

Ethics Interpretation

Ethics interpretations and rulings are promulgated by the executive committee of the professional ethics division to provide guidelines as to the scope and application of the rules; however, they are not intended to limit scope or application. The publication of an interpretation or ethics ruling in the *Journal of Accountancy* constitutes notice to members. A member who departs from interpretations or rulings shall have the burden of justifying such departure in any disciplinary hearing.

The Professional Ethics Executive Committee has adopted editorial revisions to Interpretation No. 101-3, "Performance of Nonattest Services," to clarify that establishing or maintaining controls, including performing ongoing monitoring activities for a client, would impair independence, if performed by a member. Specifically, the Committee believes that General Requirement 2e (requiring that the client must agree to establish and maintain internal controls) is more appropriately classified under the interpretation's "General Activities," rather than listed as a "client responsibility" under the "General Requirements." Conforming edits have also been made to the internal audit assistance services guidance and related footnotes. In addition, footnotes were added to the forensic accounting and tax compliance services to clarify certain terms used in the interpretation.

Finally, ethics ruling No. 101 – Client Advocacy and Expert Witness Services [ET section 191.202 -.203] has been deleted as a conforming change due to the adoption of expert witness service guidance under Interpretation 101-3.

(Added text is in boldface italic and deleted text is struck through.)

Note: Certain sections of Interpretation No. 101-3 have been intentionally omitted below since they were not revised. The examples of nonattest services, with the exception of the revised portions of sections of Internal Audit Assistance Services, Forensic Accounting Services and Tax Compliance Services have been omitted for convenience. The entire text of the Interpretation can be found at http://www.aicpa.org/about/code/et_101.html#et_101.05.

.05 101-3 – Performance of Nonattest Services. Before a member or his or her firm ("member") performs nonattest services (for example, tax or consulting services) for an attest client^{fn5}, the member should determine that the requirements described in this interpretation have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired.

Engagements Subject to Independence Rules of Certain Regulatory Bodies

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the General Accounting Office [GAO], the Department of Labor [DOL], and state boards of accountancy) where a member performs nonattest services for an attest client and is required to be independent of the client under the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

General Requirements for Performing Nonattest Services

1. The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.
2. The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
 - a. Make all management decisions and perform all management functions;
 - b. Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
 - c. Evaluate the adequacy and results of the services performed; and
 - d. Accept responsibility for the results of the services.
 - ~~e. Establish and maintain internal controls, including monitoring ongoing activities.~~

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.

3. Before performing nonattest services, the member should establish and document in writing ^{fn6} his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:
 - a. Objectives of the engagement
 - b. Services to be performed

- c. Client's acceptance of its responsibilities
- d. Member's responsibilities
- e. Any limitations of the engagement

The documentation requirement does not apply to:

- a. Nonattest services performed prior to January 1, 2005.
- b. Nonattest services performed prior to the client becoming an attest client ^{fn 7}.

General requirements 2 and 3 above do not apply to certain routine activities performed by the member such as providing advice and responding to the client's questions as part of the normal client-member relationship.

General Activities

The following are some general activities that would impair a member's independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents ^{fn8}, in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities
- Determining which recommendations of the member should be implemented
- Reporting to the board of directors on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent
- *Establishing or maintaining internal controls, including performing ongoing monitoring activities ^{fn9} for a client*

Tax Compliance Services

Authorized representation of a client in administrative proceedings before a taxing authority would not impair a member's independence provided the member obtains client agreement prior to committing the client to a specific resolution with the taxing authority. However, representing a client in a court ^{fn 14} ~~or in a public hearing~~ to resolve a tax dispute would impair a member's independence.

Forensic Accounting Services

a. Expert witness services^{fn17} are those litigation services where a member is engaged to render an opinion before a trier of fact as to the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events.

Expert witness services create the appearance that a member is advocating or promoting a client's position^{fn18}. Accordingly, if a member conditionally or unconditionally agrees to provide expert witness testimony for a client,^{fn19} independence would be considered to be impaired.

Internal Audit Assistance Services

Assisting the client in performing financial and operational internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for ~~establishing and maintaining the internal control system~~^{fn21} and directing the internal audit function, including the management thereof.

Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

~~101. Client Advocacy and Expert Witness Services~~

~~.202 Question~~—Would the performance of expert witness services be considered as acting as an advocate for a client as discussed in interpretation 102-6 [~~ET section 102.07~~]?²

~~.203 Answer~~—No. A member serving as an expert witness does not serve as an advocate but as someone with specialized knowledge, training, and experience in a particular area who should arrive at and present positions objectively.

^{fn 5} A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* [AR section 100.19]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

^{fn 6} A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202, *Compliance With Standards* [Rule 202.01], provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote revised, January 2005, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

^{fn 7} However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client. [Footnote added, effective October 31, 2004, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

^{fn 8} Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

^{fn 9} ***Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time, and is built into the normal recurring activities of an entity; these activities include regular management and supervisory activities. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities . [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee.]***

^{fn 10} [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September, 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote deleted by the Professional Ethics Executive Committee, February 2007. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 11](#) When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 12](#) For purposes of this interpretation, a tax return includes informational tax forms (for example, estimated tax vouchers, extension forms, and Forms 990, 5500, 1099, and W-2) filed with a taxing authority or other regulatory agencies. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 13](#) Making electronic tax payments under a taxing authority's specified criteria or remitting a check payable to the taxing authority and signed by the client would not be considered having custody or control over a client's funds. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

fn 14 The term 'court' encompasses a tax, district, or federal court of claims, and the equivalent state, local or foreign forums. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee.]

[fn 15](#) Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, February 2007. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 16](#) The definitions of the specific services identified in this interpretation are solely for purposes of this interpretation and are not intended to be used for any other purpose. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 17](#) In determining whether the member's services are considered to be expert witness services or fact witness testimony, members should refer to the Federal Rules of Evidence, Article VII, Opinions and Expert Testimony (Rules 701, 702, and 703), and other applicable laws, regulations, and rules. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 18](#) See advocacy threat as defined in the Conceptual Framework for AICPA Independence Standards (ET section 100.01). However, even though there is an appearance of advocacy, when providing expert witness services, a member must comply with Rule 102, Integrity and Objectivity, which requires that a member maintain objectivity and integrity and not subordinate his or her judgment to others. [Footnote added, effective February 28, 2007, by the Professional

Ethics Executive Committee. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

^{fn 19} Client in this case refers to the party to the litigation on whose behalf the member is providing testimony and not to the law firm that engaged the member on the client's behalf. If the law firm that engaged the member on behalf of the client is also an attest client of the member, the member should consider the applicability of Interpretation 101-12, Independence and Cooperative Arrangements with Clients. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee.]

^{fn 20} A fact witness is also referred to as a percipient witness or a sensory witness. Fact witness testimony is based on the member's direct knowledge of the facts or events in dispute. A fact witness may have obtained his or her direct knowledge of the facts or events in dispute from the performance of prior professional services for the client. As a fact witness, the member's role is to provide factual testimony to the trier of fact. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

^{fn 21} For purposes of complying with general requirement 2, the client may designate its attorney to oversee the litigation consulting services. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

^{fn 22} However, the member should consider the requirements of Interpretation No. 102-2, "Conflicts of Interests," [ET section 102.03]. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

^{fn 23} For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, February 2007. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

^{fn 24} ~~As part of its responsibility to establish and maintain internal control, management monitors internal control to assess the quality of its performance over time. Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time and built into the normal recurring activities of an entity; they include regular management and supervisory activities, comparisons, reconciliations, and other routine actions. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities. [Footnote added, effective December 31, 2003, by the Professional Ethics~~

~~Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, February 2007.]~~
[Footnote deleted and renumbered by the Professional Ethics Executive Committee, June 2007.]

[fn 251](#) [Footnote deleted by the Professional Ethics Executive Committee, January 2005. Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, February 2007. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn †](#) Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, *Definitions*.

[fn 26](#) The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered member's net worth. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation 101-1, September 2003. Footnote subsequently renumbered by the revision of Interpretation 101-1, July 2004. Footnote subsequently renumbered by the revision of Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 27](#) Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. Footnote renumbered by the revision of Interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 28](#) 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 covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment. [Footnote renumbered and revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. Footnote subsequently renumbered by the revision of Interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 29](#) See footnote 17. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. Footnote subsequently renumbered by the revision of Interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of

Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 30](#) See footnote 17. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. Footnote subsequently renumbered by the revision of Interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 31](#) Except for a financial reporting entity's basic financial statements, which is defined within the text of this Interpretation, certain terminology used throughout the Interpretation is specifically defined by the Governmental Accounting Standards Board. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. Footnote subsequently renumbered by the revision of Interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 32-331](#) [Footnotes deleted by the Professional Ethics Executive Committee, March 2003. Footnotes renumbered by the revision of Interpretation 101-2, April 2003. Footnotes subsequently renumbered by the revision of Interpretation 101-3, September 2003. Footnotes subsequently renumbered by the revision of Interpretation 101-3, July 2004. Footnotes subsequently renumbered by the revision of Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 34](#) As defined in the SSAEs. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. Footnote subsequently renumbered by the revision of Interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation 101-1, April 2006. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn ‡](#) Terms shown in **boldface** type upon first usage in this Interpretation are defined in ET section 92, *Definitions*. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. *Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.*]

[fn 35](#) For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [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. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation 101-1. Footnote renumbered

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[fn 39](#) When used herein, the term *control* includes situations where the covered member, individually or acting together with his or her firm or with other partners or professional employees of his or her firm, has the ability to exercise such control. [Footnote renumbered by the revision of Interpretation 101-1, April 2006. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 40](#) To determine if the mutual fund is diversified, the covered member should refer to (1) the mutual fund's prospectus to see if the prospectus discloses that the fund is *not* diversified or (2) Section 5(b)(1) of the Investment Company Act of 1940. [Footnote renumbered by the revision of Interpretation 101-1, April 2006. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 41](#) 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. [Footnote renumbered by the revision of Interpretation 101-1, April 2006. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]

[fn 42](#) However, a covered member who is an employee of a governmental organization that is required by law or regulation to audit a Section 529 plan sponsored by a governmental unit will be permitted to be an account owner in the plan for a period not to exceed one year from the effective date of this Interpretation. [Footnote renumbered by the revision of Interpretation 101-1, April 2006. ***Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.***]