our research and Bond chooses to implement such plans.

Upon conclusion of our research, we will offer a discussion on:

- Our assessment of the current status of Bond’s operations and tax position based on our review.
- Our identification of opportunities, if any, to reduce Bond’s tax burden in future years, including a full discussion of the basis (e.g., applicable tax literature) upon which our findings rest.
- If we have identified tax-saving opportunities, our recommendations for implementing action plans to achieve such savings.

Our deliverable will be designed to provide our observations and recommendations regarding a range of options, including supporting research, which we believe management will want to consider as they move forward in their decision-making process.

Our goal throughout this process will be to provide you with the information and understanding you need to meet your business objectives and expectations and to pursue any favorable tax benefits.

Client acknowledges and agrees that any tax services provided pursuant to this agreement will be based solely upon:

- a) The representations, information, documents, and other facts provided to Meridien by Client, its personnel, and any representatives thereof;

- b) Client acknowledges that Client will maintain ultimate responsibility for all management decisions and management functions. Client understands and agrees that the ultimate responsibility, with respect to the appropriate application and interpretation of any oral or written communications, rests with management of Client; and
- c) Client's understanding that any tax assistance provided pursuant hereto will be based upon the law, regulations, cases, rulings, and other tax authority in effect at the time-specific tax assistance is provided. If there are subsequent changes in or to the foregoing tax authorities (for which Meridien shall have no specific responsibility to advise Client), Client acknowledges that such changes may result in that tax assistance being rendered invalid or necessitate (upon Client's request) a reconsideration of that prior tax assistance.

Project team

We have selected the members of our engagement team because of their experience and their high potential for making a significant contribution to supporting your goals. Our team's technical and practical knowledge, combined with the desire to serve you responsively, enables us to provide you with the support and expertise you should expect from your professional services firm.

The project will be managed by the following individuals. These individuals may rely on assistance from staff as needed:

| | | |
|---------------|---------------------------------|------------|
| Dean Allison | Project Partner | London, UK |
| Terrence Tork | Partner, International Tax | London, UK |
| Sarah Camp | Sr. Manager., International Tax | London, UK |

Professional fees

Due to the nature of the services needed for this project, Meridien will be using professionals with significant experience in providing tax consulting services for financial services companies.

Our fees structure will be as follows:

- A base fee of £75,000 due upon signing this agreement.
- Using the 20X2 tax year as a baseline, 15% of any tax savings identified as a result of our study. We will invoice you for this portion of the fee upon issuance of our final report.

We will also bill you for all reasonable expenses incurred (e.g., travel, mileage, printing) for specific services rendered during this engagement. Invoices are sent monthly and are due upon receipt.

Should the scope change from what is projected at the outset or should we be directed to change our approach, we will discuss the matter with you, including any change in our fees, before proceeding with any additional work.

Client responsibilities

Client shall be solely responsible for, among other things: (a) making all management decisions and performing all management functions; (b) designating a competent management member to oversee the Services; (c) evaluating the adequacy and results of the Services; (d) accepting responsibility for the results of the Services; and (e) establishing and maintaining internal controls, including, without limitation, monitoring ongoing activities.

This engagement letter constitutes the entire agreement between Bond and Meridien with respect to this engagement, supersedes all other oral and written representations, understandings or agreements relating to this engagement, and may not be amended except by the mutual written agreement of Bond and Meridien.

By signing this agreement, you are confirming that no other advisor providing advice or assistance with respect to the subject matter of this agreement has imposed any conditions of confidentiality, as defined

by Public Company Accounting Oversight Board Rule 3522. If any other advisor imposes conditions of confidentiality with respect to the matter that is subject to this agreement after we begin providing services under this agreement, you agree to notify us immediately.

Again, we would like to thank you for the opportunity to provide assistance to you. Please do not hesitate to call me or Dean Allison with any questions or comments that you might have.

If the foregoing is acceptable to you, please indicate your acceptance of this agreement by signing in the space provided below and returning this engagement letter to us.

We are very excited about this project, and we eagerly look forward to working with you very soon.

Sincerely,

Meridien UK LLP

Agreed and Accepted:

By: _____

Terrence Tork, Partner

Title: _____

Date: _____

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Excerpt of SEC Regulation S-X Rule 2-01(c)(4) and (c)(5)

(4) **Non-audit services.** An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client:

(i) **Bookkeeping or other services related to the accounting records or financial statements** of the audit client. Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:

(A) Maintaining or preparing the audit client's accounting records;

(B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or

(C) Preparing or originating source data underlying the audit client's financial statements.

(ii) **Financial information systems design and implementation.** Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:

(A) Directly or indirectly operating, or supervising the operation of, the audit client's information system or managing the audit client's local area network; or

(B) Designing or implementing a hardware or software system that aggregates source data underlying the financial statements or generates information that is significant to the audit client's financial statements or other financial information systems taken as a whole.

(iii) **Appraisal or valuation services,** fairness opinions, or contribution-in-kind reports. Any appraisal service, valuation service, or any service involving a fairness opinion or contribution-in-kind report for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

(iv) **Actuarial services.** Any actuarially-oriented advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client other than assisting a client in understanding the methods, models, assumptions, and inputs used in computing an amount, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

(v) **Internal audit outsourcing services.** Any internal audit service that has been outsourced by the audit client that relates to the audit client's internal accounting controls, financial systems, or financial statements, for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

(vi) **Management functions.** Acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.

(vii) **Human resources.**

(A) Searching for or seeking out prospective candidates for managerial, executive, or director positions;

(B) Engaging in psychological testing, or other formal testing or evaluation programs;

(C) Undertaking reference checks of prospective candidates for an executive or director position;

(D) Acting as a negotiator on the audit client's behalf, such as determining position, status or title, compensation, fringe benefits, or other conditions of employment; or

(E) Recommending, or advising the audit client to hire, a specific candidate for a specific job (except that an accounting firm may, upon request by the audit client, interview candidates and advise the

audit client on the candidate's competence for financial accounting, administrative, or control positions).

(viii) **Broker-dealer, investment adviser, or investment banking services.** Acting as a broker-dealer (registered or unregistered), promoter, or underwriter, on behalf of an audit client, making investment decisions on behalf of the audit client or otherwise having discretionary authority over an audit client's investments, executing a transaction to buy or sell an audit client's investment, or having custody of assets of the audit client, such as taking temporary possession of securities purchased by the audit client.

(ix) **Legal services.** Providing any service to an audit client that, under circumstances in which the service is provided, could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided.

(x) **Expert services unrelated to the audit.** Providing an expert opinion or other expert service for an audit client, or an audit client's legal representative, for the purpose of advocating an audit client's interests in litigation or in a regulatory or administrative proceeding or investigation. In any litigation or regulatory or administrative proceeding or investigation, an accountant's independence shall not be deemed to be impaired if the accountant provides factual accounts, including in testimony, of work performed or explains the positions taken or conclusions reached during the performance of any service provided by the accountant for the audit client.

(5) **Contingent fees.** An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides any service or product to an audit client for a contingent fee or a commission, or receives a contingent fee or commission from an audit client.

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Meridien Independence Policy

The following are excerpts from Meridien's Independence Policy:

Importance of independence

It is fundamental to the professional practice of Meridien, LLP ("Meridien") that all personnel adhere to the highest standards of independence, integrity, and objectivity and be free from conflicts of interest. These standards guide Meridien and its professionals as they consider their interests in and relationships with entities to help avoid situations that could erode the public trust in the services Meridien provides. Disregard of these standards or inadvertent failure to comply with them, puts the Meridien and our clients at considerable risk and exposes Meridien to serious consequences, including:

- Damaged reputation in the marketplace
- Rejection of our report(s) by the Securities and Exchange Commission (SEC)
- Threatened or actual litigation against Meridien by clients and other parties
- Sanctions against Meridien by the SEC, the Public Company Accounting Oversight Board (PCAOB), the American Institute of Certified Public Accountants (AICPA), and state licensing boards
- Loss of investor and public confidence in Meridien's reports
- Sanctions by regulatory bodies against Meridien professionals
- Sanctions by Meridien against its professionals
- Loss of clients

Affiliates

An affiliate of an audit client is:

- a. A company that controls¹ the audit client, e.g., a parent company.
- b. A company that the audit client controls, e.g., a subsidiary.
- c. A company that is under common control with the audit client, i.e., company is controlled by the same parent as the audit client.
- d. A company that has significant influence² over the audit client (i.e., the company uses the equity method to account for its investment in the audit client and the investment in the audit client is considered material³ to the entity).
- e. The audit client has significant influence over a company (i.e., the audit client uses the equity method to account for its investment in the company and the investment in the company is considered material to the audit client).

¹ Control generally is attained via a majority interest (over 50 %) of the outstanding equity of a company. However, there are situations where a company (Company A) does not have over 50% of the outstanding equity of an entity, yet still has control over the entity. This can be due to Company A having a significant ownership of the entity's stock (between 20% and 50%) and a significant presence on the entity's Board of Directors (i.e., of the 10 voting Board Members, 8 of the members are associated with Company A.)

² Significant influence is generally deemed to exist when ownership interest is between 20% and 50%.

³ Material is defined as the parent company's aggregate carrying amount of investment in a subsidiary that exceeds 5% of the parent's consolidated total assets or the parent's equity in the subsidiary's income from continuing operations before income taxes exceeds 5% of the parent's consolidated income from continuing operations before income taxes.

- f. Companies that are in an “investment company complex” with the audit client, i.e., if Meridien audits a mutual fund’s sponsor (an SEC registrant), an investment company complex (ICC) exists. When an ICC exists, other funds, advisors, and similar entities that are in the ICC are considered affiliates.

Retired partners

Consistent with SEC independence rule 2-01(c)(2)(iii), a former partner who seeks to accept an accounting role or a financial reporting oversight role with an restricted entity may accept the role if the former partner:

1. Does not influence Meridien’s operations or financial policies,
2. Has no capital balance in Meridien, and

Has no financial arrangement with Meridien other than one providing for regular payment of a fixed dollar amount.

All amounts owed to the former partner should be fully funded and not dependent on Meridien’s current revenues, profits, or earnings.

Further, given the operation of the SEC’s requirement for a “cooling-off period” in different circumstances, a former partner should not accept a financial reporting oversight role with an restricted entity without the approval of the Independence Office if the former partner provided, or was in a position to influence, attest services for the restricted entity during the one-year period preceding the expected date of his or her initial employment by the restricted entity.

Broker-dealer accounts

Accounts at a restricted entity broker-dealer in which cash or securities are left on deposit or the broker-dealer extends credit or has discretionary authority to execute transactions, including margin, cash management, active asset, and other similar accounts, are prohibited for covered persons. Any such accounts owned by a professional should, upon he or she becoming a covered person, be closed at his or her expense.

Trusts or estates — beneficiary

If a covered person is the beneficiary of a trust that has a financial interest in a restricted entity, the independence of a member firm ordinarily would be impaired if (1) the indirect financial interest in the restricted entity is material to the covered person, or (2) the trust was created by the covered person who is named as beneficiary, or (3) the beneficiary had direct or indirect control over the investment decisions or assets of the trust. Generally, this also applies to a beneficial interest in an estate that has a financial interest in a restricted entity. Any financial interest in a restricted entity distributed to a covered person beneficiary from such a trust or estate should be divested upon receipt.

Spousal equivalent

A spousal equivalent:

- Resides continuously in the same residence as the professional
- Shares a committed and mutually dependent relationship with the professional that is similar to that of a married couple, but the cohabitant and professional have either chosen not to marry or cannot legally marry

Remote relatives

The appearance of independence is normally not impaired as a result of the financial interests and business relationships of a remote relative. However, if other factors indicate a particular closeness with

the remote relative (e.g., having financial ties or jointly participating in a business enterprise), an impairment of independence could result. Similarly, if there is a possibility of a substantial inheritance from the remote relative, independence could be impaired. In these cases, the relationship with the remote relative more clearly resembles that of a Close Family Member and, for independence purposes, should be treated as such. An example would be an uncle of a Partner who is a majority owner of a restricted entity; the uncle has no other living Close Family Members and the Partner is aware that the uncle's will provides that the Partner will be the chief beneficiary of his estate.

In limited circumstances, financial interests and position of the remote relative are so significant that the appearance of independence is impaired (e.g., in the case of a remote relative who is a majority shareholder and president of a restricted entity). Any unusual circumstances should be discussed with the Independence Office.

Disciplinary process

The Chief Independence Officer is primarily responsible for administering the process to address violations of independence policies of Meridien. Generally, this process is designed to be remedial rather than disciplinary. However, if after considering all relevant facts and circumstances, it is concluded that a violation of the independence policies is serious or repetitive, the response will be to impose an appropriate disciplinary action, which could be severe or punitive, including termination of employment or removal from the partnership.

All professional personnel and administrative and clerical personnel are subject to possible disciplinary action for violation of the independence policies of Meridien. It is the duty of each individual to comply with these policies, including, without limitation, the policies regarding investments, loans, insurance products, and other financial interests, and to fully cooperate with any compliance audit and verification activities conducted by the Independence Office.

Any proposed disciplinary actions will be determined by the Chief Independence Officer in consultation with national, regional, or office leadership, including the Board of Directors of Meridien, as appropriate. In determining the appropriate level of consultation, the Chief Independence Officer will consider, among other matters, (1) the level of individual with the independence violation, (2) the severity of the independence violation, (3) the severity of the proposed disciplinary action, and (4) whether the violation of the policies affects the relationship of Meridien with a restricted entity. Individuals will be given an opportunity to provide information regarding any alleged independence violation prior to disciplinary action being taken against the individual. Notwithstanding the foregoing, if the individual does not cooperate with any request for information, Meridien may prescribe whatever disciplinary action it believes is warranted.

The need for and severity of any disciplinary action will be based on the facts and circumstances surrounding each violation of the policies and procedures of Meridien. Some of the items that may be considered include:

- The manner and timeliness in which the individual resolved the independence matter. An individual's failure to promptly resolve an independence matter or lack of cooperation in responding to requests for information or in resolving the matter will generally involve a more serious sanction.
- Whether the professional knew or should have known of the circumstances causing the violation of the policies and procedures of Meridien.
- Whether the professional was a part of the audit engagement team, in the chain of command, or provided 10 or more hours of nonaudit services to a restricted entity. An independence violation by an individual providing any professional services to an audit client will generally involve a more serious sanction.
- The number, frequency, and materiality of the independence violations. A large number or high frequency of violations during a short period of time or violations that are material to the professional or the restricted entity will generally involve a more serious sanction.

- The impact of the independence violation on Meridien from a regulatory, legal, or public relations perspective. A violation that affects Meridien from a regulatory, legal, or public relations perspective will generally involve a more serious sanction.
- The impact of the independence violation on the restricted entity and its relationship with Meridien. A violation that has a detrimental effect on the restricted entity, its filings with a regulatory agency, or the client's relationship with Meridien will generally involve a more serious sanction.

Disciplinary actions could include one or more of the following actions, as deemed necessary:

- A written reprimand to be included in the individual's personnel file. The existence of such a reprimand should be taken into consideration by the individual's immediate supervisor when annual performance ratings and compensation determinations are made.
- Communication to Leadership.
- Requiring the individual to complete continuing professional education in the area of independence.
- Mandatory cap on an individual's annual performance rating.
- Reduction of annual compensation.
- Restricting the individual from providing services to a restricted entity, a class of clients, or from all restricted entities, or changing the individual's job responsibilities.
- Termination of employment or removal from the Partnership.

Individuals will have the right to appeal disciplinary actions to the Managing Partner of Meridien. A description of the appeal process will be communicated to the individual at the time the individual is notified of the disciplinary action.

When disciplinary action has been taken against an individual, a memorandum describing the nature of the violation and the sanctions imposed will be included in the individual's personnel file.

Attest versus Nonaudit services

There are some distinct differences between attest and nonaudit services. Attest services generally provide some form of assurance about the information which is being reported. The public often has a keen interest in the outcome of such services. Thus to provide attest services accounting firms must follow various independence requirements. For example, an audit opinion that is filed in a public company's annual report (Form 10-K) is posted to the SEC's web site and may be used by an unknown number of interested parties.

In a nonaudit service engagement, the accounting firm and the company's management determine the nature and scope of the work. The services may result in findings, conclusions, and recommendations but generally would not provide assurance about the information being reported. Typically, nonaudit work is performed for the sole use and benefit of the client, and distribution of the results of the work is often restricted to specified client parties.

Nonaudit services

Meridien also may provide services *other than* attest services ("nonaudit" services) to their clients. If Meridien **only** provides nonaudit services (i.e., tax or consulting services) to a client, the independence rules do not apply. However, if the firm performs both audit and nonaudit services to the same client, the firm will be subject to the independence rules, which prohibit certain nonaudit services.

Examples of nonaudit services include:

- Tax compliance services (e.g., tax return preparation) and consultations on tax matters
- Business advisory services, including consultations involving technology or risk management
- Litigation support

- IT system design and implementation.

Note: If an accounting firm provides both attest and nonaudit work to the same client, the firm must comply with the independence rules to ensure that the scope of the nonaudit work will not affect the firm's independence.

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Appendix A: Fundamentals of Independence

Definitions

1. **Accounting role:** A role in which a person is in a position to or does exercise more than minimal influence over the contents of the accounting records or anyone who prepares them.
2. **Affiliate:** Affiliate of the audit client means:
 - An entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client's parents and subsidiaries;
 - An entity over which the audit client has significant influence, unless the entity is not material to the audit client;
 - An entity that has significant influence over the audit client, unless the audit client is not material to the entity; and
 - Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex.

3. **Attest client:** An entity whose financial statements (or other information) the accounting firm audits, reviews, or is attested to.

Attest engagements include:

- Financial statement audits
 - Financial statement reviews
 - Audits of internal control over financial reporting performed under PCAOB Auditing Standard No. 5, *An Audit Of Internal Control Over Financial Reporting That Is Integrated with an Audit Of Financial Statements*
 - Engagements performed under the AICPA Statements on Auditing Standards (SASs) or Statements on Attestation Standards (SSAEs)
4. **Audit and professional engagement period** includes both:
 - The period covered by any financial statements being audited or reviewed (the “audit period”); and
 - The period of the engagement to audit or review the audit client's financial statements or to prepare a report filed with the SEC (the “professional engagement period”):
 - » The professional engagement period begins when the accountant either signs an initial engagement letter (or other agreement to review or audit a client's financial statements) or begins audit, review, or attest procedures, whichever is earlier; and
 - » The professional engagement period ends when the audit client or the accountant notifies the SEC that the client is no longer that accountant's audit client.
 - For audits of the financial statements of foreign private issuers, the “audit and professional engagement period” does not include periods ended prior to the first day of the last fiscal year before the foreign private issuer first filed, or was required to file, a registration statement or report with the SEC, provided there has been full compliance with home country independence standards in all prior periods covered by any registration statement or report filed with the SEC.

Note: If an accounting firm audits a company over multiple years, the professional engagement period is an ongoing period, i.e., does not end once the current-year audit is completed and recommence when next year's audit begins.

5. **Close family members:** A person's spouse, spousal equivalent, parent, dependent, nondependent child, and sibling.

Note: Under AICPA guidance, a close family member is equivalent to a close relative.

7. **Contingent fee:** Except as stated in the next sentence, any fee established for the sale of a product or the performance of any service pursuant to an arrangement in which no fee will be charged, unless a specified finding or result is attained or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service. A fee is not a "contingent fee" if it is fixed by courts or other public authorities or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies. Fees may vary depending, for example, on the complexity of services rendered.
8. **Covered persons:** The following partners, principals, shareholders, and employees of an accounting firm:

- The "audit engagement team";
- The "chain of command"; i.e., persons who (1) supervise or have direct management responsibility for the audit and at all successively senior levels through the chief executive officer, (2) evaluate the performance or recommend the compensation of the audit partner, and (3) provide quality control or other oversight of the audit;
- Any other partner, principal, shareholder, or managerial employee of the accounting firm who has provided 10 or more hours of nonaudit services to the audit client for the period beginning on the date such services are provided and ending on the date the accounting firm signs the report on the financial statements for the fiscal year during which those services are provided, or who expects to provide 10 or more hours of nonaudit services to the audit client on a recurring basis; and
- Any other partner, principal, or shareholder from an "office" of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.

Note: "Covered member" (AICPA *Code of Professional Conduct*) is synonymous with the SEC term "covered person."

9. **Direct financial interest:** A financial interest (ownership or guarantee of debt or equity securities, options, warrants, long or short security positions, and rights or other commitments to acquire such securities) which is owned directly by an individual, together with other persons, or through an intermediary if:
- The individual supervises or participates in the intermediary's investment decisions, or controls the intermediary, or
 - The intermediary is not a diversified management investment company as defined by the SEC, and the financial interest is 20% or more of the total value of the intermediary.
10. **Federal Deposit Insurance Corporation (FDIC):** An independent agency of the federal government, created in 1933 that preserves and promotes public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for at least \$100,000.
11. **Financial reporting oversight role:** A role in which a person is in a position to or does exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.
12. **Immediate family members:** A person's spouse, spousal equivalent, and dependents.
13. **Independence** (free of conflicts of interest that would cause the firm to be biased either for or against the attest client):

The AICPA has defined independence as:

Independence of mind — The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

Independence in appearance — The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.

14. **Independence check:** An independence check is typically completed before a public accounting firm proposes to provide any services to a new potential client. Independence may be impaired if another member firm is already providing audit or nonaudit services to the potential client. If the nonaudit services being performed are considered prohibited by the independence rules, then the proposing audit engagement team would need to factor these services into the firm's ability to perform the audit.

To make the independence check process consistent, typically a standardized form is completed by the proposing engagement team and sent to the Independence Office for review. The Independence Office will check its databases and send communications to another member firm or affiliate to make sure no services are being provided to the potential client that would impair the firm's independence. Any information received from the international or U.S. office is then forwarded to the proposing engagement team to assess the independence implications.

Generally, professionals at the manager/senior manager levels will be involved in assessing independence compliance and making recommendations to the engagement partner. Entry level (e.g., staff/associate) or senior staff (i.e., below manager level) could be involved in a support role. For example, a staff person might assist an audit manager by gathering relevant information, performing research, and checking firm databases. Ultimately, the lead engagement partner is responsible for determining that all relevant independence requirements have been met since he or she has overall responsibility for the client relationship.

15. **Indirect financial interest:** This term includes a financial interest in an entity through an intermediary that does not meet the definition of a direct financial interest. For example, an individual may have a direct financial interest in A, which in turn has a direct financial interest in B. Provided the individual does not control A, and cannot supervise or participate in A's investment decisions, and A's financial interest in B is less than 20% of the value of A's total investments, the individual's financial interest in B is considered to be an indirect financial interest to the individual.

16. **Investment company complex:** An investment company complex includes:

- (A) An investment company and its investment adviser or sponsor;
- (B) Any entity controlled by or controlling an investment adviser or sponsor, or any entity under common control with an investment adviser or sponsor if the entity:
 - » Is an investment adviser or sponsor; or
 - » Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any investment company, investment adviser, or sponsor; and
- (C) Any investment company or entity that would be an investment company but for the exclusions provided by Section 3(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)) that has an investment adviser or sponsor included in this definition by either (A) or (B).

An investment adviser, for purposes of this definition, does not include a subadviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser. Sponsor, for purposes of this definition, is an entity that establishes a unit investment trust.

17. **Objectivity:** Objectivity is a state of mind, a quality that lends value to a public accounting firm's services. It is a distinguishing feature of the public accounting profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a public accounting firm's objectivity in rendering attestation services.

18. **Professional skepticism:** An attitude and state of mind that includes a questioning mind and a critical assessment of audit evidence.
19. **Proposal:** A promotional and informative packet that is put together by the proposal engagement team. The proposal is made up of multiple sections and normally includes (1) the accounting firm's background, including locations, revenues, and market share, (2) the client service team chosen to service the potential client, including the team's background and biographies, (3) the services the accounting firm is proposing to perform, (4) the approach the firm will take to provide quality service, (5) independence confirmation (if applicable), (6) the accounting firm's commitment and dedication to the potential client, and (7) references and other resources, including accounting software and technology that will be used to serve the client. The proposal is normally bound with a glossy cover and has pictures and graphic art throughout the document.
20. **Proxy statement:** Statement required of a U.S. publicly traded company when soliciting shareholder votes. The company files the proxy statement (Schedule 14a) with the SEC. The statement is useful in assessing how management is paid and potential conflict-of-interest issues with auditors. The statement includes: 1. Voting procedure and information. 2. Background information about the company's nominated board of directors. 3. Director compensation. 4. Executive compensation. 5. A breakdown of audit and nonaudit fees paid to the auditor.
21. **Registrant:** A company publicly traded on a U.S. stock exchange for which they are required to be registered with the U.S. Securities and Exchange Commission.
22. **Restricted entities:** Accounting firm and their professionals should be independent of all "restricted entities" of the firm in accordance with the relevant independence standards. Restricted entities include:
 - (1) All attest clients of a firm, and
 - (2) Certain attest clients' affiliates.
23. **Securities Investor Protection Corporation (SIPC):** A federally mandated nonprofit corporation in the United States that protects securities investors from harm if a broker-dealer defaults. Investors are not insured for any potential loss while invested in the market. SIPC was created by the 1970 Securities Investor Protection Act, but it is not a government agency; rather, it is a membership corporation funded by its members. SIPC serves two primary roles in the event that a broker-dealer fails. First, SIPC acts to organize the distribution of customer cash and securities to investors. Second, to the extent a customer's cash and/or securities are unavailable, SIPC provides insurance coverage up to \$500,000 of the customer's net equity balance, including up to \$100,000 in cash.

Regulatory bodies that govern independence

The accounting profession has generally described ‘independence’ in various professional standards and regulations as a lack of certain interests and relationships that are presumed to impact auditor **objectivity**. The primary independence standard-setters are:⁴

- The Securities and Exchange Commission (SEC)
- The Public Company Accounting Oversight Board (PCAOB)
- American Institute of Certified Public Accountants (AICPA)

The U.S. Securities and Exchange Commission (SEC)

The SEC is a U.S. federal agency whose mission is to protect investors, maintain fair, orderly, and efficient markets and facilitate capital formation. It is the primary overseer and regulator of the U.S. securities markets. Among its many responsibilities, the SEC interprets federal securities laws and oversees the conduct of professionals who audit public companies.

Federal securities laws require public companies to disclose certain financial and other information to the public in periodic filings with the SEC. For example, a company’s annual report (e.g., Form 10-K) should include an audit report (i.e., opinion letter(s)) signed by an independent auditor, which addresses the company’s financial statements and internal control over financial reporting. Such information (in part) helps to maintain confidence in the financial and capital markets

Qualifications of accountants

[Rule 2-01, Qualifications of Accountants](#), interprets [Regulation S-X of the Securities Exchange Act of 1934](#). Under Rule 2-01, the SEC will not recognize an accountant as independent of a company (i.e., the audit client) if the accountant is not capable of exercising objective and impartial judgment on all issues encompassed within the engagement. The SEC rules provide several examples of relationships and interests that are considered to impair a firm’s independence. However, the rule does *not* purport to describe all of the circumstances that raise independence concerns. Therefore, Rule 2-01 also provides a general standard, which requires the accountant to consider whether a reasonable investor with knowledge of all relevant facts and circumstances would conclude that he or she is independent. This is referred to in the profession as the “appearance” of independence and requires the accountant to apply professional judgment in considering the perceptions of reasonable and informed third parties.

The SEC revised rule 2-01 in 2000 and again in 2003. The amendments are explained in [Release No. 33-7919, Revision of the Commission’s Auditor Independence Requirements](#) and [Release No. 33-8183A – Strengthening the Commission’s Requirements Regarding Auditor Independence](#), respectively.

The Public Company Accounting Oversight Board (PCAOB)

The Public Company Accounting Oversight Board (PCAOB) is a private, nonprofit corporation created by the [Sarbanes-Oxley Act of 2002](#) to oversee the auditors of public companies. The PCAOB was created to protect investors and the public interest by promoting informative, fair, and independent audit reports.

The PCAOB adopted the following rules as [interim independence standards](#):

- Rule 101 (Independence) of the AICPA *Code of Professional Conduct* (“AICPA Code”) and its interpretations and rulings

⁴ Other entities, such as state accountancy boards, federal and state regulators (e.g., Department of Labor), and regulators in other countries may impose additional independence requirements, depending on the type and location of the company.

- The independence standards and interpretations of the Independence Standards Board (ISB)⁵

The interim standards do not supersede the SEC's auditor independence rules. To the extent a provision of the SEC's rules is more (or less) strict than the interim standards, an accounting firm should comply with the more restrictive aspects of the rules.

The Board has also adopted several [independence and ethics standards](#) of its own.

American Institute of Certified Public Accountants (AICPA)

The AICPA is a nonprofit, membership organization of approximately 340,000 professional accountants, mainly Certified Public Accountants (CPAs). For over 100 years, the AICPA has developed independence and other ethics rules for the accounting profession. The rules are published in the [AICPA Code](#). The Professional Ethics Executive Committee is the senior technical committee of the AICPA authorized to interpret and enforce the AICPA Code.

AICPA Professional Standards require professionals to be independent when they perform attest services, such as financial statement audits. For example, AICPA Statement on Auditing Standards (SAS) No. 1,⁶ states in part that:

“In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.”

The standard goes on to say that:

“It is of utmost importance to the profession that the general public maintain confidence in the independence of independent auditors. Public confidence would be impaired by evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence. To be independent, the auditor must be intellectually honest; to be recognized as independent, he must be free from any obligation to or interest in the client, its management, or its owners.

The profession has established, through the AICPA's *Code of Professional Conduct*, precepts to guard against the presumption of loss of independence. “Presumption” is stressed because the possession of intrinsic independence is a matter of personal quality rather than of rules that formulate certain objective tests. Insofar as these precepts have been incorporated in the profession's code, they have the force of professional law for the independent auditor.”

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⁵ The ISB was created in 1997 through an agreement between the SEC and the AICPA to initiate research, develop standards, and engage in a public analysis and debate of auditor independence issues. The ISB discontinued its operations on July 31, 2001. Much of the ISB's work was incorporated into the SEC's auditor independence rules adopted in November 2000. (Source: SEC News Release 2001-72)

⁶ AU§220 of the AICPA Professional Standards, vol. I.

Appendix B: Additional Resources

| Reference in independence education tool kit | Title | Source/URL (if available) |
|----------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Video: | | |
| Act I, "Independence 101" | <p><i>"Top 10 Audit Deficiencies"</i></p> <p>Mark S. Beasley, Joseph V. Carcello, and Dana R. Hermanson</p> | <p>Journal of Accountancy, April 2001</p> <p>http://www.aicpa.org/pubs/jofa/apr2001/beasley.htm</p> |
| Act II, "The Public Accounting Profession" | <i>"The Public Accounting Profession"</i> | http://www.deloitte.com/dtt/cda/doc/content/accounting_profession4.pdf |
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| Reference in independence education tool kit | Title | Source/URL (if available) |
|----------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Case Study: | | |
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