Núm. 5328
Fecha 9 de noviembre de 1995 3:00 p.m.
Aprobado: Norma E. Burgos
Secretario de Estado
Por: [signature]
Secretaria Auxiliar de Estado

ESTADO LIBRE ASOCIADO DE PUERTO RICO
DEPARTAMENTO DE ESTADO
JUNTA DE CONTABILIDAD

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ESTADO LIBRE ASOCIADO DE PUERTO RICO
DEPARTAMENTO DE ESTADO
JUNTA DE CONTABILIDAD

REGLAMENTO DE ETICA PROFESIONAL PARA LOS CONTADORES PUBLICOS AUTORIZADOS DE PUERTO RICO

5328

Radicado: 9 de Noviembre de 1995

ARTICULO 1: BASE LEGAL

Este Reglamento se promulga por la Junta de Contabilidad del Estado Libre Asociado de Puerto Rico al amparo de la Ley Número 293, aprobada el 15 de mayo de 1945, según enmendada, conocida como "Ley de Contabilidad Pública de 1945" y la Ley Número 170, aprobada el 12 de agosto de 1988, según enmendada, conocida como "Ley de Procedimiento Administrativo Uniforme del Estado Libre Asociado de Puerto Rico".

ARTICULO 2: PROPÓSITO

La profesión de Contador Público Autorizado requiere el establecer y mantener estándares altos de competencia profesional e integridad en su práctica. Con el propósito de que el ejercicio de dicha profesión se conduzca dentro de unas normas de conducta íntegras para lograr los propósitos de la Ley de Contabilidad Pública de 1945, según enmendada, y los mejores intereses para el público, se promulga este Reglamento.

ARTICULO 3: CÓDIGO DE CONDUCTA PROFESIONAL DEL INSTITUTO AMERICANO DE CONTADORES PÚBLICOS AUTORIZADOS

El Instituto Americano de Contadores Públicos Autorizados (American Institute of Certified public Accountants, comúnmente conocido por las siglas AICPA y en adelante denominado "Instituto") es el organismo en los Estados Unidos de América que entre otras funciones promulga estándares para el ejercicio de la profesión de Contador Público Autorizado. Además de los estándares técnicos que emiten los organismos homólogos al Instituto creados para dicho propósito, tales como el Financial Accounting Standards Board (FASB), el Government Accounting Standards Board (FASB), etc., el Instituto promulga los estándares de ética profesional que regirán la conducta de sus miembros.

Dichas normas de ética están comprendidas en la siguiente jerarquía de reglas:

A. "Code of Professional Conduct" Código de Conducta Profesional adoptado por el Instituto el 12 de enero de 1988 y enmendado el 14 de enero de 1992.

1. "Principles" - Principios de conducta Profesional. Estos proveen el marco de referencia para las Reglas de Conducta Profesional.
2. "Rules" - Reglas de Conducta Profesional. Estas gobiernan el desempeño de los servicios profesionales por los miembros del Instituto.
3. "Interpretations of Rules of Conduct" - Interpretaciones de Reglas de Conducta que han sido adoptadas por los organismos del Instituto para proveer guías del alcance y aplicabilidad de las Reglas de Conducta, sin limitar el alcance de las reglas.
4. "Ethics Rulings" - Fallos o decisiones de ética emitidas formalmente por los organismos del Instituto en relación a la aplicabilidad de las Reglas de Conducta e interpretaciones a unas circunstancias en particular.

Las interpretaciones de Reglas de Conducta y las decisiones o fallos de ética son vigentes desde el último día del mes en que dicho pronunciamiento se publica en la revista del Instituto, conocido como "The Journal of Accountancy".

ARTICULO 4: REGLAS DE CONDUCTA PROFESIONAL PARA EL CONTADOR PUBLICO AUTORIZADO LICENCIADO EN EL ESTADO LIBRE ASOCIADO DE PUERTO RICO.

El ejercicio de la profesión de Contabilidad Pública en el Estado Libre Asociado de Puerto Rico, está limitado a las personas que la Junta de Contabilidad del Departamento de Estado expida licencia para dicho propósito. Estos profesionales serán miembros del Colegio de Contadores Públicos Autorizados de Puerto Rico según lo dispone la Ley Número 75 aprobada el 31 de mayo de 1973, según enmendada.

La Junta de Contabilidad de Puerto Rico promulga para todos los profesionales autorizados a ejercer la profesión de Contabilidad Pública en el Estado Libre Asociado de Puerto Rico, los principios de ética profesional que deberán regir su conducta. Las reglas adoptadas por esta Junta son el Código de Conducta Profesional del Instituto Americano de Contadores Públicos Autorizados ("Code of Professional Conduct") sus principios, reglas, interpretaciones y decisiones de ética vigente al 1 de junio de 1994, las cuales se hacen formar parte de este reglamento.

Disponiendo que enmiendas prospectivas al referido Código serán adoptadas a menos que la Junta de Contabilidad determine lo contrario.

ARTICULO 5: QUERELLAS SOBRE CONDUCTA PROFESIONAL

La Ley Número 293 aprobada el 15 de mayo de 1945, según enmendada, conocida como la Ley de Contabilidad Pública, establece en su sección 10 el proceso que seguirá la Junta de Contabilidad para la atención de querellas de conducta profesional.

Por otro lado, la Ley Número 75, aprobada el 31 de mayo de 1973, según enmendada, creó el Colegio de Contadores Públicos Autorizados de Puerto Rico y establece en el Artículo 2 las facultades de esta entidad profesional. Entre las facultades se destacan el "velar por el cumplimiento de los cánones de ética profesional" que promulgue la Junta de Contabilidad y el "recibir e investigar las querellas que se formulen respecto a la práctica y/o conducta de los miembros en el ejercicio de la profesión". Con respecto a las querellas recibidas e investigadas por el Colegio de CPA, el mismo artículo establece el procedimiento a seguirse y que serán referidas a la Junta de Contabilidad para la acción correspondiente.

La Junta de Contabilidad de Puerto Rico y el Colegio de CPA laborarán en coordinación la atención de las querellas de conducta profesional que advienen a su atención para lograr su estudio y conclusión en el plazo de tiempo más corto permitido por la Ley. De esta forma, se logra el propósito fundamental de mantener en alto el desempeño de la profesión de Contabilidad Pública en Puerto Rico.

ARTICULO 6: VIGENCIA Y DEROGACION

Este reglamento comenzará a regir a los treinta días (30) de su radicación en el Departamento de Estado del Estado Libre Asociado de Puerto Rico según dispone la Ley de Procedimiento Administrativo Uniforme, Ley Número 170 del 12 de agosto de 1988, según enmendada.

Además, este Reglamento deroga los "Cánones de Ética Profesional que regirán la Conducta de los Contadores Públicos Autorizados de Puerto Rico" adoptados por la Junta de Contabilidad el 20 de octubre de 1967.

Aprobado hoy 27 de septiembre de 1995 en San Juan, Puerto Rico.

CPA JOSÉ A. CANALS
Presidente
Junta de Contabilidad de P.R.

CPA EDUARDO BURGOS LEBRON
Secretario
Junta de Contabilidad de P.R.

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1995 edition

CODE OF PROFESSIONAL CONDUCT

5328 Rad. 9 Library 1995 3:00 p.m.

As Adopted January 12, 1988, amended January 14, 1992

INTRODUCTION

Composition, Applicability, and Compliance

The Code of Professional Conduct of the American Institute of Certified Public Accountants consists of two sections—(1) the Principles and (2) the Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members. The Council of the American Institute of Certified Public Accountants is authorized to designate bodies to promulgate technical standards under the Rules, and the bylaws require adherence to those Rules and standards.

The Code of Professional Conduct was adopted by the membership to provide guidance and rules to all members—those in public practice, in industry, in government, and in education—in the performance of their professional responsibilities.

Compliance with the Code of Professional Conduct, as with all standards in an open society, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.

Other Guidance

Interpretations of Rules of Conduct consist of interpretations which have been adopted, after exposure to state societies, state boards, practice units and other interested parties, by the professional ethics division's executive committee to provide guidelines as to the scope and application of the Rules but are not intended to limit such scope or application. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary hearing. *Interpretations* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

Ethics Rulings consist of formal rulings made by the professional ethics division's executive committee after exposure to state societies, state boards, practice units and other interested parties. These rulings summarize the application of Rules of Conduct and Interpretations to a particular set of factual circumstances. Members who depart from such rulings in similar circumstances will be requested to justify such departures. *Ethics Rulings* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

Publication of an Interpretation or Ethics Ruling in *The Journal of Accountancy* constitutes notice to members. Hence, the effective date of the pronouncement is the last day of the month in which the pronouncement is published in *The Journal of Accountancy*. The professional ethics division will take into consideration the time that would have been reasonable for the member to comply with the pronouncement.

A member should also consult, if applicable, the ethical standards of his state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental agency which may regulate his client's business or use his report to evaluate the client's compliance with applicable laws and related regulations. ...

ET Section 50

PRINCIPLES OF PROFESSIONAL CONDUCT

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ET Section 50

PRINCIPLES OF PROFESSIONAL CONDUCT

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ET Section 51

Preamble

.01 Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a certified public accountant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

.02 These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

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ET Section 52

Article I—Responsibilities

In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.

.01 As professionals, certified public accountants perform an essential role in society. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.

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ET Section 53

Article II—The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

.01 A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

.02 In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

.03 Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

.04 All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

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ET Section 54

Article III—Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

.01 Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

.02 Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

.03 Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

.04 Integrity also requires a member to observe the principles of objectivity and independence and of due care.

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ET Section 55

Article IV—Objectivity and Independence

A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

.01 Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the 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 member's objectivity in rendering attestation services.

.02 Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

.03 For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest.

.04 Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services. Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.

[The next page is 4331.]

ET Section 56

Article V—Due Care

A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.

.01 The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

.02 Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles.

.03 Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

.04 Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

.05 Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

[The next page is 4341.]

ET Section 57

Article VI—Scope and Nature of Services

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

.01 The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

.02 Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be developed to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

.03 In order to accomplish this, members should

- Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
- Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.
- Assess, in their individual judgments, whether an activity is consistent with their role as professionals (for example, Is such activity a reasonable extension or variation of existing services offered by the member or others in the profession?).

ET Section 90

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ET Section 91

Applicability

As adopted
January 12, 1988

.01 The bylaws of the American Institute of Certified Public Accountants require that members adhere to the Rules of the Code of Professional Conduct. Members must be prepared to justify departures from these Rules.

.02 Interpretation Addressing the Applicability of the AICPA Code of Professional Conduct. For purposes of the applicability section of the Code, a "member" is a member or international associate of the American Institute of CPAs.

1. The Rules of Conduct that follow apply to all professional services performed except (a) where the wording of the rule indicates otherwise and (b) that a member who is practicing outside the United States will not be subject to discipline for departing from any of the rules stated herein as long as the member's conduct is in accord with the rules of the organized accounting profession in the country in which he or she is practicing. However, where a member's name is associated with financial statements under circumstances that would entitle the reader to assume that United States practices were followed, the member must comply with the requirements of Rules 202 and 203.
2. A member may be held responsible for compliance with the rules by all persons associated with him or her in the practice of public accounting who are either under the member's supervision or are the member's partners or shareholders in the practice.
3. A member shall not permit others to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the member, would place the member in violation of the rules.

[Paragraph added, August, 1989, effective November 30, 1989.]

[The next page is 4381.]

ET Section 92

Definitions

As adopted
January 12, 1988

[Pursuant to its authority under the bylaws (BL § 360.01) to interpret the Code of Professional Conduct, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code effective November 30, 1989.]

.01 Client. (This replaces the previous definition of "Client" at paragraph .01.) 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. The term "employer" for these purposes does not include those entities engaged in the practice of public accounting.

.02 Council. The Council of the American Institute of Certified Public Accountants.

.03 Enterprise. (This replaces the previous definition of "Enterprise" at paragraph .03.) For purposes of the Code, the term "enterprise" is synonymous with the term "client."

.04 Financial statements. Statements and footnotes related thereto that purport to show financial position which relates to a point in time or changes in financial position which relate to a period of time, and statements which use a cash or other incomplete basis of accounting. Balance sheets, statements of income, statements of retained earnings, statements of changes in financial position, and statements of changes in owners' equity are financial statements.

Incidental financial data included in management advisory services reports to support recommendations to a client and tax returns and supporting schedules do not, for this purpose, constitute financial statements; and the statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

.05 Firm. A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof. [Revised January, 1992.]

.06 Institute. The American Institute of Certified Public Accountants.

.07 Interpretations of rules of conduct. Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct.

.08 Member. A member, associate member, or international associate of the American Institute of Certified Public Accountants.

.09 Practice of public accounting. (This replaces the previous definition of "Practice of public accounting" at paragraph .09.) The practice of

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ET Section 101

Independence

.01 Rule 101—Independence. A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.

[As adopted January 12, 1988.]

Interpretations Under Rule 101—Independence

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

.02 101-1—Interpretation of Rule 101. Independence shall be considered to be impaired if, for example, a member had any of the following transactions, interests, or relationships:

A. During the period of a professional engagement or at the time of expressing an opinion, a member or a member's firm
   1. Had or was committed to acquire any direct or material indirect financial interest in the enterprise.
   2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the enterprise.
   3. Had any joint, closely held business investment with the enterprise or with any officer, director, or principal stockholders thereof that was material in relation to the member's net worth or to the net worth of the member's firm.
   4. Had any loan to or from the enterprise or any officer, director, or principal stockholder of the enterprise except as specifically permitted in interpretation 101-5 [ET section 101.07].

B. During the period covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion, a member or a member's firm
   1. Was connected with the enterprise as a promoter, underwriter or voting trustee, as a director or officer, or in any capacity equivalent to that of a member of management or of an employee.
   2. Was a trustee for any pension or profit-sharing trust of the enterprise.

The above examples are not intended to be all-inclusive.

[Paragraph added by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, November 1991, effective January 1, 1992 with

earlier application encouraged, by the Professional Ethics Executive Committee.]

[.03 101-1] [Formerly paragraph .02, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly Interpretation 101-1, renumbered as 101-4 and moved to paragraph .06, April, 1992.]

.04 101-2—Former practitioners and firm independence. For purposes of this interpretation, a former practitioner is defined as a proprietor, partner, shareholder, or equivalent who leaves by resignation, termination, retirement, or sale of all or part of the practice.

For purposes of determining a firm's compliance with Rule 101 and its interpretations, a former practitioner is not included in the term "a member or a member's firm" (see Ethics Interpretation 101-9, ET section 101.11) provided that

1. Payment of the amounts due to the former practitioner for his or her interest in the firm and for unfunded, vested retirement benefits according to the payment schedule in effect should be such that they do not cause a substantial doubt about the firm's ability to continue as a going concern for a reasonable period of time. In addition, such amounts including all retirement benefits should be fixed, both as to the amount and payment dates. Such amounts due a former practitioner may be paid over a reasonable period of time, and a reasonable rate of interest may be paid on any unpaid balances. Retirement benefits may be adjusted only for inflation.

2. The former practitioner does not participate in the firm's business or professional activities whether or not compensated for such participation. This proscription does not apply to consultations on an advisory basis for a reasonable period of time during the transition period upon leaving the firm.

3. The former practitioner does not appear to participate in the activities of or be associated with his or her former firm. An appearance of participation or association results from such actions as inclusion of the former practitioner's name under the firm's name in an office building directory, inclusion of the former practitioner's name as a member of the firm in membership lists of business, professional or civic organizations, or inclusion of the former practitioner's name in the firm's internal directory without being designated as retired. The former practitioner will not be considered as participating or associating with his or her former firm solely because the former practitioner is provided an office, either in the firm's suite or in a separate location, and related office amenities such as secretarial and telephone services. (However, see 4. below for restrictions regarding office space and amenities for a former practitioner who accepts a position of significant influence with a client.)

4. A former practitioner in a position of significant influence with the client must no longer be provided with office space and related amenities by his or her former firm.

[Replaces previous Interpretation 101-2, *Retired Partners and Firm Independence*, August, 1989, effective August 31, 1989.]

.05 101-3—Accounting services. Members in public practice may be asked to provide manual or automated bookkeeping or data processing services to clients. Computer systems design and programming assistance may also be rendered by members either in conjunction with data processing services or as a separate engagement. In addition, members may rent "block time" on their computers to their clients but are not involved in the processing of transactions or maintaining the client's accounting records.

A member providing such services to a client must meet the following requirements to be considered independent:

1. The client must accept the responsibility for the financial statements as his own. The client must be sufficiently informed of the enterprise's activities and financial condition and the applicable accounting principles so that the client can reasonably accept such responsibility, including, specifically, fairness of "valuation and presentation" and adequacy of disclosure. When necessary, the member must discuss accounting matters with the client to assist the client in understanding such matters.

2. The member must not assume the role of employee or of management. For example, the member shall not consummate transactions, have custody of assets, or exercise authority on behalf of the client. The client must prepare the source documents on transactions in sufficient detail to identify clearly the nature and amount of such transactions. The member should not make changes in such basic data without the concurrence of the client.

3. When financial statements are prepared from books and records which the member has maintained, the member must comply with applicable standards for audits, reviews, or compilations.

[Formerly paragraph .04, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

.06 101-4—Honorary directorships and trusteeships of not-for-profit organization. Members may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. A member who permits his or her name to be used in this manner and who is associated with the financial statements of the organization would not be considered lacking in independence under Rule 101 so long as his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the member is named in letterheads and externally circulated materials, the member must be identified as an honorary director or honorary trustee. [Formerly paragraph .05, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly Interpretation 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Renumbered as Interpretation 101-4 and moved from paragraph .03, April, 1992.]

.07 101-5—Loans from financial institution clients and related terminology. Interpretation 101-1-A-4 [ET section 101.02] provides that, except as permitted in this interpretation, a member's independence shall be considered to be impaired if the member has any loan to or from the enterprise or any officer, director, or principal stockholder of the enterprise. This interpretation does not consider independence to be impaired for certain grandfathered loans and other permitted loans from financial institution clients for whom services are performed requiring independence as set forth below under "Grandfathered Loans" and "Other Permitted Loans," respectively.

Grandfathered Loans

This interpretation grandfathers the following types of loans obtained from a financial institution under that institution's normal lending procedures, terms, and requirements, and that meet the other specified conditions stated herein, and (a) that exist as of January 1, 1992; (b) that were obtained from a

financial institution prior to its becoming a client requiring independence; (c) that were obtained from a financial institution for which independence was not required and that were later sold to a client for which independence is required; or (d) that were obtained from a firm's financial institution client requiring independence, by a borrower prior to his or her becoming a member* with respect to such client. *However, independence will be considered to be impaired if, after January 1, 1992, a member obtains a loan of the type described in this paragraph from an entity that, at the time of obtaining the loan, is a client requiring independence.* Grandfathered loans must, at all times, be current as to all terms and such terms shall not be renegotiated after the latest of the dates in (a) through (d) above.

1. Home mortgages.
2. Other secured loans. The collateral on such loans must equal or exceed the remaining balance of the loan at January 1, 1992 and at all times thereafter.
3. Loans not material to the member's net worth.

Other Permitted Loans

This interpretation permits the following types of personal loans obtained from a financial institution client for which independence is required under that institution's normal lending procedures, terms, and requirements. Such loans must, at all times, be kept current as to all terms.

1. Automobile loans and leases collateralized by the automobile.
2. Loans of the surrender value under terms of an insurance policy.
3. Borrowings fully collateralized by cash deposits at the same financial institution (e.g., "passbook loans").
4. Credit cards and cash advances on checking accounts with an aggregate balance not paid currently of $5,000 or less.

Terminology

For purposes of interpretations 101-1-A-4 [ET section 101.02] and 101-5, the following terms are defined:

Loan

A loan is considered to be a financial transaction, the characteristics of which generally include, but are not limited to, an agreement that provides for repayment terms and a rate of interest. A loan includes a guarantee of a loan, a letter of credit and a line of credit. A loan to a limited partnership in which members have a combined investment exceeding 50 percent of the total limited partnership interest is considered a loan to those members.

Financial Institution

A financial institution is considered to be an entity that, as part of its normal business operations, makes loans to the general public.

Normal Lending Procedures, Terms, and Requirements

"Normal lending procedures, terms, and requirements" relating to a member's loan from a financial institution are defined as lending procedures, terms, and requirements that are reasonably comparable with those relating to loans of a similar character committed to other borrowers during the period in which the loan to the member is committed. Accordingly, in making such

* For the definition of "member" see interpretation 101-9 [ET section 101.11], "The meaning of certain independence terminology and the effect of certain family relationships on independence."

comparison and in evaluating whether a loan was made under "norn procedures, terms, and requirements," the member should consi circumstances under which the loan was granted, including—

1. The amount of the loan in relation to the value of the pledged as security and the credit standing of the mem member's firm.
2. Repayment terms.
3. Interest rate, including "points."
4. Closing costs.
5. General availability of such loans to the public.

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

[Revised, November 30, 1987, by the Professional Ethics Executiv tee. Formerly paragraph .06, renumbered by adoption of the Code sional Conduct on January 12, 1988. References revised to reflect AICPA Code of Professional Conduct on January 12, 1988. Revise June 30, 1990, by the Professional Ethics Executive Committee November 1991, effective January 1, 1992 with earlier a encouraged, by the Professional Ethics Executive Committee.]

.08 101-6—The effect of actual or threatened litigation or dence. Rule 101 provides that a member shall be independent in th ance of professional services as required by standards promulgated designated by Council. In some circumstances, independence may ered to be impaired as a result of litigation or the expressed ir commence litigation.

Litigation between client and member

In order for the member to fulfill his obligation to render an objective opinion on the client company's financial statements, th ship between the management of the client and the member must terized by complete candor and full disclosure regarding all asp client's business operations. In addition, there must be an absence the part of the member so that he or she can exercise professional ju the financial reporting decisions made by the management. When management of a client company commences, or expresses an in commence, legal action against the member, the member and management may be placed in adversarial positions in which th ment's willingness to make complete disclosures and the member's may be affected by self-interest.

For the reasons outlined above, independence may be impaire the member and the member's client company or its managem threatened or actual positions of material adverse interests by threatened or actual litigation. Because of the complexity and dive situations of adverse interests which may arise, however, it is prescribe precise points at which independence may be impaired. ing criteria are offered as guidelines:

1. The commencement of litigation by the present manage ing deficiencies in audit work for the client would be co impair independence.

[The next page is 4415-3.]

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

Litigation by security holders

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

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

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

[2] See footnote 1.

Other third-party litigation

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

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the member ("the plaintiff client"), the member's independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the member's firm[2] or to the plaintiff client.

Effects of impairment of independence

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

Termination of impairment

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

Actions permitted while independence is impaired

If the member was independent when his or her report was initially rendered, the member may re-sign such report or consent to its use at a later date while his or her independence is impaired provided that no post-audit work is performed by such member during the period of impairment. The term "post-audit work", in this context, does not include inquiries of subsequent auditors, reading of subsequent financial statements, or such procedures as

may be necessary to assess the effect of subsequently discovered facts on the financial statements covered by the member's previously issued report. [Formerly paragraph .07, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[.09] [101-7]—[Deleted] [Formerly paragraph .08, renumbered by adoption of the Code of Professional Conduct on January 12, 1988.]

.10 101-8—Effect on independence of financial interests in nonclients having investor or investee relationships with a member's client.

Introduction

Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in other rulings [ET section 191.138—.139, .158—.159, and .162—.163].

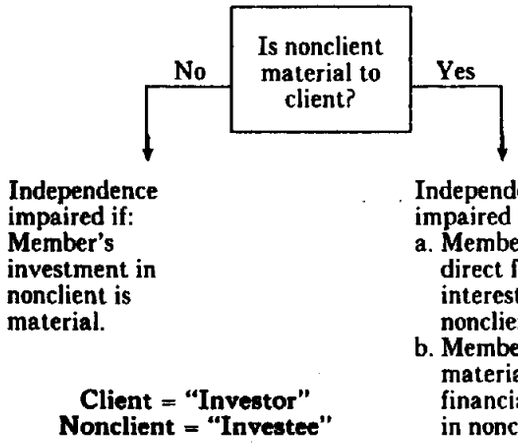
Terminology

The following specifically identified terms are used in this interpretation as indicated:

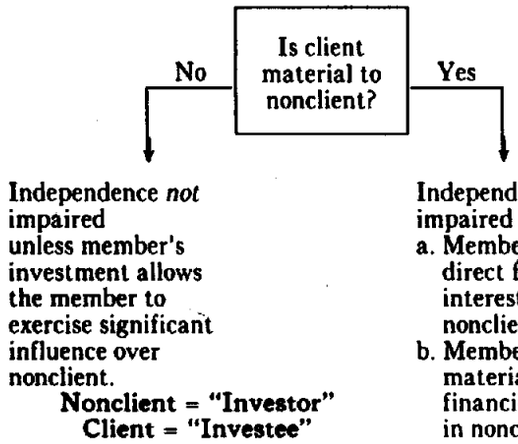
1. Client. The term client means the person or entity with whose financial statements the member or the member's firm is associated.
2. Significant Influence. The term significant influence is as defined in Accounting Principles Board (APB) Opinion 18 [AC I82].
3. Investor. The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.
4. Investee. The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

Interpretation

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



Where a client investee is material to a nonclient investor, any direct or material indirect financial interest of a member in the nonclient investor would be considered to impair the member's independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a member's financial interest in the nonclient investor allows the member to exercise significant influence over the actions of the nonclient investor, the member's independence would be considered impaired.



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

In general, in brother-sister common control situations, an immaterial financial interest of a member in the nonclient investee would not impair the independence of a member with respect to the client investee, provided the member could not exercise significant influence over the nonclient investor.

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

If a member does not and could not reasonably be expected to have knowledge of the financial interests or relationships described in this interpretation, the member's independence would not be considered to be impaired under this interpretation.

[Revised, December 31, 1983, by the Professional Ethics Executive Committee. Formerly paragraph .09, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-8, *Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Member's Client*, April 1991, effective April 30, 1991. Revised, December 31, 1991, by the Professional Ethics Executive Committee.]

.11 101-9—The meaning of certain independence terminology and the effect of family relationships on independence.

This interpretation defines certain terms used in interpretation 101-1 [ET section 101.02] and, in doing so, also explains how independence may be impaired through certain family relationships.

Member or Member's Firm

A member (as used in rule 101 [ET section 101.01]) and a member or a member's firm (as used in interpretation 101-1 [ET section 101.02]) include—

1. The member's firm and its proprietors, partners, or shareholders. A member's firm is defined as a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.
2. All individuals [3] participating in the engagement, except those who perform only routine clerical functions, such as typing and photocopying.
3. All individuals [3] with a managerial position located in an office participating in a significant portion of the engagement.
4. Any entity (for example, a partnership, corporation, trust, joint venture, or pool) whose operating, financial, or accounting policies can be controlled (see definition of control for consolidation purposes in Financial Accounting Standards Board [FASB] Statement No. 94 [AC section C51]) by one or more of the persons described in (1) through (3) or by two or more such persons if they choose to act together.

A member or a member's firm does not include an individual [3] solely because he or she was formerly associated with the client in any capacity

[3] Refers to all employees of the member and all contractors retained by the member, except specialists as discussed in SAS No. 73 [AU section 336], irrespective of their functional classification (for example, audit, tax, or management consulting services).

described in interpretation 101-1-B [ET section 101.02], if such an individual [3] has disassociated himself or herself from the client and does not participate in the engagement for the client covering any period of his or her association with the client.

A member or a member's firm includes individuals who provide services to clients and are associated with the client in any capacity described in interpretation 101-1-B [ET section 101.02], if the individuals are located in an office participating in a significant portion of the engagement.

Managerial Position

The organization of firms varies; therefore, whether an individual has a managerial position depends on his or her responsibilities and how he or she or the position itself is held out to clients and third parties. The following are some, but not necessarily all, of the responsibilities that suggest that an individual has a managerial position:

1. Continuing responsibility for the overall planning and supervision of engagements for specified clients
2. Authority to determine that an engagement is complete subject to final partner approval if required
3. Responsibility for client relationships (for example, negotiating and collecting fees for engagements and marketing the firm's services)
4. Existence of profit sharing as a significant feature of total compensation
5. Responsibility for overall management of the firm, development, or establishment of firm policies on technical matters, and implementation of or compliance with the following nine elements of quality control:
   a. Independence
   b. Assigning personnel to engagements
   c. Consultation
   d. Supervision
   e. Hiring
   f. Professional development of personnel
   g. Advancement of personnel
   h. Acceptance and continuance of clients
   i. Inspection of compliance with policies and procedures

Significant Influence

A person or entity can exercise significant influence over the operating, financial, or accounting policies of another entity if for example, the person or entity—

1. Is connected with the entity as a promoter, underwriter, voting trustee, general partner or director (other than an honorary director as defined in the AICPA Code of Professional Conduct).
2. Is connected with the entity in a policy-making position related to the entity's primary operating, financial, or accounting policies, such as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer.

[3] Refers to all employees of the member and all contractors retained by the member, except specialists as discussed in SAS No. 73 [AU section 336], irrespective of their functional classification (for example, audit, tax, or management consulting services).

3. Meets the criteria established in Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* [AC section I82], and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity.

The foregoing examples are not necessarily all-inclusive.

Office Participating in a Significant Portion of the Engagement

An office would be considered to be participating in a significant portion of an engagement if the office had primary client responsibility for a multioffice engagement. In addition, professional judgment must be exercised in deciding whether any other office participates in a significant portion of a multioffice engagement. For example, an office would be considered to be participating in a significant portion of the engagement if the office's engagement hours or fees are material to total engagement hours or fees or if the office's responsibility for reporting, whether internally or externally, on a portion of the engagement relates to a material amount of assets or income (loss) before income taxes of the client.

The foregoing examples are not necessarily inclusive of all situations in which an office may be considered to be participating in a significant portion of the engagement.

Spouses and Dependent Persons

Except as stated in the following paragraph, the term *member* includes spouses (whether or not dependent) and dependent persons (whether or not related) for all purposes of complying with rule 101 [ET section 101.01].

The exception is that the independence of the member and the member's firm will not normally be impaired solely as a result of the employment of a spouse or dependent person by a client subject to the following conditions:

1. Independence would be considered to be impaired if a spouse or dependent person of one of the following has a position with the client that allows significant influence over the client's operating, financial, or accounting policies:
   a. An individual participating in the engagement
   b. A proprietor, partner, or shareholder who—
      i. is located in an office participating in a significant portion of the engagement; or
      ii. has the ability to exercise influence over the engagement; or
      iii. has any involvement with the engagement (for example, consultation on accounting or auditing issues)
2. Independence will be considered to be impaired if a spouse or dependent person of an individual participating in the engagement has a position with the client involving activities that are *audit-sensitive* (even though the position is not one that allows *significant influence*).

In general, a person's activities would be considered audit-sensitive if such activities are normally an element of or subject to significant internal accounting controls. For example, the following positions, which are not intended to be all-inclusive, would normally be considered audit-sensitive:

cashier; internal auditor; accounting supervisor; purchasing agent; or inventory warehouse supervisor.

Nondependent Close Relative

The term *member or member's firm* excludes nondependent close relatives of the persons described in (1) through (3) of that definition. Nevertheless, in the circumstances discussed below the independence of a member or a firm can be impaired because of a nondependent close relative.

Close relatives are nondependent children, grandchildren, stepchildren, brothers, sisters, grandparents, parents, parents-in-law and their respective spouses. Close relatives do not include the brothers and sisters of the member's spouse.

The independence of a member's firm would be considered to be impaired with respect to an enterprise if—

1. During the period of the professional engagement or at the time of expressing an opinion, an individual participating in the engagement has a close relative with a financial interest in the enterprise that was material to the close relative and of which the individual participating in the engagement has knowledge.
2. During the period covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion—
   a. An individual participating in the engagement has a close relative who could exercise significant influence over the operating, financial, or accounting policies of the enterprise or who is otherwise employed in a position in which the person's activities are audit-sensitive, or
   b. A proprietor, partner, or shareholder any one of whom is located in an office participating in a significant portion of the engagement, has a close relative who could exercise significant influence over the operating, financial, or accounting policies of the enterprise.

Other Considerations

Members must be aware that it is impossible to enumerate all circumstances wherein the appearance of a member's independence might be questioned by third parties. For example, a member's relationship with a cohabitant may be equivalent to that of a spouse. In addition, in situations involving assessment of the association of any relative or dependent person with a client, members must consider whether the strength of personal and business relationships between the member and the relative or dependent person, in conjunction with the specified association with the client, would lead a reasonable person aware of all the facts, who took into consideration normal strength of character and normal behavior under such circumstances, to conclude that the situation poses an unacceptable threat to the member's objectivity and appearance of independence.

[Replaces previous interpretation 101-9, *The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence,* November 1993, effective November 30, 1993.]

.12 101-10—The effect on independence of relationships with entities included in the governmental financial statements. Under statements issued by the Governmental Accounting Standards Board, general-

purpose financial statements may be issued for a governmental reporting entity, which consists of the financial statements of an oversight entity and one or more other entities (component units).

Because the oversight entity can exercise significant influence over the component units included in the reporting entity financial statements, Rule 101 is applicable and requires a member issuing a report on the general-purpose financial statements to be independent of the oversight entity and of each component unit that should be included therein.

A member who is the auditor of a material component unit but is not the auditor of the oversight entity should be independent of that component unit and the oversight entity.

A member who is the auditor of only an immaterial component unit is only required to be independent of that component because it is immaterial to the reporting entity. If this same member also audited other immaterial component units that, when aggregated, are material to the reporting entity, the member should be independent of the oversight entity and of the component units that the member audits.

[Formerly paragraph .11, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-10, *The Effect on Independence of Relationships Proscribed by Rule 101 and its Interpretations With Nonclient Entities Included With a Member's Client in the Financial Statements of a Governmental Reporting Entity,* April 1991, effective April 30, 1991.]

.13 101-11—Independence and attest engagements.

Introduction

Rule 101, *Independence* [ET section 101.01], provides that "a member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council." The Statement on Standards for Attestation Engagements [AT section 100] requires independence in the performance of engagements covered by that Statement.

[Definitions]

Assertion. Any declaration, or a set of related declarations taken as a whole, by a party responsible for it.

Asserter. The person(s) or entity responsible for an assertion.

Attest Engagement. An engagement in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party.

Attest Engagement Team. Includes proprietors, partners, and shareholders who participate in the acceptance or performance of the attest engagement and full- or part-time professional employees who participate in the acceptance or the performance of the attest engagement, including individuals who provide consultation or supervisory services for the attest engagement.

[Applicability]

This interpretation does not apply to attest engagements covered by Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Accountants' Services on Prospective Financial Information, and such other pronouncements as may be

[The next page is 4423-3.]

determined from time to time by the Professional Ethics Executive Committee.

Interpretation

Independence will be considered to be impaired if, during the period of the attest engagement or at the time the written conclusion is issued—

1. An individual on the attest engagement team or his or her spouse, dependent or firm [4] has a relationship with the asserter that is proscribed by interpretation 101-1 of rule 101 [ET section 101.02].
2. An individual on the engagement team has a nondependent close relative [5] who has either a position of significant influence [5] with, or a financial interest material to the close relative in the asserter.
3. An owner, partner, or shareholder of the firm who is located in an office participating in a significant portion of the attest engagement, or the spouse or dependent of such an owner, partner, or shareholder, has either a position of significant influence[6] with, or a financial interest material to such person in the asserter.
4. The firm, an individual on the attest engagement team (or his or her spouse or dependent), or an owner, partner, or shareholder in an office performing a significant portion of the engagement, contributed to the development of the subject matter of the assertion (the subject) or stands to gain financially directly from the success of the subject.
5. An individual on the attest engagement team knows or could reasonably be expected to know that any owner, partner, or shareholder located in other offices of the firm (*a*) contributed to the development of the subject or stands to gain financially directly from the success of the subject, or (*b*) has a position of significant influence[6] with the asserter.

In determining whether a relationship with an asserter is one that is proscribed under interpretation 101-1 [ET section 101.02], the following guidance is provided:

- ☐ Interpretation 101-6, "The Effect of Actual or Threatened Litigation on Independence [ET section 101.08]," is not applicable unless the litigation relates to the attest engagement or is material to the firm or to the financial statements of the asserter.
- ☐ Interpretation 101-9, "The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence [ET section 101.11]," is not applicable because the applicability of this interpretation is stated herein.

[Effective February 28, 1990.]

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[4] For the purpose of this interpretation, *firm* shall mean the sole proprietorship, partnership, or professional corporation of which an individual on the attest engagement team is an owner, partner, shareholder, or employee; it does not include owners, partners, shareholders, or employees as individuals.

[5] For the purpose of this interpretation, this term shall mean the same as in interpretation 101-9, "The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence [ET section 101.11]."

[6] For the purpose of this interpretation, this term shall mean the same as in interpretation 101-9, "The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence [ET section 101.11]."

.14 101-12—Independence and cooperative arrangements with clients. Independence will be considered to be impaired if, during the period of a professional engagement or at the time of expressing an opinion, a member's firm had any cooperative arrangement with the client that was material to the member's firm or to the client.

Definition of Terms

Firm—For purposes of this interpretation only, a firm is a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting.

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

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

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

a. The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.
b. The firm assumes no responsibility for the activities or results of the client, and vice versa.
c. Neither party has the authority to act as the representative or agent of the other party.

[Effective November 30, 1993.]

ET Section 102

Integrity and Objectivity

.01 Rule 102—Integrity and objectivity. In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[As adopted January 12, 1988.]

Interpretations under Rule 102—Integrity and Objectivity

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

.02 102-1—Knowing misrepresentations in the preparation of financial statements or records. A member who knowingly makes, or permits or directs another to make, false and misleading entries in an entity's financial statements or records shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET section 102.01].

.03 102-2—Conflicts of interest. A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a significant relationship with another person, entity, product, or service that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider rule 301, "Confidential Client Information" [ET section 301.01].

Certain professional engagements require independence. Independence impairments under rule 101 [ET section 101.01] and its interpretations cannot be eliminated by such disclosure and consent.

[Effective August 31, 1989.]

.04 102-3—Obligations of a member to his or her employer's external accountant. Under rule 102 [ET section 102.01], a member must maintain objectivity and integrity in the performance of a professional service. In dealing with his or her employer's external accountant, a member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which his or her employer's external accountant requests written representation.

[Effective November 30, 1993.]

.05 102-4—Subordination of judgment by a member. Rule 102 [ET section 102.01] prohibits a member from knowingly misrepresenting facts or

subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment:[1]

1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature or omission of disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. If, after appropriate research or consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.
2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed.
3. If, after discussing his or her concerns with the appropriate person(s) in the organization, the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member also should consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In this connection, the member may wish to consult with his or her legal counsel.
4. The member should at all times be cognizant of his or her obligations under interpretation 102-3 [ET section 101.04].

[Effective November 30, 1993.]

.06 102-5—Applicability of rule 102 to members performing educational services. Educational services (for example, teaching full- or part-time at a university, teaching a continuing professional education course, or engaging in research and scholarship) are professional services as defined in ET section 92.10, and are therefore subject to rule 102 [ET section 102.01]. Rule 102 [ET section 102.01] provides that the member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[Effective March 31, 1995.]

[The next page is 4431.]

[1] A member in the practice of public accounting should refer to the Statements on Auditing Standards. For example, see SAS No. 22, *Planning and Supervision* [AU section 311], which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.

ET Section 191

Ethics Rulings on Independence, Integrity and Objectivity

Ethics Rulings and Interpretations which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

1. Acceptance of a Gift

.001 *Question*—Would the independence of a member's firm be considered to be impaired if an employee or partner accepts a gift or other unusual consideration from a client?

.002 *Answer*—If an employee or partner accepts more than a token gift from a client, even with the knowledge of the member's firm, the appearance of independence may be lacking.

2. Association Membership

.003 *Question*—If a member joined a trade association which is a client, would the independence of the member be considered to be impaired with respect to the association?

.004 *Answer*—Independence of the member would not be considered to be impaired provided the member did not serve as an officer, director, or in any capacity equivalent to that of a member of management.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

3. Member as Signer or Cosigner of Checks

.005 *Question*—A member has been requested to accept the responsibility in emergency situations of signing or cosigning checks with a designated employee of a client. Would the independence of the member be considered to be impaired under these circumstances?

.006 *Answer*—Independence of the member would be considered to be impaired since such activities are management functions.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

4. Payroll Preparation Services

.007 *Question*—A member performs payroll preparation services for clients. A single bank account in the member's name is used to clear all checks. Individual employee checks are cosigned by the member as well as by an officer of each of the respective clients. The clients reimburse the member for the net amount of the payrolls. Would the independence of the member be considered to be impaired with respect to clients who avail themselves of this service?

.008 *Answer*—Independence of the member would be considered to be impaired.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[5.]

[.009-.010] [Deleted]

6. Member's Spouse as Accountant of Client

.011 *Question*—The spouse of a member is employed as an accountant by a client. Would the independence of the member or member's firm be considered to be impaired under these circumstances?

.012 *Answer*—Independence of the member or member's firm would not necessarily be considered to be impaired. The performance of accounting services by the member would not impair independence if performed in accordance with the requirements of interpretation 101-3 [ET section 101.05]. Therefore, the spouse of a member could perform the same functions as the member without impairing the independence of the member or member's firm. If, however, the spouse's functions were not in compliance with interpretation 101-3 [ET section 101.05], independence may be impaired and should be considered under interpretation 101-9, "Spouses and Dependent Persons" [ET section 101.11].

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

7. Member Providing Contract Services

.013 *Question*—A member proposes to enter into contract with a client to supervise office personnel or approve disbursements. Would the independence of the member be considered to be impaired with respect to the client?

.014 *Answer*—Independence of the member would be considered to be impaired since management functions are being performed.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

8. Member Providing Advisory Services

.015 *Question*—A member has provided extensive advisory services for a client. In that connection, the member has attended board meetings, interpreted financial statements, forecasts and other analyses, counseled on potential expansion plans, and counseled on banking relationships. Would the independence of the member be considered to be impaired under these circumstances?

.016 *Answer*—Independence of the member would not be considered to be impaired because the member's role is advisory in nature.

9. Member as Representative of Creditor's Committee

.017 *Question*—A member performs the following functions for a creditors' committee in control of a debtor corporation which will continue to operate under its existing management subject to extension agreements:

a. Sign or cosign checks issued by the debtor corporation.

b. Sign or cosign purchase orders in excess of established minimum amounts.

c. Exercise general supervision to insure compliance with budgetary controls and pricing formulas established by management, with the consent of the creditors, as part of an overall program aimed at the liquidation of deferred indebtedness.

Would the independence of the member be considered to be impaired with respect to the debtor corporation?

.018 *Answer*—Independence of the member would be considered to be impaired under each situation described since these are management functions.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

10. Member as Legislator

.019 *Question*—A member is an elected legislator in a local government. The city manager, who is responsible for all administrative functions, is also an elected official. Would the independence of the member be considered to be impaired with respect to the governmental entity?

.020 *Answer*—Independence of the member would be considered to be impaired if the member served as an elected legislator in a municipal body at the same time the member is engaged to perform a service requiring independence for the body even though the city manager is an elected official rather than an appointee of the legislature.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

11. Member as Executor or Trustee

.021 *Question*—A member has been designated to serve as an executor or trustee of the estate of an individual who owns the majority of the stock of a corporation. Would the independence of the member be considered to be impaired with respect to the corporation?

.022 *Answer*—The mere designation of a member to become executor or trustee would not be considered to impair the independence of the member. Actual service would be considered to impair the member's independence.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

12. Member as Trustee

.023 *Question*—A charitable foundation is the sole beneficiary of the estate of the foundation's deceased organizer. If a member becomes a trustee of the foundation, would the independence of the member be considered to be impaired with respect to (1) the foundation or (2) the estate?

.024 *Answer*—If a member served as trustee of the foundation, independence of the member would be considered to be impaired with respect to both the foundation and the estate.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[13.]

[.025-.026] [Deleted]

14. Member on Board of Directors of Federated Fund-Raising Organization

.027 *Question*—A member serves as a director or officer of a local United Way or similar organization that operates as a federated fund-raising organization from which certain local charities receive funds. Would the independence of the member be considered to be impaired with respect to such charities?

.028 *Answer*—Independence of the member's firm would not normally be considered to be impaired unless the United Way or similar organization that

operates as a federated fund-raising organization exercises managerial control over the local charities participating in the fund-raising organization.

[Replaces previous ruling No. 14, *Member on Board of Directors of United Fund*, April 1991.]

[15.]

[.029-.030] [Deleted]

16. Member on Board of Directors of Nonprofit Social Club

.031 *Question*—A member serves on the board of directors of a nonprofit social club. Would the independence of the member be considered to be impaired with respect to the club?

.032 *Answer*—Independence of the member would be considered to be impaired since the board of directors has the ultimate responsibility for the affairs of the club.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

17. Member of Social Club

.033 *Question*—A member belongs to a social club (for example, country club, tennis club) in which membership requirements involve the acquisition of a pro rata share of equity or debt securities. Would the independence of the member's firm be considered to be impaired with respect to the social club?

.034 *Answer*—As long as membership in a club is essentially a social matter, independence of the member's firm would not be considered to be impaired because such equity or debt ownership is not considered to be a direct financial interest within the meaning of rule 101 [ET section 101.01]. However, the member should not serve on the club's governing board or take part in its management.

[Replaces previous ruling No. 17, *Member as Stockholder in Country Club*, February 1991.]

[18.]

[.035-.036] [Deleted]

19. Member on Deferred Compensation Committee

.037 *Question*—A member serves on a committee which administers the client's deferred compensation program. Would the independence of the member be considered to be impaired under these circumstances?

.038 *Answer*—Independence of the member would be considered to be impaired since service on a committee of this type would be participation, in management functions. The member could render consulting assistance without joining the committee.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

20. Member Serving on Governmental Advisory Unit

.039 *Question*—A member serves on a citizens' committee which is studying possible changes in the form of a county government the member audits. The member also serves on a committee appointed to make a study of the financial status of a state. Would the independence of the member be considered to be impaired with respect to a county which is in that state?

.040 *Answer*—Independence of the member would not be considered to be impaired with respect to the county through the member's service on either committee.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

21. Member as Director and Auditor of the Entity's Profit Sharing Trust

.041 *Question*—A member serves in the dual capacity of director of an enterprise and auditor of the financial statements of that enterprise's profit sharing and retirement trust. Would the independence of the member be considered to be impaired with respect to the trust?

.042 *Answer*—Independence of the member would be considered to be impaired with respect to the enterprises's profit sharing and retirement trust since as director of the enterprise, the member would be involved in management functions that affect the plan.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[22.-27.]

[.043-.054] [Deleted]

28. Cash Account with Brokerage Client

[.055-.056] [Superseded by Ethics Ruling No. 59.]

29. Member as Bondholder

.057 *Question*—A member has been asked to perform a service requiring independence for a municipal authority that has outstanding bonds of which the member owns an immaterial amount. Would the independence of the member be considered to be impaired with respect to the authority?

.058 *Answer*—Independence of the member would be considered to be impaired since the member has a loan to a client.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[30.]

[.059-.060] [Deleted]

31. Financial Interest in a Cooperative, Condominium Association, Planned Unit Development, Homeowners Association, Timeshare Development, or Other Common Interest Realty Association

.061 *Question*—Would the independence of a member of his or her firm be considered impaired with respect to an engagement to perform services for a cooperative, condominium association, planned unit development, homeown-

ers association, timeshare development, or other common interest realty association if the member or the member's firm owned a unit in such an entity?

.062 *Answer*—Independence of the member and his or her firm would be considered to be impaired under the circumstances, pursuant to Rule 101 and its interpretations, because the member or the member's firm's ownership of a unit would be a direct financial interest in the cooperative, condominium association, planned unit development, homeowners association, timeshare development, or other common interest realty association.

(This ruling takes effect on August 31, 1990; however, earlier application is encouraged.)

[Replaces previous Ruling No. 31, Financial Interest in Co-Op Apartment, effective August 31, 1989.]

[32.]

[.063-.064] [Deleted]

33. Member as Participant in Employee Benefit Plan

.065 *Question*—A member accepts the opportunity to participate in an employee benefit plan. Would the independence of the member be considered to be impaired with respect to the employee benefit plan or the sponsor of the plan?

.066 *Answer*—Independence of the member would be considered to be impaired with respect to the plan and the sponsor.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[34.]

[.067-.068] [Deleted]

35. Stockholder in Mutual Funds

.069 *Question*—A member owns shares in a regulated mutual investment fund which holds shares of stock in the member's clients. Would the independence of the member be considered to be impaired with respect to the client enterprises whose stock is held by the fund?

.070 *Answer*—Securities of the member's clients held by the regulated mutual investment fund in question represent indirect financial interests of the member in securities of his or her clients. If the indirect financial interest becomes material to the member, the member's independence would be considered to be impaired. In addition, if the member has significant influence over the regulated mutual fund, the member's independence would be considered to be impaired.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

36. Participant in Investment Club

.071 *Question*—A member owns an investment club. Would the independence of the member be considered to be impaired with respect to a client in which the investment club holds shares?

.072 *Answer*—Independence of the member would be considered to be impaired since the ownership of stock in a client through an investment club is considered a direct financial interest. Under these circumstances materiality is not an issue.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[37.]

[.073-.074] [Deleted]

38. Member as Co-Fiduciary With Client Bank

.075 *Question*—A member serves with a client bank in a co-fiduciary capacity with respect to an estate or trust. Would the independence of the member be considered to be impaired with respect to the bank or its trust department?

.076 *Answer*—Independence of the member would not be considered to be impaired provided the assets in the estate or trust were not material in relation to the total assets of the bank and/or trust department.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

39. Member as Officially Appointed Stock Transfer Agent or Registrar

.077 *Question*—Would the independence of a member be considered to be impaired with respect to a client for whom the member serves as an officially appointed stock transfer agent or registrar?

.078 *Answer*—Independence of the member would be considered to be impaired since the functions performed by the member as an officially appointed transfer agent or registrar would be considered equivalent to that of a member of management or of an employee. Functions such as distribution of dividends and warrants and the legal transfer of the shares of outstanding capital stock would cause the independence of the member to be considered to be impaired. However, if the member is not officially appointed, this is not intended to preclude the member from assisting the client in performing functions in accordance with Interpretation 101-3 [ET section 101.05].

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[40.]

[.079-.080] [Deleted]

41. Member as Auditor of Insurance Company

.081 *Question*—Contributions made by a member for a retirement plan for the member and the member's employees are invested and managed by an insurance company in a pooled separate account, not part of the general assets of the insurance company, for this and similar contracts. Would the independence of the member be considered to be impaired?

ET Section 203

Accounting Principles

.01 Rule 203—Accounting principles. A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

[As adopted January 12, 1988.]

Interpretations under Rule 203—Accounting Principles

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

.02 203-1—Departures from established accounting principles. Rule 203 [ET section 203.01] was adopted to require compliance with accounting principles promulgated by the body designated by Council to establish such principles. There is a strong presumption that adherence to officially established accounting principles would in nearly all instances result in financial statements that are not misleading.

However, in the establishment of accounting principles it is difficult to anticipate all of the circumstances to which such principles might be applied. This rule therefore recognizes that upon occasion there may be unusual circumstances where the literal application of pronouncements on accounting principles would have the effect of rendering financial statements misleading. In such cases, the proper accounting treatment is that which will render the financial statements not misleading.

The question of what constitutes unusual circumstances as referred to in rule 203 [ET section 203.01] is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle would be regarded generally by reasonable men as producing a misleading result.

Examples of events which may justify departures from a principle are new legislation or the evolution of a new form of business transaction. An unusual degree of materiality or the existence of conflicting industry practices

.082 *Answer*—Independence of the member would not be considered to be impaired as a result of the member's investment in the pooled separate account.

[Replaces previous Ruling No. 41, *Member as Auditor of Mutual Insurance Company*, November, 1990.]

[42.-43.]

[.083-.086] [Deleted]

44. Past Due Billings

[.087-.088] [Superseded by Ethics Ruling No. 52.]

[45.]

[.089-.090] [Deleted]

46. Member as General Counsel

[.091-.092] [Superseded by Ethics Ruling No. 51.]

[47.]

[.093-.094] [Deleted]

48. Faculty Member as Auditor of a Student Fund

.095 *Question*—A member employed full or part-time on the faculty of a university is asked to audit the financial statements of the Student Senate Fund. The university:

1. Acts as a collection agent for student fees and remits them to the Student Senate.

2. Requires that a university administrator approve and sign Student Senate checks.

Would the independence of the member be considered to be impaired under these circumstances?

.096 *Answer*—Independence of the member would be considered to be impaired with respect to the Student Senate Fund since the member would be auditing several of the management functions performed by the university, the member's employer.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

49. Investor and Investee Companies

[.097-.098] [Superseded by Interpretation No. 101-8.]

[50.]

[.099-.100] [Deleted.]

51. Member Providing Legal Services

.101 *Question*—A member who is an attorney serves as general counsel or its equivalent for a client. Would the independence of the member be considered to be impaired with respect to the client?

.102 *Answer*—The member would not be considered to be independent with respect to the client because serving as general counsel or its equivalent would be acting in a management capacity.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

52. Unpaid Fees

.103 *Question*—A member's client has not paid fees for previously rendered professional services. Would the independence of the member's firm be considered to be impaired with respect to the client for the current year?

.104 *Answer*—Independence of the member's firm is considered to be impaired if, when the report on the client's current year is issued, fees remain unpaid, whether billed or unbilled, for any professional services provided more than one year prior to the date of the report. Such amounts assume the characteristics of a loan within the meaning of rule 101 [ET section 101.01] and its interpretations.

This ruling does not apply to fees outstanding from a client in bankruptcy.

[Replaces previous ruling No. 52, *Past Due Fees*, November 1990.]

[53.]

[.105-.106] [Deleted]

54. Member Providing Appraisal, Valuation, or Actuarial Services

.107 *Question*—Would the performance by a member of appraisal, valuation, or actuarial services for a client impair the independence of that member?

.108 *Answer*—Performance by a member of appraisal, valuation, or actuarial services, the results of which may be incorporated in the client's financial statements, would not impair a member's independence if all of the significant matters of judgment involved are determined or approved by the client and the client is in a position to have an informed judgment on the results of those services.

[Replaces previous ruling No. 54, *Member Providing Actuarial Services*, November 1990.]

55. Independence During Systems Implementation

.109 *Question*—A member has been requested by a client to perform an engagement involving the implementation of an information and control system. As part of this implementation, the member will arrange interviews for client's hiring of new personnel, and instruct and oversee the training of current client personnel. Would the independence of the member be considered to be impaired with respect to the client if the member performs this engagement?

.110 *Answer*—Independence of the member would not be considered impaired under these circumstances provided the client makes all significant management decisions related to the hiring of new personnel and the implementation of the system. The member also must limit his or her supervisory activities to initial instruction and training of personnel and should avoid direct supervision of the actual operation of the system or any related activities that would constitute undue involvement in or identification with management functions.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

56. Executive Search

.111 *Question*—A member's client is establishing a new operation in another locality. The client has asked the member to recruit and hire for the company a controller and a cost accountant for its new operation. Would the

independence of the member be considered to be impaired with respect to the client if the member performed this engagement?

.112 *Answer*—Independence of the member would be considered to be impaired since decisions as to employment of personnel are considered a management function. However, a member may perform services consisting of recommending a position description and candidate specifications, searching for and initially screening candidates, and recommending qualified candidates to the client. Such consulting assistance would not impair independence provided client management is responsible for any ultimate hiring decision.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

57. MAS Engagement to Evaluate Service Bureaus

.113 *Question*—A client has asked a member's firm to evaluate and recommend service bureaus for processing a client's accounting records. Partners in the member's firm hold material financial interests in one of these service bureaus. Does a conflict of interest exist?

.114 *Answer*—Yes. Under rule 102 [ET section 102.01] if the partners' financial interests in the service bureau are disclosed to the client and the client's consent is obtained for the performance of the engagement, the rule would not operate to prohibit the performance of the engagement.

[Replaces previous ruling No. 57, *MAS Engagement to Evaluate Service Bureaus*, April 1991.]

58. Member as Lessor

.115 *Question*—A member owns a building and leases a portion of the space to a client. Would the independence of the member be impaired with respect to the client lessee?

.116 *Answer*—Leasing property to a client results in an indirect financial interest in that client. Therefore, a member's independence would be considered to be impaired if the indirect financial interest in a client is material to the member.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[59.]

[.117—.118] [Deleted]

60. Employee Benefit Plans—Member's Relationships With Participating Employer(s)

.119 *Question*—A member has been asked to audit the financial statements of an employee benefit plan that may have one or more participating employer(s). Must the member maintain independence with respect to the participating employer(s) in order to be considered independent of the plan?

.120 *Answer*—Independence would not be considered to be impaired with respect to the plan unless the member has a financial interest in the participating employer(s) or other relationships with the participating employer(s) that would give the member significant influence over such employer(s). When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations must be followed.*

* Note: Currently, DOL regulations are more restrictive than the position stated in this ruling.

[Replaces previous ruling No. 60, *Employee Benefit Plans—Member's Relationships With Participating Employer(s)*, November 1993.]

61. Participation of Member's Spouse in Client's Stock Ownership Plans (Including an ESOP)

.121 *Question*—The spouse of a member is employed by a client of the member in a position that would not, in itself, impair independence. The spouse participates in the client's employee stock ownership plan. Would the spouse's participation in the stock ownership plan impair the member's independence?

.122 *Answer*—Until the right of possession with respect to the shares exists, the interest in the plan is deemed to be an indirect financial interest in the client, ascribed to the member; accordingly, until such right exists independence will not be impaired unless the indirect financial interest is material to the member's net worth.

[As modified, February 1986, to reflect the guidance contained in interpretation 101-9. (See section 101.11.) Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[62.-63.]

[.123-.127] [Deleted]

64. Member on Board of Organization for Which Client Raises Funds

.128 *Question*—Is a member independent of an entity that functions solely to raise funds for an organization if the member serves on the board of directors of the organization?

.129 *Answer*—A member's independence would be considered to be impaired with respect to a fund-raising foundation if the member serves on the board of directors of the organization. However, if the directorship is clearly honorary, the member's independence would not be considered to be impaired.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

65. Use of the CPA Designation by Member Not in Public Practice

.130 *Question*—A member who is not in public practice wishes to use his or her CPA designation in connection with financial statements and correspondence of the member's employer. The member also wants to use the CPA designation along with employment title on business cards. Is it permissible for the member to use the CPA designation in these manners?

.131 *Answer*—The use of the CPA designation by a member who is not in the practice of public accounting in a manner to imply that the member is independent of the employer constitutes a knowing misrepresentation of fact in violation of rule 102 [ET section 102.01].

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

66. Member's Retirement or Savings Plan Has Financial Interest in Client

.132 *Question*—A member has been engaged to perform a service requiring independence for a client company. The member has established a retirement or savings plan through which the member has a financial interest in the client company. Would the member's independence be considered impaired because of this financial interest?

.133 *Answer*—Any direct or material indirect financial interest owned by a member's retirement or savings plan in a client company would be considered to be a direct or material indirect financial interest of the member in that client and would, therefore, impair the member's independence with respect to that client.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

67. Servicing of Loan

.134 *Question*—Would the mere servicing of a member's loan by a client financial institution impair the member's independence with respect to the client?

.135 *Answer*—No.

[Replaces previous ruling No. 67, *Servicing of Loan*, November 1993.]

68. Blind Trust

.136 *Question*—A member has a direct financial interest in an enterprise for which the member has been engaged to perform a service requiring independence. Would the independence of the member be considered to be impaired if the member transfers the direct financial interest into a blind trust?

.137 *Answer*—The independence of the member would be considered impaired whether or not the financial interest is placed in a blind trust. Further, a member should ensure that a blind trust does not hold a direct or material indirect financial interest in clients for which the member provides services requiring independence.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committe.]

69. Investment With a General Partner

.138 *Question*—A private, closely held entity is the general partner and controls limited partnership A as defined in FASB Statement No. 94. The member has a material (to his or her net worth) limited partnership interest in limited partnership A. The member has been asked to provide a service requiring independence for a new limited partnership B with the same general partner. Would the member be independent for purposes of providing services to limited partnership B?

.139 *Answer*—Because the general partner has control over limited partnership A, the member is considered to have a joint closely held business investment with the general partner, who has significant influence over limited partnership B, the proposed client. Since the member has a material investment in limited partnership A, independence would be considered to be impaired with respect to limited partnership B.

[Replaces previous Ruling No. 69, *Joint Investment With a Promoter and/or General Partner*, April 1991, effective April 30, 1991.]

70. Member's Depository Relationship With Client Financial Institution

.140 *Question*—A member maintains checking accounts or has savings accounts, certificates of deposit or money market accounts at a financial institution for which the member provides a service requiring independence. Would the member's checking accounts or savings accounts, certificates of deposit or money market accounts impair the member's and his firm's independence with respect to the financial institution under Rule 101 and its interpretations?

.141 *Answer*—The member's and his firm's independence would not be considered to be impaired with respect to the financial institution provided that the checking accounts, savings accounts, certificates of deposit or money market accounts were fully insured by the appropriate state or federal government deposit insurance agencies. Checking accounts, savings accounts, certificates of deposit and money market accounts not fully insured by state or federal government deposit insurance agencies would not impair independence provided that the uninsured amounts are not material to the member or the member's firm.

71. Use of Nonindependent CPA Firm on an Engagement

.142 *Question*—Firm A is not independent with respect to an entity. Partners, shareholders, or professional employees of Firm A are participating on Firm B's engagement team for that entity. Would Firm B's independence be considered to be impaired?

.143 *Answer*—Yes. The use by Firm B of partners, shareholders, or professional employees from Firm A as part of the engagement team will impair Firm B's independence with respect to that engagement.

However, use of the work of such individuals in a manner similar to internal auditors is permissible provided that there is compliance with the Statements on Auditing Standards. Applicable literature contained in the Statements on Auditing Standards should be consulted.

72. Member on Advisory Board of Client

.144 *Question*—A member has agreed to serve on the advisory board of a client. Would service on the advisory board impair the member's or the member's firm's independence with respect to the client?

.145 *Answer*—The member's services on the advisory board would impair the member's and the member's firm's independence unless all the following criteria are met: (1) the responsibilities of the advisory board are in fact advisory in nature; (2) the advisory board has no authority to make nor does it appear to make management decisions on behalf of the client; and (3) the advisory board and those having authority to make management decisions (including the board of directors or its equivalent) are distinct groups with minimal, if any, common membership.

73. Meaning of the Period of a Professional Engagement

.146 *Question*—Under Rule 101 and its interpretations, a member's independence is considered to be impaired if the member has certain financial interests in or management roles with the client during the "period of a professional engagement." What is the period of a professional engagement?

.147 *Answer*—The period of a professional engagement starts when the member begins to perform professional services requiring independence and ends with the notification of the termination of that professional relationship either by the member or by the client.

74. Audits, Reviews, or Compilations and a Lack of Independence

.148 *Question*—If a member in public practice is not independent with respect to a client, is it permissible under Rule 101 for the member to issue an audit, review, or compilation report for the client?

.149 *Answer*—A member may not issue an audit opinion or review report if the member is not independent with respect to the client. A member may issue a compilation report for a client with respect to which the member is not independent. However, the member must specifically disclose his or her lack of independence without giving reasons for the impairment.

75. Member Joining Client Credit Union

.150 *Question*—A member's partners and employees are members of a credit union that requests the member's firm to provide professional services requiring independence. Does membership in the credit union impair the independence of the member and the member's firm with respect to the credit union?

.151 *Answer*—Membership in the credit union would not impair the member's independence with respect to the credit union as long as all of the following criteria are met:

1. A member and/or his or her partners or employees must individually qualify to join the credit union other than by virtue of the professional services provided to the credit union.
2. The exercise of the member's vote or other activities must not have significant influence over the operating, financial, or accounting policies of the credit union.
3. Any loans from the credit union must meet the conditions specified in Interpretation 101-1-A-4 [ET section 101.02] and be made under normal lending procedures, terms, and requirements (see Interpretation 101-5 [ET section 101.07]).
4. Any deposits with the credit union must meet the conditions specified in Ruling No. 70 under Rule 101 [ET section 191.140—.141].

[Effective February 28, 1992, earlier application is encouraged.]

[76.]

[.152-.153] [Deleted]

77. Individual Considering or Accepting Employment With the Client

.154 *Question*—During the performance of an engagement, an individual participating in the engagement may be offered employment by the client or may seek employment with the client. What are the implications of these actions with respect to the AICPA Code of Professional Conduct?

.155 *Answer*—An individual participating in an engagement who is offered employment by, or seeks employment with, that client during the conduct of the engagement must consider whether or not his or her ability to act with integrity and objectivity has been impaired. When the engagement is one requiring independence, the individual must remove himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought, in order to prevent any appearance that integrity or objectivity has been impaired.

A member may become aware that an individual participated in the engagement while employment with the client was being considered or after it had been accepted. In these circumtances the member should consider what, if any, additional procedures may be necessary to ensure that all work had been performed with objectivity and integrity as required under Rule 102. Any additional procedures will depend on the nature of the engagement and may require reperformance of the work or other appropriate procedures.

78. Service on Governmental Board

.156 *Question*—May a member serve on a governmental board (for example, board of tax appeals, zoning commission) if, at the same time, the member provides professional services for a client or employer who comes before the board?

.157 *Answer*—Rule 102 would prohibit the member from serving on the board unless the member: (1) discloses this to the client or employer, the board, and any other appropriate parties; and (2) receives consent from all parties to participate as a board member with respect to matters involving the client or employer.

79. Member's Investment in a Partnership That Invests in Member's Client

.158 *Question*—A member has a direct financial interest in a partnership that invests in a client of the member's firm. Would the member's independence be considered to be impaired with respect to the client?

.159 *Answer*—If the member is a general partner, or functions in a capacity similar to that of a general partner, in a partnership that invests in a client of the member's firm, the member is deemed to have a direct financial interest in the client. Independence is considered to be impaired.

If the member is a limited partner in a partnership that invests in a client of the member's firm, the member is considered to have an indirect financial interest in the client. Independence would be considered to be impaired if the indirect financial interest is material to the member's net worth.

80. The Meaning of a Joint Closely Held Business Investment

.160 *Question*—Under Rule 101 and interpretation 101-1 [ET section 101.02], a member's independence is considered to be impaired if, during the period of the professional engagement or at the time of expressing an opinion, the member or the member's firm had any joint closely held business investment with the client or any officer, director, or principal stockholder thereof that was material in relation to the member's net worth or to the net worth of the member's firm. What is a joint closely held business investment?

.161 *Answer*—For purposes of Rule 101, its interpretations, and rulings, a joint closely held business investment is a business investment that is subject to control, as defined in FASB Statement No. 94 [AC C51], by the member, the

client, its officers, directors, or principal stockholders, individually or in any combination.

81. Member's Investment in a Limited Partnership

.162 *Question*—A member is a limited partner in a limited partnership (LP), including a master limited partnership. A client is a general partner in the same LP. Is the member's independence considered to be impaired with respect to (1) the LP, (2) the client, and (3) any subsidiaries of the LP?

.163 *Answer*—1. The member's limited partnership interest in the LP is a direct financial interest in the LP that would impair independence under interpretation 101-1-A-1 [ET section 101.02].

2. The LP is an investee of the client because the client is a general partner in the LP. Therefore, under interpretation 101-8 [ET section 101.10], if the investment in the LP is material to the client, the member's financial interest in the LP would impair the member's independence with respect to the client. However, if the client's financial interest in the LP is not material to the client, an immaterial financial interest of the member in the LP would not impair independence with respect to the client.

3. Since the member is a limited partner in the LP, the member is considered to have an indirect financial interest in all subsidiaries of the LP. If the indirect financial interest in the subsidiaries is material to the member, the member's independence would be considered to be impaired with respect to the subsidiaries under interpretation 101-1-A-1 [ET section 101.02].

If the member or client general partner, individually or together can control the LP, the LP would be considered a joint closely held business investment under interpretation 101-1-A-3 [ET section 101.02] [see Ruling No. 80 [ET section 191.160—.161]].

82. Campaign Treasurer

.164 *Question*—A member has been asked to serve as the campaign treasurer of the campaign organization of a candidate for the office of mayor. If the member serves in this capacity, would the member's independence be impaired with respect to (1) the political party with which the candidate is associated, (2) the municipality of which the candidate may become mayor, and (3) the campaign organization?

.165 *Answer*—Independence would not be considered to be impaired with respect to the political party or municipality. However, due to his or her role as treasurer, the member would not be considered to be independent with respect to the campaign organization itself.

83. Member on Board of Component Unit and Auditor of Oversight Entity

.166 *Question*—A member serves on the governing board of a local transit authority, which is a component unit of the city (the oversight entity). Would the member be considered to be independent with respect to the city's general-purpose financial statements?

.167 *Answer*—No. As stated in Interpretation 101-10 [ET section 101.12], a member reporting on the general-purpose financial statements must be independent of the oversight entity (the city) and of each component unit that should be included therein. The member is not independent with respect to the transit authority, a component unit.

84. Member on Board of Material Component Unit and Auditor of Another Material Component Unit

.168 *Question*—A member who is not the auditor of the county, which is the oversight entity, serves on the governing board of a local library authority, which is a material component unit of the county. Would the member be considered to be independent with respect to the flood-control district, which is also a material component unit of the county?

.169 *Answer*—Yes. As stated in Interpretation 101-10 [ET section 101.12], the member's position with the library would not impair independence with respect to the flood-control district. However, the member is not considered to be independent with respect to the county, because of his or her membership on the governing board of the local library.

85. Bank Director

.170 *Question*—May a member in public practice serve as a director of a bank?

.171 *Answer*—Yes; however, before accepting a bank directorship, the member should carefully consider the implications of such service if the member has clients that are customers of the bank.

These implications fall into two categories:

a. Confidential Client Information—Rule 301 [ET section 301.01] provides that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This ethical requirement applies even though failure to disclose information may constitute a breach of the member's fiduciary responsibility as a director.

b. Conflict of Interest—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member has a significant relationship with another entity that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed and consent is obtained from all the appropriate parties, performance of the service shall not be prohibited.

In view of the above factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is engaged in public practice the member should avoid the high probability of conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with the member's ability to serve the clients' interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances it would be more appropriate for the member as part of the member's public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit activities to those which did not involve conflicts of interest or confidentiality problems.

86. Partially Secured Loans

.172 *Question*—A member has a loan from a financial institution that is subject to the "grandfathered loans" provision of Interpretation 101-5 [ET

section 101.07]. The loan is partially secured by real estate. Is the loan grandfathered under Interpretation 101-5 [ET section 101.07]?

.173 *Answer*—The loan is grandfathered if, at all times after the member is required to be independent with respect to the client, the portion of the loan that exceeds the value of the collateral is not material to the member's net worth.

87. Loan Commitment or Line of Credit

.174 *Question*—For purposes of applying the "grandfathered loans" provisions of Interpretation 101-5 [ET section 101.07] may the date of a loan commitment or line of credit be used, rather than the date a transaction would close or funds would be obtained?

.175 *Answer*—Yes, as long as the loan would have met the conditions of Interpretation 101-5 [ET section 101.07] on the date the loan commitment or line of credit was extended. If such a loan commitment or line of credit was renegotiated (including renewals that are not solely at the option of the borrower) subsequent to the time the member was required to be independent, independence would be impaired.

88. Loans to Partnership in Which Members are Limited Partners

.176 *Question*—A member is a limited partner in a limited partnership that has obtained a loan from a financial institution client. Is the loan to the limited partnership ascribed to tne member and, therefore, does it impair independence under Interpretation 101-1.A.4 [ET section 101.02]?

.177 *Answer*—As stated in Interpretation 101-5 [ET section 101.07], a loan to a limited partnership in which members have a combined interest exceeding 50 percent of the total limited partnership interest is considered a loan to those members. For purposes of applying the "grandfathered loans" provisions of Interpretation 101-5 [ET section 101.07] when such combined interests exceed 50 percent, the loan should be ascribed to each limited partner on the basis of individual legal liability. Even in such situations where the amount ascribed may be zero, independence will be considered to be impaired if the limited partnership renegotiates the loan or enters into a new loan after the latest of the dates in (a) through (d) of Interpretation 101-5 [ET section 101.07].

89. Loan to Partnership in Which Members are General Partners

.178 *Question*—A member is a general partner in a partnership that has obtained a loan from a financial institution client. Is the loan to the partnership ascribed to the member and, therefore, does it impair independence under Interpretation 101-1.A.4 [ET section 101.02]?

.179 *Answer*—If the member as a general partner can control the partnership, a loan to that partnership is considered to be a loan to the member. Solely for purposes of the exceptions in Interpretation 101-5 [ET section 101.07] for "grandfathered loans," the loan is ascribed to the member on the basis of his or her legal liability as a general partner, which is usually the entire loan because of the joint and several liability usually assumed by a general partner.

90. Credit Card Balances and Cash Advances

.180 *Question*—Under Interpretations 101-1.A.4 [ET section 101.02] and 101-5 [ET section 101.07], if a member has credit cards and cash advances from a client financial institution and the aggregate balance outstanding exceeds $5,000, would independence be considered to be impaired?

.181 *Answer*—Independence would not be considered to be impaired if the aggregate outstanding balance is reduced to $5,000 or less on a current basis.

91. Member Leasing Property From a Client

.182 *Question*—A member is leasing property from a client. Would such a transaction constitute an impairment of independence with respect to the client?

.183 *Answer*—Independence would not be considered to be impaired for a leasing transaction if, at the time the transaction is entered into, it meets the criteria of an operating lease (as defined in Financial Accounting Standards Board Statement of Financial Accounting Standards No. 13, paragraph 6.a.ii [AC L10.102]) if made under normal leasing procedures, terms, and requirements. The terms and conditions set forth in the lease agreement should be comparable with other leases of a similar nature.

Independence would be considered to be impaired for a leasing transaction if, at the time the transaction is entered into, it meets the criteria of a capital lease (as defined in FASB Statement No. 13, paragraph 6.a.i [AC L10.102]) unless the lease is in compliance with interpretations 101-1.A.4 [ET section 101.02] and 101-5 [ET section 101.07], because the lease would be considered to be a loan from the client.

92. Joint Interest in Vacation Home

.184 *Question*—A member holds a joint interest in a vacation home along with an officer, director, or principal stockholder of an entity for which the member performs services requiring independence. Would the vacation home constitute a "joint closely held business investment" for the purposes of interpretation 101-1.A.3 [ET section 101.02]?

.185 *Answer*—Yes. The vacation home, even if solely intended for the personal use of the owners, would be considered a joint closely held business investment as defined in ethics ruling No. 80 [ET section 191.160—.161]. Accordingly, the materiality provisions of interpretation 101-1.A.3 [ET section 101.02] must be considered in assessing independence.

93. Service on Board of Directors of Federated Fund-Raising Organization

.186 *Question*—A member serves as director or officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities that are clients of the member receive funds. Does the member have a conflict of interest under rule 102 [ET section 102.01]?

.187 *Answer*—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs a professional service for a client and the member has a significant relationship with another entity that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed and consent is obtained from the appropriate parties, performance of the service shall not be prohibited. (If the service is one requiring independence, consult ethics ruling No. 14 [ET section 191.027—.028], under rule 101 [ET section 101.01].)

94. Indemnification Clause in Engagement Letters

.188 *Question*—A member proposes to include in engagement letters a clause that provides that the client would release, indemnify, defend, and hold the member (and his or her partners, heirs, executors, personal representatives,

successors, and assigns) harmless from any liability and costs resulting from knowing misrepresentations by management. Would the inclusion of such an indemnification clause in engagement letters impair the member's independence with respect to the client?

.189 *Answer*—No.

95. Agreement With Attest Client to Use ADR Techniques

.190 *Question*—Alternative dispute resolution (ADR) techniques are used to resolve disputes (in lieu of litigation) relating to past services, but are not used as a substitute for the exercise of professional judgment for current services. Would a predispute agreement to use ADR techniques between a member and a client cause the member's independence to be impaired?

.191 *Answer*—No. Such an agreement would not cause an impairment of independence since the member and the client are not in threatened or actual positions of material adverse interests by reason of threatened or actual litigation.

96. Commencement of ADR Proceeding

.192 *Question*—Would the commencement of an alternative dispute resolution (ADR) proceeding impair independence?

.193 *Answer*—Except as stated in the next sentence, independence would not be considered to be impaired because many of the ADR techniques designed to facilitate negotiation and the actual conduct of those negotiations do not place the member and the client in threatened or actual positions of material adverse interests. Nevertheless, if the member and client are in a position of material adverse interests because the ADR proceedings are sufficiently similar to litigation, ethics interpretation 101-6 [ET section 101.08] should be applied. Such a position would exist if binding arbitration were used.

97. Performance of Certain Extended Audit Services

.194 *Question*—A client is considering engaging a member to assist with the performance of its internal audit activities or extend the member's audit services when the client does not maintain an internal audit function. The activities that the member would be engaged to perform could include, among other things, the following: (1) testing the system of internal controls, confirming accounts receivable, and analyzing fluctuations of income and expense accounts; (2) reviewing loan originations or similar activities as part of the client's approval process or internal control system; and (3) reviewing the client's loan origination or other business processes for their functioning, efficiency or effectiveness and providing recommendations to management. Would independence be considered to be impaired if the member performs any of these services?

.195 *Answer*—The performance of activities such as those described in (1) above would not impair independence regardless of whether the member assists in the performance or performs all such activities for the client. The activities described in (1) above are generally of the type considered to be extensions of audit procedures to be performed in conducting the annual audit, even though the extent of testing may exceed that required by generally accepted auditing standards. The performance of the activities in (2) above would impair independence because the member would be performing a management function. The activities described in (3) above, although not generally considered necessary for conducting the annual audit, are services that would not impair independence as long as the member does not perform management functions or make management decisions.

98. Member's Loan From a Nonclient Subsidiary or Parent of an Attest Client

.196 *Question*—A member has obtained a loan from a nonclient. The parent or a subsidiary of the nonclient is a client of the member requiring independence. Does the member's loan from the nonclient subsidiary or parent impair the member's independence with respect to the client?

.197 *Answer*—A member's loan, that is not a "grandfathered" or "permitted" loan under interpretation 101-5 [ET section 101.07], from a nonclient subsidiary would impair the member's independence with respect to the client. However, a loan from a nonclient parent would not impair the member's independence with respect to the client subsidiary as long as the subsidiary is not material to its parent.

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ET Section 200

GENERAL STANDARDS
ACCOUNTING PRINCIPLES

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ET Section 201

General Standards

.01 Rule 201—General standards. A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council.

A. *Professional Competence.* Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

B. *Due Professional Care.* Exercise due professional care in the performance of professional services.

C. *Planning and Supervision.* Adequately plan and supervise the performance of professional services.

D. *Sufficient Relevant Data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

[As adopted January 12, 1988.]

(See appendix A.)

Interpretations under Rule 201—General Standards

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

.02 201-1—Competence. A member's agreement to perform professional services implies that the member has the necessary competence to complete those professional services according to professional standards, applying his or her knowledge and skill with reasonable care and diligence, but the member does not assume a responsibility for infallibility of knowledge or judgment.

Competence to perform professional services involves both the technical qualifications of the member and the member's staff and the ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques and the technical subject matter involved, and to the capability to exercise sound judgment in applying such knowledge in the performance of professional services.

The member may have the knowledge required to complete the services in accordance with professional standards prior to performance. In some cases, however, additional research or consultation with others may be necessary during the performance of the professional services. This does not ordinarily represent a lack of competence, but rather is a normal part of the performance of professional services.

However, if a member is unable to gain sufficient competence through these means, the member should suggest, in fairness to the client and the public, the engagement of someone competent to perform the needed professional service, either independently or as an associate.

[.03] [201-2]—[Deleted]

[.04] [201-3]—[Deleted]

[.05] [201-4]—[Deleted]

[The next page is 4571.]

ET Section 202

Compliance With Standards

.01 Rule 202—Compliance with standards. A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council.

[As adopted January 12, 1988.]

(See appendix A.)

Interpretation under Rule 202—Compliance With Standards

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

[.02] [202-1]—[Deleted]

[The next page is 4581.]

are examples of circumstances which would not ordinarily be regarded as unusual in the context of rule 203 [ET section 203.01].

.03 203-2—Status of FASB and GASB interpretations. Council is authorized under rule 203 [ET section 203.01] to designate bodies to establish accounting principles. Council has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB Statements of Financial Accounting Standards, together with those Accounting Research Bulletins and APB Opinions which are not superseded by action of the FASB, constitute accounting principles as contemplated in rule 203 [ET section 203.01]. Council has also designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1994 and thereafter, as the body to establish financial accounting principles for state and local governmental entities pursuant to rule 203 [ET section 203.01].

In determining the existence of a departure from an accounting principle established by a Statement of Financial Accounting Standards, Accounting Research Bulletin or APB Opinion encompassed by rule 203 [ET section 203.01], or the existence of a departure from an accounting principle established by a Statement of Governmental Accounting Standards encompassed by rule 203 [ET section 203.01], the division of professional ethics will construe such Statements, Bulletin or Opinion in the light of any interpretations thereof issued by the FASB or the GASB.

[.04] [203-3]—[Deleted]

.05 203-4—Responsibility of employees for the preparation of financial statements in conformity with GAAP. Rule 203 [ET section 203.01] provides, in part, that a member shall not state affirmatively that financial statements or other financial data of an entity are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by Council to establish such principles that has a material effect on the statements or data taken as a whole.

Rule 203 [ET section 203.01] applies to all members with respect to any affirmation that financial statements or other financial data are presented in conformity with GAAP. Representation regarding GAAP conformity included in a letter or other communication from a client entity to its auditor or others related to that entity's financial statements is subject to rule 203 [ET section 203.01] and may be considered an affirmative statement within the meaning of the rule with respect to members who signed the letter or other communication; for example, signing reports to regulatory authorities, creditors and auditors.

[Effective November 30, 1993.]

[The next page is 4601.]

ET Section 291

Ethics Rulings on General and Technical Standards

Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

1. Association of Name With Unaudited Statements When Member is Not Independent

.001 *Question*—A member in the practice of public accounting is a minority stockholder, officer, and director of a corporation for which his firm performs management and accounting services. As a corporate officer, the member has prepared financial statements for the corporation for presentation to a bank. The accounting firm was paid for the member's services in connection with the preparation of the statements, and the bank was made aware that the statements were not audited. What are the ethical considerations?

.002 *Answer*—When a CPA submits to his client or another unaudited financial statements which he has prepared, he is deemed to be associated with the statements. This association is deemed to exist even though the CPA does not append his name to the financial statements.

The member, as an officer, can prepare the statements for the corporation. But because he is also engaged in public practice and the corporation is a client of his firm, he should disclaim an opinion as he is lacking in independence.

[2.] Opinion by Member Not in Public Practice

[.003—.004] [Superseded by Ethics Ruling No. 65 Under Section 191.]

[3.-4.]

[.005—.008] [Deleted]

5. Interim Financial Statements

.009 *Question*—Interim reports issued by public entities, as defined in Statement on Auditing Standards No. 26 [AU section 504], sometimes contain the auditor's name listed on the cover or elsewhere along with the company's officers, board of directors, and legal counsel. Would this listing constitute an "association" of a member's name with financial statements as that term is used in rule 202 [ET section 202.01] of the Code of Professional Conduct?

.010 *Answer*—Yes, such a listing would be considered an "association" of a member's name with the accompanying financial statements as that term is used in rule 202 [ET section 202.01]. Accordingly, in such circumstances, each financial statement in such a report should be marked "unaudited."

The auditor should also be aware that Statement on Auditing Standards No. 26 [AU section 504] states that a disclaimer of opinion should accompany unaudited financial statements with which the CPA is associated. Accordingly, he may suggest to his client that wording such as the following be included in

the interim report: "The financial information included in this interim report has been prepared by management without audit by independent public accountants who do not express an opinion thereon. Semiannual (annual) reports will contain audited financial statements."

The member should have a clear understanding with his client with respect to issuance of interim reports which display the name of the member's firm along with unaudited financial statements, and he should not permit his name to be associated with the financial statements in a manner which might lead a reader to believe that the auditor is assuming some degree of responsibility for the unaudited statements.

6. Letterhead

.011 *Question*—A member performs accounting services on a gratis basis for a private club of which he is treasurer. His firm does no work for the club. Would it be proper for him to issue financial statements in connection with his accounting services for the club on his firm letterhead with a disclaimer for lack of independence?

.012 *Answer*—It would be preferable for the stationary of the club to be used for presentation of the financial statements with an indication that the auditor is acting as treasurer. However, should he use his firm's letterhead, Statement on Standards for Accounting and Review Services No. 1 [AR section 100] is applicable.

[7.] Non-CPA Partner

[.013—.014] [Transferred to section 591.379—.380 as Ethics Ruling No. 190 Under Section 591, April 1995.]

8. Subcontractor Selection for Management Consulting Service Engagements

.015 *Question*—A member has been engaged to design and program a computer system. The engagement is well within his or her competence. The member plans to retain a contract programming organization as a subcontractor to provide additional qualified personnel. What procedures should the member consider in making his or her selection of a subcontractor?

.016 *Answer*—When selecting subcontractors, the member has a responsibility to assure himself or herself that the subcontractors have the professional qualifications, technical skills and other resources required. Factors that can be helpful in evaluating a prospective subcontractor include business, financial and personal references from banks, other CPAs, and other customers of the subcontractor; the subcontractor's professional reputation and recognition; published materials (articles and books authored); and the practitioner's personal evaluation of the subcontractor.

9. Supervision of Technical Specialist on Management Consulting Service Engagements

.017 *Question*—A member would like to add to his or her staff a systems analyst who specializes in developing computer systems. Must the member be able to perform all of the services that the specialist can perform in order to be able to supervise the specialist?

.018 *Answer*—The member must be qualified to supervise and evaluate the work of specialists in his or her employ. Although supervision does not require that the member be qualified to perform each of the specialist's tasks, the member should be able to define the tasks and evaluate the end product.

[The next page is 4651.]

ET Section 300

RESPONSIBILITIES TO CLIENTS

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[The next page is 4671.]

ET Section 301

Confidential Client Information

.01 Rule 301—Confidential client information. A member in public practice shall not disclose any confidential client information without the specific consent of the client.

This rule shall not be construed (1) to relieve a member of his or her professional obligations under rules 202 and 203, (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

[As amended January 14, 1992.]

Interpretations Under Rule 301—Confidential Client Information

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

[.02] [301-1]—[Deleted]

[.03] [301-2]—[Deleted]

.04 301-3—Confidential information and the purchase, sale, or merger of a practice. Rule 301 prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client. The rule provides that it shall not be construed to prohibit the review of a member's professional practice under AICPA or state CPA society authorization.

For purposes of Rule 301, a review of a member's professional practice is hereby authorized to include a review in conjunction with a prospective purchase, sale, or merger of all or part of a member's practice. The member must take appropriate precautions (for example, through a written confidentiality agreement) so that the prospective purchaser does not disclose any

information obtained in the course of the review, since such information is deemed to be confidential client information.

Members reviewing a practice in connection with a prospective purchase or merger shall not use to their advantage nor disclose any member's confidential client information that comes to their attention.

[Effective February 28, 1990.]

[The next page is 4681.]

ET Section 302

Contingent Fees

.01 Rule 302—Contingent fees. A member in public practice shall not

(1) Perform for a contingent fee any professional services for, or receive such a fee from a client for whom the member or the member's firm performs,
   (a) an audit or review of a financial statement; or
   (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
   (c) an examination of prospective financial information;
   or
(2) Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

The prohibition in (1) above applies during the period in which the member or the member's firm is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in any such listed services.

Except as stated in the next sentence, a contingent fee is a fee established for 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 service. Solely for purposes of this rule, fees are not regarded as being contingent if 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.

A member's fees may vary depending, for example, on the complexity of services rendered.

[As adopted May 20, 1991.]

Interpretation under Rule 302—Contingent Fees

.02 302-1—Contingent fees in tax matters. This interpretation defines certain terms in Rule 302 and provides examples of the application of the rule.

Definitions of Terms

(a) Preparation of an original or amended tax return or claim for tax refund includes giving advice on events which have occurred at the time the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a return or claim for refund.

(b) A fee is considered determined based on the findings of governmental agencies if the member can demonstrate a reasonable expectation, at the time of a fee arrangement, of substantive consideration by an agency with respect to the member's client. Such an expecta-

tion is deemed not reasonable in the case of preparation of original tax returns.

Examples

The following are examples, not all-inclusive, of circumstances where a contingent fee would be permitted:

1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return.
2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case (involving a different taxpayer) or with respect to which the taxing authority is developing a position.
3. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation ($1 million at March 1991) or state taxing authority.
4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests.
5. Requesting, by means of "protest" or similar document, consideration by the state or local taxing authority of a reduction in the "assessed value" of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value.
6. Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute.

The following is an example of a circumstance where a contingent fee would not be permitted:

1. Preparing an amended federal or state income tax return for a client claiming a refund of taxes because a deduction was inadvertently omitted from the return originally filed. There is no question as to the propriety of the deduction; rather the claim is filed to correct an omission.

[The next page is 4691.]

ET Section 391

Ethics Rulings on Responsibilities to Clients

Ethics Rulings and Interpretations which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

1. Computer Processing of Clients' Returns

.001 *Question*—May a member make use of an outside service bureau for the processing of clients' tax returns? The member's firm would control the input of information and the computer service would perform the mathematical computations and print the return. Is there any violation of the confidential relationship in the fact that client information leaves the member's office?

.002 *Answer*—A member may utilize outside services to process tax returns. He must take all necessary precautions to be sure that the use of outside services does not result in the release of confidential information.

2. Distribution of Client Information to Trade Associations

.003 *Question*—A member's firm is requested by a trade association to supply profit and loss percentages taken from the reports of the accountants' clients. The association would distribute them to its members. May the firm comply with the request?

.004 *Answer*—Rule 301 would not be violated if the firm has the clients' permission to distribute the figures.

3. Information to Successor Accountant About Tax Return Irregularities

.005 *Question*—A member withdrew from an engagement on discovering irregularities in his client's tax return. May he reveal to the successor accountant why the relationship was terminated?

.006 *Answer*—Rule 301 is not intended to help an unscrupulous client cover up illegal acts or otherwise hide information by changing CPAs. If the member is contacted by the successor he should, at a minimum, suggest that the successor ask the client to permit the member to discuss all matters freely with the successor. The successor is then on notice of some conflict. Because of the serious legal implications, the member should seek legal advice as to his status and obligations in the matter.

[4.]

[.007-.008] [Deleted]

5. Records Retention Agency

.009 *Question*—May a member use a records-retention agency to store his clients' records, working papers, and so forth?

.010 *Answer*—There is no objection to the use of such a records center. However, responsibility for preserving the confidential nature of the records rests with the member.

6. Revealing Client Information to Competitors

.011 *Question*—A municipality in a particular state enforces a personal property tax on business inventories, fixtures and equipment, and machinery by retaining a firm of CPAs to examine the books and records of the businesses to be sure the proper amount has been declared. In the course of its engagement, the CPA firm will examine sales, purchases, gross profit percentages, and inventories as well as fixed asset accounts. A member serving one of the companies involved objects to these procedures on the ground that information gathered from the books and records of his client could be inadvertently conveyed to competitors by employees of the CPA firm doing the audit. Is such an engagement ethically proper?

.012 *Answer*—It would be proper for a member's firm to perform such services. It should be emphasized to everyone concerned that Rule 301 prohibits members from revealing to others any confidential information obtained in their professional capacity.

7. Revealing Names of Clients

.013 *Question*—May a member in public practice disclose the name of a client for whom the member or the member's firm performed professional services?

.014 *Answer*—It is permissible under Rule 301 for a member to disclose the name of a client, whether publicly or privately owned, without the client's specific consent unless the disclosure of the client's name constitutes the release of confidential information. For example, if a member's practice is limited to bankruptcy matters, the disclosure of a client's name would suggest that the client may be experiencing financial difficulties, which could be confidential client information.

[Replaced previous Ruling No. 7, Revealing Names of Employer's Clients, effective August 31, 1989.]

[8.—13.]

[.015-.026] [Deleted]

14. Use of Confidential Information on Management Consulting Service Engagements

.027 *Question*—In the course of performing a feasibility study a non-client outside source has provided pertinent information to the member's firm with the understanding that the source and the details of the information will not be disclosed. The information, which the firm believes is pertinent, directly affects its conclusions and recommendations. How may this information be utilized in connection with the feasibility study engagement and related conclusions and recommendations?

.028 *Answer*—Rule of Conduct 301 regarding confidential client information is not directly applicable to the circumstances described; however, Rule of Conduct 501—Acts Discreditable—is applicable to situations involving confidential relationships with non-clients. For an engagement in which it appears likely that the development of pertinent information will have to come from outside non-client sources, and such information must remain confidential, the terms of the engagement with the client should specify that the confidences of outside non-client sources will not be divulged by the member's firm even when they might affect the outcome of the engagement. If the use of confidential outside sources is necessary and the terms of the engagement are silent regarding disclosure of source and details, the member should promptly seek the approval of the client to present his recommendations without making

disclosures that include confidential information. If the client does not agree to this, the member should withdraw rather than breach a confidence or improperly limit the inclusion of information in his final recommendation.

15. Earlier Similar Management Consulting Service Study with Negative Outcome

.029 *Question*—A prospective client has asked a member's firm to study the desirability of his using a newly developed electronic ticketing system for his business. A recent study made for another client leads the member's firm to believe that the system would not be desirable for him. Must the firm state its reservations at the risk of disclosing information acquired while performing an assignment for a client competitor?

.030 *Answer*—Rule of conduct 301 [ET section 301.01] provides that a member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. Knowledge and expertise which results in a special competence in a particular field can be provided to a client without violating the confidence of another client. Reservations that the firm may have concerning the electronic ticketing system should be communicated to the prospective client provided the details of the other client's engagement are not disclosed. If, however, circumstances are such that the prospective client would clearly know the origin of the information on which the member's reservations are based, and such information is sensitive, the engagement should not be accepted without clearance with the first client.

16. Disclosure of Confidential Client Information

.031 *Question*—A member has prepared a married couple's joint tax returns for several years. The member was engaged by and has dealt exclusively with spouse A. Divorce proceedings are now under way and spouse B has approached the member with requests for confidential information relating to prior tax returns. Spouse A has directed the member not to comply with spouse B's requests. Would release of this information by the member to spouse B constitute a violation of rule 301 [ET section 301.01]?

.032 *Answer*—As defined by the Code of Professional Conduct, spouse B would be considered to be a client with respect to the prior tax returns in question. Therefore, release of the requested information to spouse B would not be prohibited by rule 301 [ET section 301.01]. The member should consider, however, reviewing the legal implications of such a disclosure with an attorney.

17. Definition of the Receipt of a Contingent Fee or a Commission

.033 *Question*—Rules 302 [ET section 302.01] and 503 [ET section 503.01] prohibit, among other acts, the receipt of contingent fees for the performance of certain services and the receipt of a commission for the referral of products or services under certain circumstances. When is a contingent fee or commission deemed to be received?

.034 *Answer*—A contingent fee or a commission is deemed to be received when the performance of the related services is complete and the fee or the commission is determined. For example, if in one year a member sells a life insurance policy to a client and the member's commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year the policy is sold.

18. Bank Director

.035 *Question*—May a member in public practice serve as a director of a bank?

.036 *Answer*—Yes; however, before accepting a bank directorship, the member should carefully consider the implications of such service if the member has clients that are customers of the bank.

These implications fall into two categories:

a. Confidential Client Information—Rule 301 [ET section 301.01] provides that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This ethical requirement applies even though failure to disclose information may constitute a breach of the member's fiduciary responsibility as a director.

b. Conflict of Interest—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member has a significant relationship with another entity that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed and consent is obtained from all the appropriate parties, performance of the service shall not be prohibited.

In view of the above factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is engaged in public practice the member should avoid the high probability of conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with the member's ability to serve the clients' interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances it would be more appropriate for the member as part of the member's public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit activities to those which did not involve conflicts of interest or confidentiality problems.

19. Receipt of Contingent Fees or Commissions by Member's Spouse

.037 *Question*—May a member's spouse provide services to the member's attest client for a contingent fee or refer products or services for a commission to or from the member's attest client without causing the member to be in violation of rule 302 [ET section 302.01] or rule 503 [ET section 503.01]?

.038 *Answer*—Yes, if the activities of the member's spouse are separate from the member's practice and the member is not significantly involved in those activities. The member, however, should consider whether a conflict of interest may exist as described in rule 102 [ET section 102.01] and interpretation 102-2 [ET section 102.03].

20. Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

.039 *Question*—A member has learned of a potential claim that may be filed against the member. The member's professional liability insurance policy requires that the carrier be promptly notified of actual or potential claims. If the member notifies the carrier and complies with its request for documents that would constitute confidential client information without the client's permission, would the member be in violation of rule 301 [ET section 301.01]?

.040 *Answer*—No. Rule 301 [ET section 301.01] is not intended to prohibit a member from releasing confidential client information to the member's liability insurance carrier solely to assist the defense against an actual or potential claim against the member.

[The next page is 4741.]

FT Section 400

RESPONSIBILITIES TO COLLEAGUES

[Reserved.]

ET Section 500

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[The next page is 4831.]

ET Section 501

Acts Discreditable

.01 Rule 501—Acts discreditable. A member shall not commit an act discreditable to the profession.

[As adopted January 12, 1988.]

Interpretations Under Rule 501—Acts Discreditable

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

.02 501-1—Retention of client records. Retention of client records after a demand is made for them is an act discreditable to the profession in violation of Rule 501. The fact that the statutes of the state in which a member practices may grant the member a lien on certain records in his or her possession does not change this ethical standard.

A client's records are any accounting or other records belonging to the client that were provided to the member by or on behalf of the client. If an engagement is terminated prior to completion, the member is required to return only client records.

A member's workpapers—including, but not limited to, analyses and schedules prepared by the client at the request of the member—are the member's property, not client records, and need not be made available.

In some instances a member's workpapers contain information that is not reflected in the client's books and records, with the result that the client's financial information is incomplete. This would include (1) adjusting, closing, combining or consolidating journal entries and (2) information normally contained in books of original entry and general ledgers or subsidiary ledgers. In those instances when an engagement has been completed, such information should also be made available to the client upon request. However, the member may require that fees due the member with respect to such completed engagements be paid before such information is provided.

Once the member has complied with the foregoing requirements, he or she need not comply with any subsequent requests to again provide such information.

.03 501-2—Discrimination in employment practices. Discrimination based on race, color, religion, sex, age or national origin in hiring, promotion or salary practices is presumed to constitute an act discreditable to the profession in violation of Rule 501.

.04 501-3—Failure to follow standards and/or procedures or other requirements in governmental audits. Engagements for audits of government grants, government units or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules, and regulations, in addition to

generally accepted auditing standards. If a member has accepted such an engagement and undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules and regulations, in addition to generally accepted auditing standards, he is obligated to follow such requirements. Failure to do so is an act discreditable to the profession in violation of Rule 501, unless the member discloses in his report the fact that such requirements were not followed and the reasons therefor.

.05 501-4—Negligence in the preparation of financial statements or records. A member who, by virtue of his negligence, makes, or permits or directs another to make, false and misleading entries in the financial statements or records of an entity shall be considered to have committed an act discreditable to the profession in violation of rule 501.

.06 501-5—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies in performing attest or similar services. Many governmental bodies, commissions or other regulatory agencies have established requirements such as audit standards, guides, rules, and regulations that members are required to follow in performing attest or similar services for clients subject to their jurisdiction. For example, the Securities and Exchange Commission, Federal Communications Commission, state insurance commissions, and other regulatory agencies have established such requirements.

When a member agrees to perform an attest or similar service for the purpose of reporting to such bodies, commissions, or regulatory agencies, the member should follow such requirements, in addition to generally accepted auditing standards (where applicable). Failure to substantially follow such requirements is an act discreditable to the profession, unless the member discloses in his or her report that such requirements were not followed and the reasons therefore. Not following such requirements could require the member to modify his or her report.

If the agency requires additional disclosures of the auditor, they must be made in accordance with the disclosure requirements established by the governmental body, commission or other regulatory agency. Failure to substantially follow such requirements is an act discreditable to the profession.

[Effective August 31, 1989.]

[The next page is 4841.]

ET Section 502

Advertising and Other Forms of Solicitation

.01 Rule 502—Advertising and other forms of solicitation. A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited.

[As adopted January 12, 1988.]

Interpretations under Rule 502—Advertising and Other Forms of Solicitation

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

[.02] [502-1]—[Deleted]

.03 502-2—False, misleading or deceptive acts in advertising or solicitation. Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that—

1. Create false or unjustified expectations of favorable results.
2. Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
3. Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood.
4. Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

[Revised, November 30, 1990, by the Professional Ethics Executive Committee.]

[.04] [502-3]—[Deleted]

[.05] [502-4]—[Deleted]

.06 502-5—Engagements obtained through efforts of third parties. Members are often asked to render professional services to clients or customers of third parties. Such third parties may have obtained such clients or customers as the result of their advertising and solicitation efforts.

Members are permitted to enter into such engagements. The member has the responsibility to ascertain that all promotional efforts are within the bounds of the Rules of Conduct. Such action is required because the members will receive the benefits of such efforts by third parties, and members must not do through others what they are prohibited from doing themselves by the Rules of Conduct.

[The next page is 4871.]

ET Section 503

Commissions and Referral Fees

.01 Rule 503—Commissions and referral fees.

A. *Prohibited commissions*

A member in public practice shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to be supplied by a client, or receive a commission, when the member or the member's firm also performs for that client

(a) an audit or review of a financial statement; or

(b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or

(c) an examination of prospective financial information.

This prohibition applies during the period in which the member is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in such listed services.

B. *Disclosure of permitted commissions*

A member in public practice who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall disclose that fact to any person or entity to whom the member recommends or refers a product or service to which the commission relates.

C. *Referral fees*

Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

[As adopted May 23, 1990, effective August 9, 1990.]

Interpretation under Rule 503—Commissions and Referral Fees

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

[.02] [503-1]—[Deleted]

[The next page is 4891.]

ET Section 505

Form of Organization and Name

.01 Rule 505—Form of organization and name. A member may practice public accounting only in a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council.

A member shall not practice public accounting under a firm name that is misleading. Names of one or more past owners may be included in the firm name of a successor organization. Also, an owner surviving the death or withdrawal of all other owners may continue to practice under a name which includes the name of past owners for up to two years after becoming a sole practitioner.

A firm may not designate itself as "Members of the American Institute of Certified Public Accountants" unless all of its owners are members of the Institute.

[As amended January 14, 1992.]

(See appendix B.)

Interpretations Under Rule 505—Form of Organization and Name

Interpretations and Ethics Rulings which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

.02 505-1—Investment in accounting organization. A member in the practice of public accounting may have an unlimited investment in an accounting organization as long as the practice of public accounting through that form of organization is permitted by state law or regulation and the organization's characteristics conform to resolutions of council. If the practice of public accounting through a corporate form is not permitted by state law or regulation, the member may invest in the corporation. However, the member's relation to the corporation must be solely that of an investor, and the investment cannot allow the member significant influence over the corporation. [Replaces previous interpretation 505-1, *Investment in Commercial Accounting Corporation*, March 1993, effective March 31, 1993.]

.03 505-2—Application of rules of conduct to members who operate a separate business. A member in the practice of public accounting may participate in the operation of a separate business that performs for clients any of the professional services of accounting, tax, personal financial planning, litigation support services, and those services for which standards are promulgated by bodies designated by Council (see ET section 92.09). Such a member is considered to be in the practice of public accounting in connection with the separate business and must observe all of the Rules of Conduct.

A member who is not otherwise in the practice of public accounting must observe the Rules of Conduct in the operation of the separate business if the member holds out as a CPA and performs for a client any of the professional services included in the definition of the practice of public accounting (see ET section 92.09). [Replaces previous interpretation 505-2, with the same title, March 1993, effective March 31, 1993.]

[The next page is 4901.]

ET Section 591

Ethics Rulings on Other Responsibilities and Practices

Ethics Rulings and Interpretations which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

1. Retention of Records

[.001-.002] [Superseded by Interpretation 501-1.]

2. Fees: Collection of Notes Issued In Payment

.003 *Question*—A member's firm made arrangements with a bank to collect notes issued by a client in payment of fees due, and so advised the delinquent client. Is this procedure ethical?

.004 *Answer*—The procedure followed does not violate any provision of the Code.

3. Employment by Non-CPA Firm

.005 *Question*—A member is considering employment with a public accounting firm made up of one or more non-CPA practitioners. If he is employed by such a firm, what are his responsibilities under the Rules of Conduct?

.006 *Answer*—A member so employed must comply with all the Rules of Conduct. If he becomes a partner in such a firm, he will then in addition be held responsible for compliance with the Rules of Conduct by all persons associated with him.

[4.—32.]

[.007-.064] [Deleted]

33. Course Instructor

.065 *Question*—What responsibility does a member have for the information included in advertising material used to promote a course which he has been asked to conduct?

.066 *Answer*—It is of value to prospective students to know the instructor's background—such as degrees he holds, professional society affiliations, and the name of his firm. The member has the responsibility to ascertain that all promotional efforts are within the bounds of Rule 502.

[34.—37.]

[.067-.074] [Deleted]

example, if compilation or attest engagements are performed, the member must comply with the applicable standards and independence requirements.

[Replaces previous ruling No. 158, *Data Processing: Employee-Shareholder in Public Practice*, November 1993.]

[159.—161.]

[.317-.322] [Deleted]

[162.] CPA Designation on Professional Organization Letterhead

[.323-.324] [Superseded August, 1975.]

[163.—167.]

[.325-.334] [Deleted]

[168.] Audit Guides Issued by Governmental Agencies

[.335-.336] [Superseded by interpretation 501-3.]

[169.—174.]

[.337-.348] [Deleted]

[175.] Bank Director

[.349-.350] [Replaced by ethics ruling No. 85 under rule of conduct 102 and ethics ruling No. 18 under rule of conduct 301.]

176. Newsletters and Publications Prepared by Others

.351 *Question*—May a member permit a newsletter, tax booklet, or similar publication to be imprinted with his or her firm's name if it has not been prepared by the member's firm?

.352 *Answer*—A member may permit his or her firm's name to be imprinted on a newsletter, tax booklet, or similar publication provided that he or she has a reasonable basis to conclude that the information contained therein is not false, misleading or deceptive.

[Replaced previous ruling No. 176, *Newsletters and Publications Prepared by Others*, effective August 31, 1989.]

177. Data Processing: Billing Services

.353 *Question*—A member in public practice plans to form a separate business to perform centralized billing services for local doctors. The member maintains that this service, which is similar to one currently offered and advertised by a local bank, does not constitute the practice of public accounting and that rules 502 [ET section 502.01] and 505 [ET section 505.01] do not apply. Is the member correct in this conclusion?

.354 *Answer*—No, the service in question does in fact constitute service of a type performed by public accountants and consequently the member could proceed with this plan only if the operation were conducted in accordance with the Institute's rules of conduct.

[178.]

[.355-.356] [Deleted]

179. Practice of Public Accounting Under Name of Association or Group

.357 *Question*—Several CPA firms wish to form an association or group whereby certain joint advertising, training, professional development and management assistance will take place. The firms will otherwise remain

separate and distinct. Would it be proper for such firms to practice public accounting under the name of an association or group in the United States?

.358 *Answer*—The practice of public accounting under such a name in the United States is not permitted since it would be likely to confuse the public as to the nature of the actual relationship which exists among the firms. Instead, each firm should practice only in its own firm name and may indicate the association or group name elsewhere on the firm stationery. Each firm may also list on its stationery the names of the other firms in the association or group.

[180.-181.]

[.359-.362] [Deleted]

182. Termination of Engagement Prior to Completion

.363 *Question*—Does rule 501 [ET section 501.01] require a member to furnish a tax return or supporting detail to a client if the engagement to prepare the tax return is terminated prior to its completion?

.364 *Answer*—As provided in interpretation 501-1 [ET section 501.02], if an engagement is terminated by either the member or the client prior to completion, the member is required to return or furnish copies of only those records originally given to the member by the client. Therefore, if a member has been engaged to prepare a tax return and the client or the member terminates the engagement before the tax return is delivered to the client, the member's responsibility is to return only those records originally provided to the member by the client.

183. Use of the AICPA Accredited Personal Financial Specialist Designation

.365 *Question*—In what circumstances may a firm include the AICPA-awarded designation "Accredited Personal Financial Specialists" on the firm's letterhead and in marketing materials?

.366 *Answer*—It is permissible under rule 502 [ET section 502.01] for the designation "Accredited Personal Financial Specialists" (APFS) to be used on a firm's letterhead and in marketing materials if all partners or shareholders of the firm currently have the AICPA-awarded designation. An individual member who holds the designation may use it after his or her name.

184. Definition of the Receipt of a Contingent Fee or a Commission

.367 *Question*—Rules 302 [ET section 302.01] and 503 [ET section 503.01] prohibit, among other acts, the receipt of contingent fees for the performance of certain services and the receipt of a commission for the referral of products or services under certain circumstances. When is a contingent fee or commission deemed to be received?

.368 *Answer*—A contingent fee or a commission is deemed to be received when the performance of the related services is complete and the fee or the commission is determined. For example, if in one year a member sells a life insurance policy to a client and the member's commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year the policy is sold.

185. Sale of Products to Clients

.369 *Question*—May a member purchase a product from a third-party supplier and resell the product to a client without violating rule 503 [ET section 503.01]?

.370 *Answer*—Yes. If a member purchases a product and resells it to a client, any profit on the sale would not constitute a commission. Purchasing entails taking title to the product and having all the associated risks of ownership.

186. Billing for Subcontractor's Services

.371 *Question*—A member has contracted with a computer-hardware maintenance servicer to provide support for a client's computer operations. Would it be a violation of rule 503 [ET section 503.01] for that member to bill the client a higher service fee than that charged the member by the service provider?

.372 *Answer*—No. The increased fee would not constitute a commission.

187. Receipt of Contingent Fees or Commissions by Member's Spouse

.373 *Question*—May a member's spouse provide services to the member's attest client for a contingent fee or refer products or services for a commission to or from the member's attest client without causing the member to be in violation of rule 302 [ET section 302.01] or rule 503 [ET section 503.01]?

.374 *Answer*—Yes, if the activities of the member's spouse are separate from the member's practice and the member is not significantly involved in those activities. The member, however, should consider whether a conflict of interest may exist as described in rule 102 [ET section 102.01] and interpretation 102-2 [ET section 102.03].

188. Referral of Products of Others

.375 *Question*—A member refers computer products of wholesalers to clients of the firm through distributors and agents. A payment is received by the member from the wholesaler if the clients purchase the computer products. Must the member consider rule 503 [ET section 503.01] in connection with this payment?

.376 *Answer*—Yes. Section 91.03 [ET section 91.03] of the Code of Professional Conduct provides that a member shall not permit others to perform acts on behalf of the member that, if carried out by the member, would place the member in violation of the rules. Therefore, the member would be held responsible for the actions of the distributors and agents.

Rule 503 [ET section 503.01] provides that, if a member or the member's firm performs for a client a service described in rule 503 [ET section 503.01], the member may not recommend or refer to that client for a commission any product or service, or receive a commission for a recommendation or referral. This prohibition applies during the period in which the member is engaged to perform any of the services described in rule 503 [ET section 503.01] and during the period covered by any historical financial statements involved in such services.

If the products are referred on a commission basis to clients for which the member is not engaged to perform any of the services described in rule 503 [ET section 503.01], rule 503 [ET section 503.01] would not be violated as long as the commission is disclosed to the client. However, any subsequent performance of services described in rule 503 [ET section 503.01] during a period in which the commission was received would constitute a violation of rule 503 [ET section 503.01].

189. Requests for Client Records and Other Information

.377 *Question*—Individuals associated with a client entity who are currently on opposing sides in an internal dispute have each issued separate requests calling for the member to supply them with client records and other information that, pursuant to interpretation 501-1 [ET section 501.02], is required to be provided in certain circumstances. What ethical obligations exist under interpretation 501-1 [ET section 501.02] with respect to complying with such requests?

.378 *Answer*—In providing professional services to individuals, partnerships, or corporations, a member will often deal with an individual who has been designated or held out as the client's representative. Such a representative might include, for example, a general partner or a majority shareholder. A member will have satisfied his or her obligations under interpretation 501-1 [ET section 501.02] when all client records and other information, as defined therein, have been supplied, where required, to the individual who has been previously designated or held out as the client's representative. The member need only supply such information once and need not comply with subsequent requests from the representative, or from other individuals associated with the client entity, to again provide this information.

190. Non-CPA Partner

.379 *Question*—May a member who is in partnership with non-CPAs sign reports with the firm name and below it affix his own signature with the designation "Certified Public Accountant"?

.380 *Answer*—This would not be improper, provided it is clear that the partnership itself is not being held out as composed entirely of CPAs.

[Formerly Ethics Ruling No. 7 Under Section 291. Transferred from section 291.013-.014, April 1995.]

[The next page is 5101.]

ET

APPENDIXES

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[The next page is 5121.]

ET Appendix A

Council Resolution Designating Bodies to Promulgate Technical Standards

[As amended January 12, 1988; revised April, 1992.]

Financial Accounting Standards Board

WHEREAS: In 1959 the Council designated the Accounting Principles Board to establish accounting principles, and

WHEREAS: The Council is advised that the Financial Accounting Standards Board (FASB) has become operational, it is

RESOLVED: That as of the date hereof the FASB, in respect of statements of financial accounting standards finally adopted by such board in accordance with its rules of procedure and the bylaws of the Financial Accounting Foundation, be, and hereby is, designated by this Council as the body to establish accounting principles pursuant to rule 203 and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 of the Rules of the Code of Professional Conduct of the American Institute of Certified Public Accountants provided, however, any accounting research bulletins, or opinions of the accounting principles board issued or approved for exposure by the accounting principles board prior to April 1, 1973, and finally adopted by such board on or before June 30, 1973, shall constitute statements of accounting principles promulgated by a body designated by Council as contemplated in rule 203 of the Rules of the Code of Professional Conduct unless and until such time as they are expressly superseded by action of the FASB.

Governmental Accounting Standards Board

WHEREAS: The Governmental Accounting Standards Board (GASB) has been established by the board of trustees of the Financial Accounting Foundation (FAF) to issue standards of financial accounting and reporting with respect to activities and transactions of state and local govenmental entities, and

WHEREAS: The American Institute of Certified Public Accountants is a signatory to the agreement creating the GASB as an arm of the FAF and has supported the GASB professionally and financially, it is

RESOLVED: That as of the date hereof, the GASB, with respect to statements of governmental accounting standards adopted and issued in July 1984 and subsequently in accordance with its rules of procedure and the bylaws of the FAF, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for state and local governmental entities pursuant to rule 203, and standards on disclosure of financial information for such entities outside

financial statements in published financial reports containing financial statements under rule 202.

AICPA COMMITTEES AND BOARDS

WHEREAS: The membership of the Institute has adopted rules 201 and 202 of the Rules of the Code of Professional Conduct, which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is

Accounting and Review Services Committee

RESOLVED: That the AICPA accounting and review services committee is hereby designated to promulgate standards under rules 201 and 202 with respect to unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market.

Auditing Standards Board

RESOLVED: That the AICPA auditing standards board is hereby designated as the body authorized under rules 201 and 202 to promulgate auditing and attest standards and procedures.

RESOLVED: That the auditing standards board shall establish under statements on auditing standards the responsibilities of members with respect to standards for disclosure of financial information outside financial statements in published financial reports containing financial statements.

Management Advisory Services Executive Committee

RESOLVED: That the AICPA management consulting services executive committee is hereby designated to promulgate standards under rules 201 and 202 with respect to the offering of management consulting services, provided, however, that such standards do not deal with the broad question of what, if any, services should be proscribed.

AND FURTHER RESOLVED: That any Institute committee or board now or in the future authorized by the Council to issue enforceable standards under rules 201 and 202 must observe an exposure process seeking comment from other affected committees and boards, as well as the general membership.

[Revised April, 1992.]

Attestation Standards

RESOLVED: That the AICPA accounting and review services committee, auditing standards board, and management consulting services executive committee are hereby designated as bodies authorized under rules 201 and 202 to promulgate attestation standards in their respective areas of responsibility.

[Added by Council, May, 1988; revised April, 1992.]

[The next page is 5131.]

ET Appendix B

Council Resolution Concerning Form of Organization and Name

[As revised May 23, 1994.]

RESOLVED: That the characteristics of an organization permitted by state law or regulation under Rule 505 are as follows:

1. A super majority (66 2/3 percent) of the ownership of the firm in terms of financial interests and voting rights must belong to CPAs. The non-CPA owner would have to be actively engaged as a firm member in providing services to the firm's clients as his or her principal occupation. Ownership by investors or commercial enterprises not actively engaged as firm members in providing services to the firm's clients as their principal occupation is against the public interest and continues to be prohibited.[1]

2. There must be a CPA who has ultimate responsibility for all the services provided by the firm and by each business unit[2] performing financial statement attest and compilation services and other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services.

3. Non-CPA owners could not assume ultimate responsibility for any financial statement attest or compilation engagement.

4. Non-CPAs becoming owners after adoption of Council's resolution would have to possess a baccalaureate degree and, beginning in the year 2010, have obtained 150 semester hours of education at an accredited college or university.

5. Non-CPA owners would be permitted to use the title "principal," "owner," "officer," "member" or "shareholder," or any other title permitted by state law, but not hold themselves out to be CPAs.

6. Non-CPA owners would have to abide by the AICPA Code of Professional Conduct. AICPA members may be held responsible under the Code for acts of co-owners.

7. Non-CPA owners would have to complete the same work-related CPE requirements as set forth under AICPA bylaw section 2.3 [BL section 230] for AICPA members.

8. Owners shall at all times own their equity in their own right and shall be the beneficial owners of the equity capital ascribed to them. Provision would have to be made for the ownership to be transferred to the firm or to other qualified owners if the non-CPA ceases to be actively engaged in the firm.

9. Non-CPA owners would not be eligible for membership in the AICPA.

[The next page is 5161.]

[1] Existing firms not in compliance when these standards are adopted would have three years in which to bring themselves into compliance.

[2] "Business unit" is meant to indicate geographic (such as offices) and functional arrangements (such as tax and management consulting services).

38. CPA Title, Controller of Bank

.075 *Question*—A member not in public practice is controller of a bank. May the member permit the bank to use his CPA title on bank stationery and in paid advertisements listing the officers and directors of the bank?

.076 *Answer*—The use of the CPA title on bank stationery by a member not in public practice is proper. It would also be proper for the CPA title of the member to appear in paid advertisements of the bank that list the officers and directors.

[39.—44.]

[.077-.088] [Deleted]

45. CPA Title on Agency Letterhead

[.089-.090] [Superseded August, 1975.]

[46.—62.]

[.091-.124] [Deleted]

63. Directory Listing, White Pages

[.125-.126] [Superseded February, 1976.]

[64.—77.]

[.127-.154] [Deleted]

78. Letterhead: Lawyer-CPA

.155 *Question*—May a member who is also admitted to the Bar represent himself on his letterhead as both an attorney and a CPA, or should he use separate letterheads in the conduct of the two practices?

.156 *Answer*—The Code does not prohibit the simultaneous practice of accounting and law by a member licensed in both professions. Either a single or separate letterheads may be used, provided the information with respect to the CPA designation complies with Rule 502. However, the member should also consult the rules of the applicable Bar Association.

[79.—81.]

[.157-.162] [Deleted]

82. Newsletter

.163 *Question*—A publishing company has discussed the possibility of issuing a newsletter on financial management under a member's name. His name would be featured prominently. The letter would be sold for a fee, and subscriptions would be solicited by direct mail or other forms of advertising. Would this arrangement violate the Code?

.164 *Answer*—No, if (1) the letter bearing the member's name was written by him or under his supervision and (2) he ensures that those promoting such a publication do not make statements concerning the author or his writings that would be in violation of Rule 502.

[83.—90.]

[.165-.180] [Deleted]

91. Press Release on Change in Staff

[.181-.182] [Superseded March, 1975.]

92. Press Release on Change in Staff

[.183-.184] [Superseded March, 1975.]

[93.—107.]

[.185-.214] [Deleted]

108. Member Interviewed by the Press

.215 *Question*—What ethical standards should a member observe when he is interviewed by the press?

.216 *Answer*—When interviewed by a writer or reporter, the member should observe the limitations imposed on him by the Rules of Conduct. The member may not provide the press with any information for publication that he could not publish himself.

[109.—115.]

[.217-.230] [Deleted]

116. Bank Director

[.231-.232] [Superseded June, 1976.]

117. Consumer Credit Company Director

.233 *Question*—A consumer credit company purchases installment sales contracts from retailers and receives payments from consumers. May a practicing CPA serve as a director or officer of such a corporation?

.234 *Answer*—Yes, as long as he does not audit the corporation and does not participate in matters which might involve a conflict of interest.

[118.—133.]

[.235-.266] [Deleted]

134. Association of Accountants Not Partners

.267 *Question*—Two members who are not partners share an office, have the same employees, have a joint bank account, and work together on each other's engagements. Would it be proper to have a joint letterhead showing both names, "Certified Public Accountants," and their addresses?

.268 *Answer*—In these circumstances the public would assume that a partnership existed. If any reports were to be issued under the joint heading, rule 505 [ET section 505.01] would be violated.

Members should not use a letterhead showing the names of two accountants when a partnership does not exist.

135. Association of Firms Not Partners

.269 *Question*—Three CPA firms wish to form an association—not a partnership—to be known as "Smith, Jones & Associates." Is there any impropriety in this?

.270 *Answer*—The use of such a title is not permitted since it might mislead the public into thinking a true partnership exists. Instead, each firm is advised to use its own name on its letterhead, indicating the other two as correspondents.

136. Audit with Former Partner

.271 *Question*—A member's firm consisting of one certified and one noncertified partner has been dissolved. One account was retained which the

two practitioners plan to continue to service together. Should the audit report be submitted on partnership stationery?

.272 *Answer*—It would appear proper for the audit to be carried out jointly by the two former partners. The opinion should be presented on plain paper and signed somewhat as follows:

John Doe, Certified Public Accountant

Richard Roe, Accountant

Such a signature would leave no doubt as to whether a partnership existed, and the client and others would have the assurance that both accountants participated in the audit.

137. Nonproprietary Partners

.273 *Question*—A member's firm wishes to institute the designation "nonproprietary partner" to describe certain high-ranking staff who were former partners of merged firms who did not qualify for partnership in the merging firm. With this title, they would be eligible to participate in the firm's pension plan. In holding themselves out to the public they would be required to use this designation. Is there any impropriety in the proposed title?

.274 *Answer*—The use of the designation "partner" should be restricted to those members of the firm who are legally partners. Those who are not parties to the partnership agreement should not hold themselves out in any manner which might lead others to believe that they are partners. The use of the designation "nonproprietary partner" by one who is not in fact a partner is considered misleading and therefore is not permitted.

138. Partner Having Separate Proprietorship

.275 *Question*—May a member be a partner of a firm of public accountants, all other members of which are noncertified, and at the same time retain for himself a practice of his own as a CPA?

.276 *Answer*—Rule 505 [ET section 505.01] would not prohibit such a practice. However, clients and others interested should be advised about the dual position of the member to prevent any misunderstanding or misrepresentation.

139. Partnership with Non-CPA

.277 *Question*—May a member form a partnership for the practice of public accounting with a non-CPA?

.278 *Answer*—Rule 505 [ET section 505.01] of the Institute's code does not prohibit a member from forming a partnership with a non-CPA provided that mixed partnerships are permitted by state law or regulation and the characteristics of the partnership conform to the May 1994 resolution of Council. In addition, the partnership would not be permitted to represent itself as a partnership of CPAs. [Revised, December 31, 1986, by the Professional Ethics Executive Committee.]

140. Political Election

.279 *Question*—A member's firm, consisting of four members, practices under the name of the managing partner who is presently seeking election to high public office. If he is elected and withdraws from the partnership, may the three remaining partners continue to use the present firm name?

.280 *Answer*—It would not be a violation for the three remaining partners to continue to practice under the name of the managing partner followed by the designation "and Company."

141. Responsibility for Non-CPA Partner

.281 *Question*—Is a member who has formed a partnership with a noncertified public accountant ethically responsible for all the acts of the partnership?

.282 *Answer*—Yes. If the noncertified partner should violate the Code, the member would be held accountable.

[142.—143.]

[.283-.286] [Deleted]

144. Title: Partnership Roster

.287 *Question*—Is there any prohibition in the Code to the use of an established firm name in a different state where there is some difference in the roster of partners?

.288 *Answer*—It would be proper for the firm to use the established name in different states even though the roster of partners differed as long as the firm otherwise complies with rule 505 [ET section 505.01].

145. Firm Name of Merged Partnerships

.289 *Question*—When two partnerships merge, is it permissible for the newly merged firm to practice under a title which includes the name of a partner who had retired from one of the two firms prior to the merger?

.290 *Answer*—Rule 505 [ET section 505.01] of the Code of Professional Conduct states that partnerships may practice under a firm title which includes the name or names of former partners. Since the retired partner was once a partner in one of the merged firms, it would be proper for his name to appear in the title of a newly created firm.

146. Membership Designation

.291 *Question*—On the letterhead of a partnership of members and noncertified public accountants, the designation "Members of the American Institute of Certified Public Accountants" appears in a manner which attempts to distinguish members of the Institute from nonmembers. Is such use of the designation of Institute membership by a mixed partnership permitted by rule 505 [ET section 505.01]?

.292 *Answer*—Rule 505 [ET section 505.01] states, "A firm may not designate itself as Members of the American Institute of Certified Public Accountants unless all of its partners or shareholders are members of the Institute." Individual members may be designated as such.

[147.—157.]

[.293-.314] [Deleted]

158. Operation of Separate Data Processing Business by a Public Practitioner

.315 *Question*—A member in the practice of public accounting also participates in the operation of a separate business that provides data processing services to the public. These services include the preparation of financial statements. Must the member comply with all the rules of conduct in connection with the separate business?

.316 *Answer*—Yes. As provided in interpretation 505-2 [ET section 505.03], the member is considered to be in the practice of public accounting in connection with the data processing center. The member, therefore, must comply with all the rules of conduct in connection with this business. For