
EXPOSURE DRAFT

OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

- Proposed Revision to the Subsections “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client” and “Application of the Independence Rules to a Covered Member’s Immediate Family” of Interpretation No. 101-1, “Interpretation of Rule 101,” Under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .02)
- Proposed Revision to Ethics Ruling No. 107, “Participation in ~~Health and Welfare Employee Benefit~~ Plan Sponsored by Client,” of ET Section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2)
- Proposed Revision to the Subsection “Retirement, Savings, Compensation, or Similar Plans” of Interpretation No. 101-15, “Financial Relationships,” Under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .17)
- Proposed Revision to Ethics Ruling No. 2, “Distribution of Client Information to ~~Trade Associations~~ *Third Parties*,” of ET Section 391, *Ethics Rulings on Responsibilities to Clients* (AICPA, *Professional Standards*, vol. 2)
- Proposed Addition to ET Section 92, *Definitions*: “Confidential Client Information” (AICPA, *Professional Standards*, vol. 2)

September 4, 2009

Prepared by the AICPA Professional Ethics Executive Committee for comments from persons interested in independence, behavioral, and technical standards matters.

Comments should be received by November 6, 2009, and addressed to
Lisa A. Snyder, Director
Professional Ethics Division, AICPA
1211 Avenue of the Americas
New York, NY 10036-8775
or via the Internet to lsnyder@aicpa.org.

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September 4, 2009

This exposure draft contains important proposals for review and comment by the AICPA's membership and other interested parties regarding pronouncements for possible adoption by the Professional Ethics Executive Committee (PEEC). The text and an explanation of the proposed pronouncements are included in this exposure draft.

After the exposure period is concluded and the PEEC has evaluated the comments, the PEEC may decide to publish one or more of the proposed pronouncements. Once published, the pronouncements become effective on the last day of the month in which they are published in the *Journal of Accountancy*, except if otherwise stated in the pronouncements.

Your comments are an important part of the standard setting process. Please take this opportunity to comment. Responses must be received at the AICPA by November 6, 2009. All written replies to this exposure draft will become part of the public record of the AICPA.

All comments received will be considered by the PEEC at its next open meeting.

Please send comments to Lisa A. Snyder, Director, Professional Ethics Division, AICPA, 1211 Avenue of the Americas, 19th Floor, New York, NY 10036 or via e-mail to lsnyder@aicpa.org. Comments submitted via e-mail are encouraged and would be appreciated.

Sincerely,

Kenneth E. Dakdduk, *Chair*
AICPA Professional Ethics Executive Committee

Lisa A. Snyder, *Director*
AICPA Professional Ethics Division

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Proposed Revision to the Subsection “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client” of Interpretation No. 101-1, “Interpretation of Rule 101,” Under Rule 101, *Independence*

[Explanation]

The Professional Ethics Executive Committee (PEEC) is exposing for comment proposed revisions to the subsection "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated with a Client" of Interpretation No. 101-1, “Interpretation of Rule 101,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .02), of the AICPA Code of Professional Conduct. The proposed revisions clarify that individuals on the attest engagement team and individuals in a position to influence the attest engagement who were formerly employed by or associated with an attest client need to dissociate from the client and cannot utilize the employee benefit plan participation exception, as discussed in the following paragraphs.

Current guidance imposes certain restrictions upon individuals who were formerly employed by or associated with an attest client. Specifically, the guidance prohibits these individuals from being on the attest engagement team for that client or in a position to influence the attest engagement for that client during any period that includes his or her former employment or association. The guidance also requires covered members to dissociate from the attest client.

Dissociation includes taking actions, such as disposing of any direct or material indirect financial interests in the attest client and ceasing to participate in employee benefit plans sponsored by the client. The current guidance includes an exception, however, that permits all covered members formerly employed by or associated with an attest client to not liquidate or transfer all vested benefits in the attest client's employee benefit plans if doing so would cause the individual to incur a penalty levied under the tax law that would be significant to the benefits.

The PEEC concluded that no safeguards can reduce to an acceptable level the financial self-interest threat of such participation if the covered member is a member of the attest engagement team or in a position to influence the attest engagement. Therefore, the PEEC proposes to narrow the scope of the exception so that it can only be utilized by a covered member who is a partner or manager providing 10 or more hours of nonattest services to the attest client and one who is a partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement. The proposal would thus make the guidance more restrictive for individuals on the attest engagement team and in a position to influence the attest engagement. Accordingly, the PEEC proposes a delayed effective date for those covered members to comply with the provisions of subitem a(iii) of the revised interpretation.

Requests for Specific Comments

Although the PEEC welcomes comments on all aspects of this proposal, it specifically requests feedback on the following issues:

1. The PEEC is proposing to clarify the existing guidance to make clear that individuals on the attest engagement team and in a position to influence the attest engagement may not utilize the exception to liquidating or transferring vested benefits because it believes that no

safeguards can reduce the financial self-interest threat to an acceptable level. If you believe that safeguards could be applied to reduce the financial self-interest threat to an acceptable level, please provide examples of those safeguards.

2. The PEEC is proposing a delayed effective date for subitem a(iii) because it is possible that some members may have applied the exception more broadly than was intended based on the wording of the existing guidance. Do you believe the delayed effective date of January 1, 2011, is appropriate or that additional time beyond the proposed effective date is warranted? If you believe additional time is needed, please explain what effective date you believe would be appropriate and why.

[Text of Proposed Revision]

(Additions appear in boldface italic and deletions are stricken.)

Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client

~~An individual~~ ***A firm's independence would be impaired if a covered member*** who was formerly ~~(ia)~~ ***employed by a client or (ib) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client would impair his or her firm's independence if the individual—***

~~1. Participated on the attest engagement team or was an individual in a position to influence the attest engagement for the client when the attest engagement covers any period that includes his or her former employment or association with that client; or~~

~~2. a. Was otherwise a covered member with respect to the client unless the individual first fails to dissociates himself or herself from the client prior to joining the firm. Dissociation occurs by—~~

~~(a.) i. Terminating any relationships with the client described in i Interpretation No. 101-1 subitem C [ET section 101.02];~~

~~(b.) ii. Disposing of any direct or material indirect financial interest in the client ceasing to participate in all employee health and welfare plans sponsored by the client, unless the client is legally required to allow the covered member to participate in the plan (for example, Consolidated Omnibus Budget Reconciliation Act [COBRA]) and the covered member pays 100 percent of the cost of participation on a current basis;~~

~~(c.) iii. Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under interpretation 101-5 [ET section 101.07] ceasing to participate in all other employee benefit plans by liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, share-based compensation~~

arrangements,¹ deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan (when the covered member does not participate on the attest engagement team and is not in a position to influence the attest engagement, he or she is not required to liquidate or transfer any vested benefits if such an action is not permitted under the terms of the plan or if a penalty² significant to the benefits is imposed upon such liquidation or transfer);

~~(d.) iv. Ceasing to participate^{fn-1} in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and disposing of any direct or material indirect financial interest in the client; and~~

~~(e.) v. Liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty^{fn-2} significant to the benefits is imposed upon liquidation or transfer collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under Interpretation No. 101-5, "Loans From Financial Institution Clients and Related Terminology" (par. .07).~~

b. *participates on the attest engagement team or is an individual in a position to influence the attest engagement for the client when the attest engagement covers any period that includes his or her former employment or association with that client.*

Effective Date

Except for the more restrictive provisions in subitem a(iii) of Interpretation No. 101-1 applicable to a covered member on the attest engagement team or in a position to influence the attest engagement, which has an effective date of January 1, 2011, the proposed revisions to this section of Interpretation No. 101-1 will be effective on the last day of the month in which they are published in the *Journal of Accountancy*.

¹ As defined in the Financial Accounting Standards Board (FASB) Accounting Standards CodificationTM (ASC) glossary.

fn-1 See Ethics Ruling No. 107, "Participation in Health and Welfare Plan of Client" [ET section 191.214-.215], for instances in which participation was the result of permitted employment of the individual's spouse or spousal equivalent.

fn-2 A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.

² A penalty includes an early withdrawal penalty levied under the tax law, but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.

Proposed Revision to the Subsection “Application of the Independence Rules to a Covered Member’s Immediate Family” of Interpretation No. 101-1

[Explanation]

The PEEC is exposing for comment proposed revisions to the subsection “Application of the Independence Rules to a Covered Member’s Immediate Family” of Interpretation No. 101-1 and related revisions to Ethics Ruling No. 107, “Participation in Health and Welfare Plan Sponsored by Client,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, par. .214–.215).

Background

In November 2007, the PEEC appointed a task force to reconsider existing guidance under which independence would be considered to be impaired if immediate family members of an individual on the attest engagement team or in a position to influence the attest engagement participated in a client’s retirement, savings, compensation, or similar plan sponsored by their employer even though such participation did not result in the immediate family member having an investment in the client. The task force studied the implications of such a participation to the covered member’s independence, including applying the principles set out in ET section 100.01, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), and presented its findings and recommendations to the PEEC. As a result, the PEEC developed the proposed revisions to the guidance that are discussed as follows.

Proposal

Employment

The PEEC continues to believe that independence would be considered to be impaired if the immediate family member of a covered member were employed in a key position with the attest client. Therefore, except for minor editorial changes, the PEEC is not proposing any changes to the existing guidance.

Plan Participation

Under the current guidance, independence would not be considered to be impaired if immediate family members of covered members who are not on the attest engagement team or in a position to influence the attest engagement participated in a retirement, savings, compensation, or similar plan that is a client, is sponsored by a client, or that invests in a client, provided the plan is normally offered to all employees in similar positions. In addition, under current guidance, independence would not be considered to be impaired if an immediate family member of any covered member participated in a client-sponsored health and welfare plan, provided the individual were employed in other than a key position with the client. (See Ethics Ruling No. 107.)

After studying the typical types of employee benefit plans, the PEEC concluded that independence would not be considered to be impaired if an immediate family member of any covered member participated in a client’s employee benefit plans, other than certain share-based compensation arrangements or nonqualified deferred compensation plans, provided that in addition to the safeguards currently required by the existing guidance (for example, the

immediate family member is employed by the client in a position other than a key position and the plan is normally offered to all employees in similar positions), the immediate family member did not

- have the ability to supervise or participate in the plan’s investment decisions;
- have the ability to supervise or participate in the selection of investment options available to plan participants; and
- serve in a position of governance for the plan.

The PEEC believes that these safeguards are consistent with the provisions of Interpretation No. 101-15, “Financial Relationships,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .17). Although participation in an employee benefit plan does not impair independence if the safeguards are applied, the provisions of Interpretation No. 101-15 apply with respect to direct and indirect financial interests held in such plans. Therefore, if the immediate family member held direct or material indirect financial interests in an attest client through participation in such a plan, independence would be considered to be impaired absent any permitted exceptions discussed in subitems *c–d* of this section of the interpretation.

Therefore, the PEEC proposes to revise subitem *b* in the guidance. If all of those safeguards are present, independence would not be considered to be impaired if immediate family members of individuals on the attest engagement team and in a position to influence the attest engagement participated in an employee benefit plan, including a health and welfare plan, that is an attest client or sponsored by an attest client. The requirement to comply with the additional proposed safeguards would make this guidance more restrictive than the current guidance.

Share-Based Compensation Arrangements and Nonqualified Deferred Compensation Plans

Consistent with other independence interpretations in the Code of Professional Conduct, the PEEC concluded that independence would be considered to be impaired if the immediate family member of a covered member who is on the attest engagement team or in a position to influence the attest engagement participated in share-based compensation arrangements (for example, stock options, restricted stock award plans, employee stock purchase plans, or similar plans) or nonqualified deferred compensation plans and the plan is an attest client or the plan or arrangement is sponsored by an attest client.

The PEEC concluded, however, that independence would not be considered to be impaired if, as a result of permitted employment, an immediate family member of a covered member who does not participate on the attest engagement team and is not in a position to influence the attest engagement participated in certain share-based compensation arrangements or nonqualified deferred compensation plans when such an arrangement or plan is an attest client or is sponsored by an attest client, provided that in addition to the safeguard specified in the current guidance, additional safeguards are applied. This aspect of the proposal is more restrictive than current guidance because currently these immediate family members are permitted to participate in all employer-sponsored compensation plans subject only to the requirement that such plans be normally offered to all employees in similar positions. The proposal would limit their participation to certain plans only and require that the additional safeguards specified be applied.

Proposed exceptions to the general rule that independence would be considered to be impaired due to a direct or material indirect financial interest or certain debtor or creditor relationships with an attest client follow.

Employee Stock Ownership Plans

The PEEC concluded that an employer's Employee Stock Ownership Plan (ESOP) and the benefits received by employees who participate in such a plan are typically part of an employee's total compensation package. As such, the PEEC assessed whether certain conditions exist under which participation in such a plan would not be considered to impair independence.

After studying these plans and consulting with representatives of the AICPA Employee Benefit Plan Expert Panel, the PEEC concluded that allocated shares in an ESOP should be treated as indirect financial interests, as defined by Interpretation No. 101-15, because they represent a beneficial interest in the attest client. Once an individual has the right to dispose of the allocated interests, however, the PEEC believes the interests convert to a direct financial interest in the attest client.

In order to reduce independence threats created by participation in an ESOP to an acceptable level, the PEEC concluded that certain safeguards are necessary. However, the PEEC concluded that for members of the attest engagement team and those in a position to influence the attest engagement, no safeguards could reduce the threats to an acceptable level. Accordingly, any relief would be limited to immediate family members of covered members who are not in these positions.

Similar to its conclusions in subitem *b* of this section of the exposure draft, the PEEC also believes that no safeguards exist that could reduce to an acceptable level the familiarity threat created by an immediate family member serving as a trustee of the client's ESOP or supervising or participating in the selection of the ESOP's investment options and, therefore, concluded that independence would be considered to be impaired if an immediate family member served in such positions.

The PEEC noted that, in some cases, the immediate family member may be unable to dispose of the financial interests because a ready market for the employer's securities does not exist. To reduce the threats to an acceptable level, the immediate family member is required to exercise any available put option to require the employer to repurchase the shares as soon as permitted by the terms of the ESOP.

In addition, the PEEC concluded that at all times the amounts due (whether it be the employer's equity shares, cash, or other assets) to the immediate family member from the plan or the employer should be immaterial to the covered member and not exceed 5 percent of the client's outstanding equity securities or other ownership interests in order for the financial self-interest threat to be at an acceptable level. The PEEC believes it is important that these amounts be immaterial to the covered member throughout the immediate family member's participation in the plan. Even though a materiality test applies to all indirect financial interests, once the conversion to a direct financial interest occurs, the PEEC believes that the financial self-interest threat created by holding the direct interest pending disposal or collection of the cash or other

assets can be reduced to an acceptable level only if that interest continues to be immaterial.

Employee Stock Option Plans and Stock Rights Plans

Unlike the allocated shares in an ESOP, in accordance with Interpretation No. 101-15, interests in a stock option or stock rights plan are direct financial interests, regardless of whether such interests are vested or exercisable. The PEEC believes, however, that stock option and stock rights plans (such as restricted stock purchase rights plans, stock appreciation plans, or phantom stock plans) have characteristics that are fundamentally different from other share-based arrangements. Under such plans, no stock is issued at the grant date. Instead, the employee receives rights to obtain stock (or a cash equivalent) or rights to participate in the appreciation of the employer's share value, which is satisfied in an equivalent value of stock (or cash). Such rights do not give an employee the ability to vote the shares to which the rights relate or have other incidents of stock ownership (such as the ability to sell the shares). The PEEC believes such plans do not create the same level of threats as a plan, such as a restricted stock award plan, under which shares of stock are awarded at the grant date and the holder is permitted to vote the shares and receive dividends even though restrictions on transferability apply. Therefore, the PEEC explored under what conditions immediate family members of certain covered members could participate in stock rights plans and stock option plans without creating a threat to independence that is not at an acceptable level.

The PEEC concluded that threats to independence would be too significant if an immediate family member of a covered member held an exercisable vested right, such as a vested stock option, until the term of the right expired. In that situation, holding a fully vested and exercisable right to acquire stock would create an unacceptable threat because the holder would presumably wait for the most financially advantageous time to exercise the right and maximize any gain on sale of the underlying shares. The PEEC decided, however, that the application of additional safeguards could reduce the threats to independence to an acceptable level when applied by an immediate family member of a covered member who is not on the attest engagement team or in a position to influence the attest engagement. Specifically, when the market price of a vested stock option or other stock right equals or exceeds the exercise price, the threat to independence can be reduced to an acceptable level if the immediate family member disposes of the stock or forfeits the rights as soon as practicable, but no later than 30 days, after the exercise date. The PEEC believes that disposal under these conditions strikes an appropriate balance between allowing those immediate family members to receive some level of benefit while sufficiently reducing the financial self-interest threat to an acceptable level.

Similar to ESOPs, the PEEC is proposing that if the shares are sold back to the employer or if the rights are settled in cash or other assets, and the member is paid the proceeds over a period of time, the amount owed should be immaterial to the covered member at all times during the payout period in order for the threat to remain at an acceptable level.

Nonqualified Deferred Compensation Plan

The PEEC believes that deferred compensation payable through a nonqualified deferred compensation plan generally results in a debtor or creditor relationship between the employer and employee. The PEEC has determined that any financial self-interest threats created by the relationship can be reduced to an acceptable level by the application of certain safeguards only

where the individual is an immediate family member of a covered member who is not on the attest engagement team or in a position to influence the attest engagement. Specifically, the PEEC believes that threats would be at an acceptable level if the plan is not funded by financial interests in the employer; the amount of the deferred compensation payable that is material to the immediate family member is funded through life insurance, an annuity, a taxable or Rabbi trust, or similar vehicle; and any unfunded portion is immaterial to the covered member at all times.

Employer is Not an Attest Client

When an immediate family member of a covered member who is not on the attest engagement team or in a position to influence the attest engagement is employed by a nonattest client, current guidance permits those individuals to invest in an attest client through their employer-sponsored retirement, savings, compensation or similar plan, provided the plan is offered to all employees in similar positions. The PEEC is proposing to replace that safeguard with three new safeguards in order for the financial self-interest threat to be reduced to an acceptable level. First, if the immediate family member has an investment in an attest client through the plan, the investment is permitted only when the plan does not offer any nonclient investment options. Next, the financial interest in the attest client in that situation should not exceed 5 percent of the attest client's outstanding equity securities or other ownership interests. Finally, if a nonclient investment option becomes available in the plan, the immediate family member should select that investment option and dispose of the financial interest in the attest client no later than 30 days after the nonclient investment option becomes available, regardless of whether a loss on disposal will occur. These additional safeguards make the proposed guidance more restrictive.

Requests for Specific Comments

Although the PEEC welcomes comments on all aspects of this proposal, it specifically requests feedback on the following issues:

1. The PEEC is proposing that the ESOP shares allocated to immediate family members who participate in an ESOP be immaterial to the covered member, consistent with the general requirement in the Code of Professional Conduct that indirect financial interests be immaterial. The PEEC believes this safeguard, combined with the requirement to dispose of the shares as soon as practicable, but no later than 30 days after obtaining the right to dispose of the shares, would reduce to an acceptable level the financial self-interest threat created when the allocated shares are distributed to the immediate family member. Do you believe the requirement that the indirect financial interest be immaterial is appropriate? If you believe other safeguards are available, please provide examples of such safeguards.
2. The PEEC is proposing specific safeguards that would reduce to an acceptable level the threats created by an immediate family member's participation in certain share-based compensation arrangements, specifically employee stock ownership, employee stock option, restricted stock rights, stock appreciation rights, and phantom stock plans. Are there any other similar share-based compensation arrangements that you believe should be specifically addressed? If so, please advise what additional share-based compensation arrangements should be addressed, why you believe they should be addressed, and what, if any, safeguards you believe could be implemented to reduce the threats to independence to an acceptable level.

3. The PEEC believes that threats to independence can be reduced to an acceptable level when an immediate family member exercises or forfeits vested stock rights when the market price of the underlying stock equals or exceeds the exercise price. Do you agree with this? If not, please explain. If you believe other safeguards exist that can reduce the financial self-interest threat for vested stock rights to an acceptable level, please describe them.
4. The PEEC is proposing that after exercising a stock right or option, independence would be impaired if the immediate family member does not dispose of the stock as soon as practicable, but no later than 30 days, after the exercise date, even if the employer's stock does not have a ready market, the plan does not permit disposition or transfer, or the employer does not agree to repurchase the shares. Consistent with its conclusions in Interpretation No. 101-15, the PEEC concluded that no safeguards could reduce the financial self-interest threat to an acceptable level if the immediate family member held direct financial interests in an attest client for an extended period of time. Do you agree? If you believe that other safeguards exist that would reduce the financial self-interest threat to an acceptable level, please provide examples of such safeguards.
5. The PEEC is proposing that specified new safeguards be applied to reduce to an acceptable level the threats that are created when an immediate family member of a covered member who is not on the attest engagement team or in a position to influence the attest engagement has a financial interest in an attest client due to his or her participation in a nonclient employer's benefit plan that has limited investment options. If the plan does not offer any nonclient investment options, the immediate family member may select a financial interest in an attest client as his or her investment option. If a nonclient investment option is offered by the plan, the immediate family member would be required to dispose of any financial interest in an attest client and select the nonclient investment option as soon as practicable, but no later than 30 days, after the date that the plan permits the election of the nonclient investment option. Do you agree with these new safeguards? If not, why not? If you believe there other safeguards that would be effective in reducing the threats to an acceptable level, please describe them.
6. The PEEC is proposing a delayed effective date for the more restrictive provisions of the revised interpretation. Do you believe a delayed effective date is necessary? If so, will the proposed delayed effective date provide covered members and their immediate family members with sufficient time to implement the new requirements and for firms to educate personnel on the new rules? If not, please explain what effective date you believe would be appropriate and why.

[Text of Proposed Revision]

(Additions appear in **boldface italic** and deletions are stricken.)

Application of the Independence Rules to a Covered Member's Immediate Family

Except as stated in the following paragraph, ~~a~~**A** covered member's immediate family is subject to ~~Rule 101 [ET section 101.01]~~, and its interpretations and rulings. The **following** exceptions ~~are~~ that **address situations where** independence ~~would~~ **will** not be considered to be impaired solely as a result of the following:

- ~~1.~~ **a.** An individual in a covered member's immediate family ~~was~~ **may be** employed by ~~the~~ **an attest** client in a position other than a **key position**.

- ~~2.~~ **b.** ~~In connection with his or her~~ **As a result of a permitted** employment **position described in item (a)**, an individual in ~~the~~ **a covered member's** immediate family of one of the following covered members ~~may~~ participated in ~~an~~ retirement, savings, compensation, or similar **employee benefit** plan, **other than share-based compensation arrangements³ or nonqualified deferred compensation plans, which are addressed as follows**, that is ~~an~~ **attest** client; ~~or that~~ is sponsored by an ~~attest~~ **attest** client, ~~or that invests in a client (provided such plan participation is normally offered to all employees in similar equivalent employment positions)~~ **and the immediate family member does not:**
 - ~~a.~~ **i.** A partner or ~~manager~~ who provides ten or more hours of non attest services to the client; **serve in a position of governance (for example, Board of Trustees) for the plan, or**

 - ~~b.~~ **ii.** Any partner in the ~~office~~ in which the lead attest engagement partner primarily practices in connection with the attest engagement. **have the ability to supervise or participate in the plan's investment decisions or in the selection of the investment options that will be made available to plan participants.**

- c.** **Except as provided in items i-iii that follow, a covered member's immediate family member may not participate in share-based compensation arrangements (for example, stock option plans, restricted stock award plans, employee stock purchase plans, or similar plans) or nonqualified deferred compensation plans if the plan is an attest client or is sponsored by an attest client. As a result of a permitted employment position described in item a in the preceding, however, an immediate family member of a covered member who does not participate on the attest engagement team and is not in a position to influence the attest engagement may participate in the following types of share-based compensation arrangements or nonqualified deferred compensation plan that is an attest client or is sponsored by an attest client:**

³ As defined by the FASB ASC glossary.

- i. **An employee stock ownership plan (ESOP), provided that**
- (1) the immediate family member is not a trustee of the ESOP or does not have the ability to supervise or participate in the selection of the investment options that are available to plan participants;**
 - (2) holdings by the immediate family member of indirect financial interests in the form of allocated shares⁴ of the attest client sponsor are not material to the covered member; and**
 - (3) if the immediate family member terminates employment, whether through retirement, death, disability, or voluntary or involuntary termination, and**
 - (a) receives the employer's shares, he or she disposes of the shares as soon as practicable, but no later than 30 days after he or she has the right to dispose of the shares; or in the event that a ready market for such shares does not exist, the immediate family member exercises his or her put option to require the employer to repurchase the allocated shares as soon as permitted by the terms of the ESOP.**
 - (b) will receive, according to the terms of the plan, cash, other assets, or the proceeds of the exercise of the put option over a period of time, the unpaid amount is immaterial to the covered member at all times during the payout period.**
- ii. **An employee stock option plan⁵ or other share-based rights arrangements (such as restricted stock rights, stock appreciation rights or phantom stock plans), provided that**
- (1) when the immediate family member's rights under the arrangement are vested and the market price of the underlying stock equals or exceeds the exercise price, the immediate family member exercises or forfeits the rights as soon as practicable, but no later than 30 days after obtaining the right to exercise;**
 - (2) upon exercise, the immediate family member disposes of the employer's stock as soon as practicable, but no later than 30 days after the exercise date; and**

⁴ See Interpretation No. 101-15, "Financial Relationships" (par. .17) for Employee Stock Ownership Plans (ESOP) guidance. Allocated shares held in an ESOP are considered indirect financial interests that are beneficially owned until such time as the participant has the right to dispose of the financial interest. Once the participant has the right to dispose of the financial interest, the financial interests are considered direct financial interests.

⁵ See Interpretation No. 101-15 for guidance on stock option plans.

(3) *if, in meeting the requirement in item (2) of the preceding, the shares are sold back to the employer or the rights are settled in cash or other assets rather than the employer's stock, the immediate family member is permitted to receive the proceeds from the employer over a period of time. The unpaid balance should be immaterial to the covered member at all times during the payout period.*

iii. *A nonqualified deferred compensation plan provided the amount of the deferred compensation payable to the immediate family member is funded through life insurance, an annuity, a taxable or Rabbi trust, or similar vehicle or any unfunded portion is immaterial to the covered member at all times. Further, any funding of the deferred compensation may not include financial interests in the employer.*

Notwithstanding the exceptions in i–iii of the preceding, at no time may any permitted financial interests (on an as-exercised or as-if-converted basis) exceed 5 percent of the client's outstanding equity securities or other ownership interests.

- d. *An immediate family member of a covered member who does not participate on the attest engagement team and is not in a position to influence the attest engagement is permitted to hold a direct or material indirect financial interest in an attest client that is not his or her employer through participation in an employee retirement, savings, deferred compensation, or similar plan of his or her employer, provided the investment is due to the unavoidable consequence⁶ of such participation and*
- i. *such permitted financial interests do not exceed 5 percent of the attest client's outstanding equity securities or other ownership interests (on an as-exercised or as-if-converted basis), and*
 - ii. *in the event any other investment option in nonattest client securities becomes available, the immediate family member selects the other investment option. The immediate family member should dispose of any direct or material indirect financial interests in the attest client as soon as practicable, but no later than 30 days after the other investment option becomes available.⁷*

⁶ *Unavoidable consequence means that the immediate family member has no investment options available for selection, including money market or invested cash options, other than in an attest client. If other available investment options exist in a nonclient, the immediate family member may not have a financial interest in an attest client.*

⁷ *Where legal or other similar restrictions exist on a person's right to dispose of a financial interest at a particular time, the person need not dispose of the interest until the restrictions have lapsed. For example, a person will not have to dispose of a financial interest in an attest client if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not fall within the exception.*

For purposes of determining materiality under Rule 101, the financial interests of the covered member and his or her immediate family members in all plans should be aggregated.

Effective Date

Except for the more restrictive provisions in subitems *b–d* of this section of the interpretation, which have an effective date of January 1, 2011, the proposed revisions to this section of Interpretation No. 101-1 will be effective on the last day of the month in which they are published in the *Journal of Accountancy*.

**Proposed Revision to Ethics Ruling No. 107,
“Participation in ~~Health and Welfare~~ Employee Benefit Plan Sponsored by Client,” of ET
Section 191**

[Explanation]

As discussed in the preceding proposal, the PEEC concluded that independence would not be considered to be impaired if immediate family members of any covered members participated in a client's employee benefit plans, other than certain share-based compensation arrangements or nonqualified deferred compensation plans, provided certain safeguards are in place. Accordingly, the ethics ruling that follows is being revised to convey this conclusion. The PEEC also proposes incorporating into this ethics ruling the existing exception for governmental auditors who are required to audit plans in which they participate (presently included in Interpretation No. 101-15) and a reference to the guidance for covered members who were formerly employed by or otherwise associated with a client.

[Text of Proposed Revision]

*(Additions appear in **boldface italic** and deletions are stricken.)*

107. Participation in ~~Health and Welfare~~ Employee Benefit Plan Sponsored by Client

.214 *Question*—A member participates in or receives benefits from *an ~~health or welfare~~ employee benefit* plan (the “plan”) *that is a client or is* sponsored by a client. Would independence be considered to be impaired with respect to the client sponsor or the plan?

.215 *Answer*—A *covered* member's participation in a plan sponsored by a client would impair independence with respect to the client sponsor and the plan, ~~However, if the covered member's participation in the plan, or benefits received thereunder, arises as a result of the permitted employment of the covered member's immediate family in accordance with interpretation 101-1 [ET section 101.02], independence would not be considered to be impaired provided that the plan is normally offered to all employees in equivalent employment positions. *except a covered member may participate in such a plan*~~

- *as permitted by Interpretation No. 101-1 subsection “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client.”*
- *when the member is an employee of a governmental organization and is required by law or regulation to audit a plan sponsored by a governmental unit. In such circumstances, a covered member's participation in the plan will not impair independence provided the plan is offered to all employees in equivalent employment positions, and the covered member*
 - *is not associated with the plan in any capacity prohibited by Interpretation No. 101-1 subitem C;*

- *has no influence or control over the investment strategy, benefits, or other management activities associated with the plan; and*
- *is required to participate in the plan as a condition of employment.*

In addition, as a result of an immediate family member’s participation in the plan as permitted by Interpretation No. 101-1 subsection “Application of the Independence Rules to a Covered Member’s Immediate Family,” a covered member may receive benefits through the immediate family member’s permitted participation in an employee benefit plan that is an attest client or that is sponsored by an attest client.

Effective Date

The proposed revisions to Ethics Ruling No. 107 will be effective on the last day of the month in which they are published in the *Journal of Accountancy*.

Proposed Revision to the Subsection “Retirement, Savings, Compensation, or Similar Plans” of Interpretation No. 101-15

[Explanation]

The PEEC is proposing revisions to the “Retirement, Savings, Compensation, or Similar Plans” subsection of Interpretation No. 101-15. Accordingly, please limit your comments to this section of the interpretation.

In order to be consistent with the definition of a financial interest in Interpretation No. 101-15, the PEEC proposes to delete the statement indicating that participation in a benefit plan creates a direct financial interest in the plan. Under the definition, a financial interest is "an ownership interest in an equity or debt security issued by an entity." The PEEC concluded that mere participation in a benefit plan does not result in the participant owning an interest in an equity or debt security of the plan or plan sponsor.

In addition, the PEEC is proposing additional guidance on the conclusions reached in preceding sections of this exposure draft. The PEEC proposes to add explanations regarding the characterization of shares in ESOPs as direct or indirect and certain share-based compensation arrangements that may result in the creation of a financial interest. The PEEC also proposes to make editorial clarifications to this subsection of the interpretation.

Note: Only the “Retirement, Savings, Compensation, or Similar Plans” subsection of Interpretation No. 101-15 has been included in this exposure draft because it is the only section being proposed for revision. The entire text of the interpretation can be found at

www.aicpa.org/about/code/et_101.html#et_101.17.

[Text of Proposed Revisions]

(Additions appear in **boldface italic** and deletions are stricken.)

Retirement, Savings, Compensation, or Similar Plans

~~A covered member who participates in a retirement, savings, compensation, or similar plan is considered to have a direct financial interest in the plan.⁴⁴~~

Depending upon the facts and circumstances, investments held in a retirement, savings, compensation, or similar plan may be considered a covered member's direct or indirect financial interests as follows:

- Investments held by a retirement, savings, compensation, or similar plan sponsored by a covered member's firm would be considered direct financial interests of the firm.
- If a covered member ~~controls~~ ***or his or her immediate family member self-directs the investments in*** a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan's investment decisions, the investments held by the plan would be considered direct financial interests of the covered member. Otherwise, the underlying plan investments would be considered indirect financial interests of the covered member.
- Investments held in a defined benefit plan would not be considered financial interests of the covered member unless the covered member ***or his or her immediate family member*** is a trustee of the plan or otherwise has the ability to supervise or participate in the plan's investment decisions ~~because the benefits are not dependent upon investment performance.~~
- ***Allocated shares held in an ESOP would be considered indirect financial interests that are beneficially owned until such time as the covered member or his or her immediate family has the right to dispose of the financial interest. Once the participant has the right to dispose of the financial interest, the financial interest is considered a direct financial interest.***
- ***Investments held in a stock option plan, restricted stock plan, or other share-based compensation arrangements are considered direct financial interests regardless of whether such financial interests are vested or exercisable.***

⁴⁴~~A covered member who is an employee of a governmental organization that is required by law or regulation to audit a retirement plan sponsored by a governmental unit will be permitted to be a participant in the plan, provided the plan is offered to all employees in equivalent employment positions, and the covered member (1) is not associated with the plan in any capacity prohibited by interpretation 101 1.C; (2) has no influence or control over the investment strategy, benefits, or other management activities associated with the plan; and (3) is required to participate in the plan as a condition of employment.~~

The following examples illustrate these concepts:

- 1- a. If a covered member *or his or her immediate family member* is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan's investment decisions (*including through selection of investment managers or pooled investment vehicles*), the underlying investments would be considered to be direct financial interests of the covered member.
- 2- b. If investments in a defined contribution plan are participant directed, whereby a covered member *or his or her immediate family member* selects his or her underlying plan investments or selects from investment alternatives offered by the plan, the covered member *underlying investments* would be considered to ~~have a~~ *be* direct financial interests ~~in those investments~~ *of the covered member*.
- 3- c. If investments in a defined contribution plan are not participant directed and the covered member *or his or her immediate family member* has no authority to supervise or participate in the plan's investment decisions, the covered member *underlying investments* would be considered to ~~have an~~ *be* indirect financial interests ~~in the underlying plan investments~~ *of the covered member*.

Also refer to ~~e~~**E**thics ~~r~~**R**uling No. 107, "Participation in ~~Health or Welfare~~ **Employee Benefit** Plan Sponsored by Client," ~~[ET (section 191 par. .214-.215)]~~, and Interpretation No. 101-1, ~~Interpretation of Rule 101 [ET section 101.02]~~, subsections "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client," "Application of the Independence Rules to a Covered Member's Immediate Family," and "Application of the Independence Rules to Close Relatives.

Effective Date

The proposed revisions to Interpretation No. 101-15 will be effective on the last day of the month in which they are published in the *Journal of Accountancy*.

Proposed Revision to Ethics Ruling No. 2, “Distribution of Client Information to Trade Associations Third Parties,” of ET Section 391, *Ethics Rulings on Responsibilities to Clients*

[Explanation]

In May 2008, the PEEC appointed a task force to determine whether a member would be in violation of Rule 301, *Confidential Client Information* (AICPA, *Professional Standards*, vol. 2, ET sec. 301), if client information was shared with a third-party on a “no-name” basis for research or benchmarking purposes without the client’s specific consent.

After studying this issue, the PEEC concluded it would be appropriate to revise Ethics Ruling No. 2, “Distribution of Client Information to Trade Associations,” of ET section 391, *Ethics Rulings on Responsibilities to Clients* (AICPA, *Professional Standards*, vol. 2), to reflect the broader types of requests for, and possible uses of, such information by either third parties or the member conducting his or her own business. The PEEC is proposing that the use or disclosure of client information that is not known to be in the public domain or is not available to the public would be considered a breach of client confidentiality (that is, a violation of Rule 301) unless the member received the client’s consent to disclose or use information. The PEEC believes this would be the case even if the information is used on a “no name” basis. Although the PEEC understands and appreciates the value of providing client information to third parties for research and benchmarking purposes, it also believes that it would be necessary for a member to determine that the client does not object to sharing such information when it is not publicly available because it may be viewed by the client as being confidential.

To provide further clarification concerning what client information would be considered confidential, the PEEC is proposing that a new definition of *confidential client information* be added to ET section 92, *Definitions* (AICPA, *Professional Standards*, vol. 2). The proposed definition explains that confidential client information is information that is not known to be in the public domain or available to the public. The definition provides examples of information that would not be considered confidential because it would be considered to be in the public domain or available to the public (for example, information obtained from commercially available databases).

[Text of Proposed Revision]

(Additions appear in **boldface italic** and deletions are stricken.)

2. Distribution of Client Information to Trade Associations *Third Parties*

.003

Question—A member's firm is requested by a trade association to supply profit and loss percentages taken from the reports of the accountant's clients. The association would distribute them to its members. ***has received a request from a third party (for example, a trade association or a professor conducting academic research) to disclose client information or intends to use such information for the member's own purposes (for example, publication of benchmarking studies) in a manner that results in the client's information being distributed to third parties, without the client being specifically identified.*** May the firm member comply with ~~the~~ ***such a request or use client information without violating Rule 301?***

.004

Answer—A member would be in violation of Rule 301 ~~[ET section 301.01]~~ would not be violated if the firm ***information is considered to be confidential client information unless the member has the client's specific permission to for the distributeion the figures or use of such information. The distribution or use of information already in the public domain or that is available to the public is not limited. However, unless the member knows that the particular client information to be distributed or used is in the public domain or available to the public, such information should be treated as confidential. The member should be cautious in the distribution or use of the information so as not to disclose client information that may go beyond what is expressly included in the public domain or available to the public, or that the client has specifically agreed may be disclosed, even when the information is aggregated or redacted.***

Proposed Addition to ET Section 92, *Definitions*: “Confidential Client Information”

[Text of Proposed Addition]

Confidential client information. Confidential client information is any client information that is not known to be in the public domain or available to the public. Information in the public domain or available to the public includes, but is not limited to

- information in a book, periodical, newspaper, or similar publication;
- information obtained from commercially available databases;
- information in a client document that has been released by the client to the public or that has otherwise become a matter of public knowledge;
- information on client Web sites that is available to persons accessing that Web site without restrictions imposed by the client concerning use or access;
- information maintained by or filed with regulatory or governmental bodies that is available to the public without restriction; or
- information maintained by or filed with regulatory or governmental bodies that is made available through freedom of information or similar requests filed with and approved by such bodies in accordance with their rules or regulations

Unless it is known that the particular client information is in the public domain or available to the public, such information should be considered confidential client information.