

Code of Professional Conduct

As of December 14, 2014

As of December 15, 2014, this version of the AICPA Code of Professional Conduct will be superseded by a new version. The feature-enhanced new version of the AICPA Code of Professional Conduct that is effective as of December 15, 2014, is accessible at <http://pub.aicpa.org/codeofconduct/Ethics.aspx>.

Code of Professional Conduct

INTRODUCTION

As Adopted January 12, 1988, unless otherwise indicated.

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 or her state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental

agency, which may regulate his or her client's business or use his or her report to evaluate the client's compliance with applicable laws and related regulations.

ET Section 50

PRINCIPLES OF PROFESSIONAL CONDUCT

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.

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.

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.

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.

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.

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.

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.

[Revised May 15, 2000.]

ET Section 90

RULES: APPLICABILITY AND DEFINITIONS

ET Section 91

Applicability

As adopted
January 12, 1988,
unless otherwise
indicated

- .01** The bylaws of the AICPA 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, an associated member, or an international associate of the AICPA [sec. 92 par. .21].
1. The rules of conduct that follow apply to all professional services performed except
 - a. when the wording of the rule indicates otherwise.
 - b. that a member who is practicing outside the United States will not be considered in violation of a particular rule 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, when a member is associated with financial statements under circumstances that would lead the reader to assume that U.S. practices were followed, the member must comply with the requirements of Rules 202, *Compliance With Standards* [sec. 202 par. .01], and 203, *Accounting Principles* [sec. 203 par. .01].
 - c. a member who is a member of a group engagement team (see the clarified SAS *Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors]*) will not be considered in violation of a particular rule if a foreign component auditor (accountant) departed from any of the ethics requirements stated herein with respect to the audit or review of group financial statements or other attest engagement, as long as the foreign component auditor's (accountant's) conduct, at a minimum, is in accordance with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants' (IESBA's) Code of Ethics for Professional Accountants, and the members of the group engagement team are in compliance with the rules stated herein.
 - d. the independence of the member's firm will not be considered impaired if another firm or entity located outside the United States that is within the member firm's network departed from any of the rules stated herein, as long as the other firm or entity's conduct, at a minimum, is in accordance with the independence requirements set forth in the IESBA's Code of Ethics for Professional Accountants.
 2. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts that, if carried out by the member, would place the member in violation of the rules. Further, a member

may be held responsible for the acts of all persons associated with him or her in public practice whom the member has the authority or capacity to control.

3. A member (as defined in paragraph .21 of section 92) or a covered member (as defined in paragraph .07 of section 92) may be considered to have his or her independence impaired, with respect to a client, as the result of the actions or relationships of certain persons or entities, as described in Rule 101, *Independence* [sec. 101 par. .01], and its interpretations and rulings, whom the member or covered member does not have the authority or capacity to control. Therefore, nothing in this section should lead one to conclude that the member's or covered member's independence is not impaired solely because of his or her inability to control the actions or relationships of such persons or entities.

[Revised September 2011, effective November 30, 2011. Paragraph added August 1989, effective November 30, 1989. Revised December 1998. Revised July 2002 to reflect conforming changes necessary due to the revision of Interpretation 101-1. Revised March 2013, revisions effective May 31, 2013. Revised June 2014, effective September 30, 2014.]

ET Section 92

Definitions

As adopted,
January 12, 1988,
unless otherwise
indicated

[Pursuant to its authority under the bylaws (BL § 3.6.2.2) 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 Attest engagement. An attest engagement is an engagement that requires independence as defined in AICPA Professional Standards.

[Revised November 2001.]

.02 Attest engagement team. The attest engagement team consists of individuals participating in the attest engagement, including those who perform concurring and second partner reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists as discussed in AU-C section 620], *Using the Work of an Auditor's Specialist*, and individuals who perform only routine clerical functions, such as word processing and photocopying.

[Revised November 2001. Revised May 2013, revisions effective June 30, 2013.]

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

- a. Entities engaged in public practice.
- b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities is
 - i. directly elected by voters of the government or component unit thereof with respect to which professional services are performed;
 - ii. an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
 - iii. appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.

[Revised December 1998. Revised March 2013, revisions effective May 31, 2013.]

.04 Close relative. A close relative is a parent, sibling, or nondependent child.

[Revised November 2001.]

.05 Confidential client information. Confidential client information is any information obtained from the client that is not available to the public. Information that is available to the public includes, but is not limited to, information

- in a book, periodical, newspaper, or similar publication;
- in a client document that has been released by the client to the public or that has otherwise become a matter of public knowledge;
- on publicly accessible websites, databases, online discussion forums, or other electronic media by which members of the public can access the information;
- released or disclosed by the client or other third parties in media interviews, speeches, testimony in a public forum, presentations made at seminars or trade association meetings, panel discussions, earnings press release calls, investor calls, analyst sessions, investor conference presentations, or a similar public forum;
- maintained by, or filed with, regulatory or governmental bodies that is available to the public; or
- obtained from other public sources.

Unless the particular client information is available to the public, such information should be considered confidential client information.

Members are advised that federal, state, or local statutes, rules, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct.

[Effective November 30, 2011.]

.06 Council. The council of the AICPA.

[Paragraph renumbered September 2011.]

.07 Covered member. A covered member is

- a. an individual on the attest engagement team;
- b. an individual in a position to influence the attest engagement;
- c. a partner, partner equivalent, or manager who provides nonattest services to the attest client beginning once he or she provides 10 hours of nonattest services to the client within any fiscal year and ending on the later of the date (i) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis;

- d. a partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest engagement;
- e. the firm, including the firm's employee benefit plans; or
- f. an entity whose operating, financial, or accounting policies can be controlled (as defined in Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 810, *Consolidation*) by any of the individuals or entities described in (a)–(e) or by two or more such individuals or entities if they act together.

[Revised November 2001. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011. Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.]

[.08] **Enterprise.** [Paragraph renumbered September 2011. Revised November 2001.]

.09 Financial institution. A financial institution is considered to be an entity that, as part of its normal business operations, makes loans or extends credit to the general public. In addition, for automobile leases addressed under Interpretation 101-5, "Loans From Financial Institution Clients" under Rule 101, *Independence* [sec. 101 par. .07], an entity would be considered a financial institution if it leases automobiles to the general public.

[Revised November 2002 and September 2003. Paragraph renumbered September 2011.]

.10 Financial statements. A presentation of financial data, including accompanying notes, if any, intended to communicate an entity's economic resources obligations, or both, at a point in time or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

Incidental financial data to support recommendations to a client or in documents for which the reporting is governed by Statements on Standards for Attestation Engagements and tax returns and supporting schedules do not, for this purpose, constitute financial statements. 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.

[Paragraph renumbered September 2011.]

.11 Firm. A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the council of the AICPA and that is engaged in public practice. *Firm* includes the individual partners thereof except for purposes of applying Rule 101 [sec. 101 par. .01]. For purposes of applying Rule 101, *firm* includes a network firm when the engagement is either a financial statement audit or review engagement, and the audit or review report is not restricted, as defined by professional standards.

[Revised November 2001. Revised May 2010, effective for engagements covering periods beginning on or after July 1, 2011. Paragraph renumbered September 2011. Revised March 2013, revisions effective May 31, 2013.]

[.12] **Holding out.** [Deleted March 2013, effective May 31, 2013.]

.13 Immediate family. Immediate family is a spouse, spousal equivalent, or dependent (whether or not related).

[Revised November 2001. Paragraph renumbered September 2011.]

.14 Individual in a position to influence the attest engagement. An individual in a position to influence the attest engagement is one who

- a. evaluates the performance or recommends the compensation of the attest engagement partner;
- b. directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm's chief executive;
- c. consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement; or
- d. participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring, with respect to the specific attest engagement.

[Revised November 2001. Paragraph renumbered September 2011.]

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

[Paragraph renumbered September 2011.]

.16 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.

[Paragraph renumbered September 2011.]

.17 Joint closely held investment. A joint closely held investment is an investment in an entity or property by the member and the client (or the client's officers or directors, or any owner who has the ability to exercise significant influence over the client) that enables them to control (as defined in FASB ASC 810) the entity or property.

[Revised November 2001. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011.]

.18 Key position. A key position is a position in which an individual

- a. has primary responsibility for significant accounting functions that support material components of the financial statements;
- b. has primary responsibility for the preparation of the financial statements; or
- c. has the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of attest engagements not involving a client's financial statements, a key position is one in which an individual is primarily responsible for, or able to influence, the subject matter of the attest engagement, as previously described.

[Revised November 2001. Paragraph renumbered September 2011.]

- .19 Loan.** A loan is 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, but is not limited to, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment.

[Revised November 2001. Paragraph renumbered September 2011.]

- .20 Manager.** A manager is a professional employee of the firm who has responsibility for the planning and supervision of engagements for specified clients.

[Revised November 2001. Paragraph renumbered September 2011. Revised March 2013, effective May 31, 2013.]

- .21 Member.** A member, associate member, or international associate of the AICPA.

[Paragraph renumbered September 2011.]

- .22 Member in business.** A member employed or engaged on a contractual or volunteer basis in an executive, a staff, a governance, an advisory, or an administrative capacity in such areas as industry, the public sector, education, the not-for-profit sector, or regulatory or professional bodies. This does not include a member while engaged in public practice.

[Effective November 30, 2011. Revised March 2013, effective May 31, 2013.]

- .23 Network.** For purposes of Interpretation No. 101-17, "Networks and network firms," of Rule 101 [sec. 101 par. .19], a network is an association of entities that includes one or more firms that (a) cooperate for the purpose of enhancing the firms' capabilities to provide professional services and (b) share one or more of the following characteristics:

1. The use of a common brand name (including common initials) as part of the firm name
2. Common control (as defined in FASB ASC 810) among the firms through ownership, management, or other means
3. Profits or costs, excluding the following:
 - a. Costs of operating the association
 - b. Costs of developing audit methodologies, manuals, and training courses
 - c. Other costs that are immaterial to the firm
4. Common business strategy that involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the association's strategy and are held accountable for performance pursuant to that strategy

5. Significant part of professional resources
6. Common quality control policies and procedures that firms are required to implement and that are monitored by the association

A network may comprise a subset of entities within an association if only that subset of entities cooperates and shares one or more of the characteristics set forth in the preceding list.

[Paragraph added May 2010, effective for engagements covering periods beginning on or after July 1, 2011. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011.]

- .24 Network firm.** A network firm is a firm or other entity that belongs to a network, as defined in paragraph .23. This includes any entity (including another firm) that the network firm, by itself or through one or more of its owners, controls (as defined in FASB ASC 810), is controlled by, or is under common control with.

[Paragraph added May 2010, effective for engagements covering periods beginning on or after July 1, 2011. Revised March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Paragraph renumbered September 2011.]

- .25 Normal lending procedures, terms, and requirements.** Normal lending procedures, terms, and requirements relating to a covered 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 covered member is committed. Accordingly, in making such comparison and in evaluating whether a loan was made under normal lending procedures, terms, and requirements, the covered member should consider all the circumstances under which the loan was granted, including the following:

- a. The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member.
- b. Repayment terms.
- c. Interest rate, including "points."
- d. Closing costs.
- e. General availability of such loans to the public.

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

[Revised November 2002. Paragraph renumbered May 2010. Paragraph renumbered September 2011.]

- .26 Office.** An office is a reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, where personnel who make up the subgroup generally serve the same group of clients or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual's physical location.

[Revised November 2001. Paragraph renumbered May 2010. Paragraph renumbered September 2011.]

- .27 Partner.** A partner is a proprietor, shareholder, equity or non-equity partner or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

[Revised November 2001. Paragraph renumbered May 2010. Paragraph renumbered September 2011.]

- .28 Partner equivalent.** A *partner equivalent* is a professional employee who is not a partner of the firm as defined in paragraph .27, but who
- a. has the authority to bind the firm to conduct an attest engagement without partner approval (for example, the professional employee has the authority to sign or affix the firm's name to an attest engagement letter or contract to conduct an attest engagement without partner approval); or
 - b. has the ultimate responsibility for the conduct of an attest engagement, including the authority to sign or affix the firm's name to an attest report or issue, or authorize others to issue, an attest report on behalf of the firm without partner approval.

Firms may use different titles to refer to professional employees with this authority, although a title is not determinative of a partner equivalent. For purposes of this definition, partner approval does not include any partner approvals that are part of the firm's normal approval and quality control review procedures applicable to a partner.

This definition is solely for the purpose of applying Rule 101 [sec. 101 par. .01] and its interpretations and rulings and should not be used or relied upon in any other context, including the determination of whether the partner equivalent is an owner of the firm.

[Paragraph added March 2013, effective for engagements covering periods beginning on or after December 15, 2014.]

- .29 Period of the professional engagement.** The period of the professional engagement begins when a member either signs an initial engagement letter or other agreement to perform attest services or begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship (which could cover many periods) and ends with the formal or informal notification, either by the member or the client, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year's attest engagement.

[Revised November 2001. Paragraph renumbered May 2010. Paragraph renumbered September 2011. Paragraph renumbered March 2013.]

- .30 Public practice.** Public practice consists of the performance of professional services for a client by a member or a member's firm.

[Paragraph renumbered May 2010. Revised June 2009. Paragraph renumbered September 2011. Revised and renumbered March 2013, effective May 31, 2013.]

- .31 Professional services.** Professional services include all services performed by a member for a client, an employer, or on a volunteer basis, requiring accountancy or related skills, including but not limited to, accounting, audit and other attest services, tax, bookkeeping, management consulting, financial man-

agement, corporate governance, personal financial planning, business valuation, litigation support, educational, and those services for which standards are promulgated by bodies designated by council.

[Paragraph renumbered May 2010. Paragraph renumbered September 2011. Revised and renumbered March 2013, effective May 31, 2013.]

.32 Significant influence. The term *significant influence* is as defined in FASB ASC 323-10-15.

[Revised November 2001 and June 2009. Paragraph renumbered May 2010. Paragraph renumbered September 2011. Paragraph renumbered March 2013.]

.33 Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

When an interpretation requires communicating with those charged with governance, the member should determine the appropriate person(s) within the entity's governance structure with whom to communicate, based on the nature and importance of the particular circumstances and matter to be communicated. If the member communicates with a subgroup of those charged with governance (for example, an audit committee or an individual), the member should determine whether communication with all of those charged with governance is also necessary, so that they are adequately informed.

[Paragraph added April 2014, effective April 30, 2014.]

ET Section 100

INDEPENDENCE, INTEGRITY, AND OBJECTIVITY

ET Section 100-1

Conceptual Framework for AICPA Independence Standards

Introduction

- .01** This conceptual framework describes the risk-based approach to analyzing independence matters that is used by the Professional Ethics Executive Committee (PEEC) of the AICPA when it develops independence standards. Under that approach, a member's relationship with a client is evaluated to determine whether it poses an unacceptable risk to the member's independence. Risk is unacceptable if the relationship would compromise (or would be perceived as compromising by an informed third party having knowledge of all relevant information) the member's professional judgment when rendering an attest service to the client. Key to that evaluation is identifying and assessing the extent to which a threat to the member's independence exists and, if it does, whether it would be reasonable to expect that the threat would compromise the member's professional judgment and, if so, whether it can be effectively mitigated or eliminated. Under the risk-based approach, steps are taken to prevent circumstances that threaten independence from compromising the professional judgments required in the performance of an attest engagement.
- .02** Professional standards of the AICPA require independence for all attest engagements. The PEEC bases its independence interpretations and rulings under section 100 on the concepts in this framework. However, in certain circumstances the PEEC has determined that it is appropriate to prohibit or restrict certain relationships notwithstanding the fact that the risk may be at an acceptable level. For example, the PEEC has determined that a covered member should not own even an immaterial direct financial interest in an attest client.
- .03** Because this conceptual framework describes the concepts upon which the AICPA's independence interpretations and rulings are based, it may assist AICPA members and others in understanding those interpretations and rulings. In addition, this conceptual framework should be used by members when making decisions on independence matters that are not explicitly addressed by the Code of Professional Conduct. Under no circumstances, however, may the framework be used to overcome prohibitions or requirements contained in the independence interpretations and rulings.
- .04** The risk-based approach entails evaluating the risk that the member would not be independent or would be perceived by a reasonable and informed third party having knowledge of all relevant information as not being independent. That risk must be reduced to an acceptable level to conclude that a member is independent under the concepts in this framework. Risk is at an acceptable level when threats are at an acceptable level, either because of the types of threats and their potential effect, or because safeguards have sufficiently mitigated or eliminated the threats. Threats are at an acceptable level when it is not reasonable to expect that the threat would compromise professional judgment.
- .05** The risk-based approach involves the following steps.
- a. Identifying and evaluating threats to independence—Identify and evaluate threats, both individually and in the aggregate, because threats can have a cumulative effect on a member's independence. Where threats are identified but, due to the types of threats and their potential effects, such threats are considered to be at an acceptable level (that is, it is not reasonable to expect that the threats would compromise professional judgment), the consideration of safeguards is not re-

quired. If identified threats are not considered to be at an acceptable level, safeguards should be considered as described in paragraph .05b.

- b. Determining whether safeguards already eliminate or sufficiently mitigate identified threats and whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards—Different safeguards can mitigate or eliminate different types of threats, and one safeguard can mitigate or eliminate several types of threats simultaneously. When threats are sufficiently mitigated by safeguards, the threats’ potential to compromise professional judgment is reduced to an acceptable level. A threat has been sufficiently mitigated by safeguards if, after application of the safeguards, it is not reasonable to expect that the threat would compromise professional judgment.^{fn 1}
- c. If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

Definitions

.06 *Independence* is defined as:

- a. *Independence of mind*—The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.
- b. *Independence in appearance*—The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards^{fn 2} applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.

.07 This definition reflects the longstanding professional requirement that members who provide services to entities for which independence is required be independent both in fact and in appearance.^{fn 3} The state of mind of a member who is independent “in fact” assists the member in performing an attest engagement in an objective manner. Accordingly, independence of mind reflects the longstanding requirement that members be independent in fact.

.08 This definition is used as part of the risk-based approach to analyze independence. Because the risk-based approach requires judgment, the definition should not be interpreted as an absolute. For example, the phrase “without being affected by influences that compromise professional judgment” is not intended to convey that the member must be free of any and all influences that might compromise objective judgment. Instead, a determination must be made about whether such influences, if present, create an

^{fn 1} In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented as required under “Other Considerations” of Interpretation 101-1, *Interpretation of Rule 101* [section 101.02].

^{fn 2} The term *safeguards* is defined in paragraph .20.

^{fn 3} Section 55, *Article IV—Objectivity and Independence*, states, “A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.”

unacceptable risk that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement, or would be perceived as not being able to do so by a reasonable and informed third party that has knowledge of all relevant information.

- .09** *Impair*—For purposes of this framework, *impair* means to effectively extinguish (independence). When a member’s independence is impaired, the member is not independent.
- .10** *Threats*—Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether it would be reasonable to expect that the threat would compromise the member’s professional judgment and, if so, the specific safeguards applied to reduce or eliminate the threat, and the effectiveness of those safeguards as described in paragraph .21.
- .11** Threats might not involve violations of existing interpretations or rulings. For example, the circumstance described in paragraph .18*b* of this framework is permissible in limited instances under current AICPA independence interpretations and rulings.
- .12** Many different circumstances (or combinations of circumstances) can create threats to independence. It is impossible to identify every situation that creates a threat. However, seven broad categories of threats should always be evaluated when threats to independence are being identified and assessed. They are self-review, advocacy, adverse interest, familiarity, undue influence, financial self-interest, and management participation threats. The following paragraphs define and provide examples, which are not all-inclusive, of each of these threat categories. Some of these examples are the subject of independence interpretations and rulings contained in the Code of Professional Conduct.
- .13** *Self-review threat*—Members reviewing as part of an attest engagement evidence that results from their own, or their firm’s, nonattest work such as, preparing source documents used to generate the client’s financial statements
- .14** *Advocacy threat*—Actions promoting an attest client’s interests or position.^{fn 4}
- a. Promoting the client’s securities as part of an initial public offering
 - b. Representing a client in U.S. tax court
- .15** *Adverse interest threat*—Actions or interests between the member and the client that are in opposition, such as, commencing, or the expressed intention to commence, litigation by either the client or the member against the other.
- .16** *Familiarity threat*—Members having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client.
- a. A member of the attest engagement team whose spouse is in a key position at the client, such as the client’s CEO

^{fn 4} This threat does not arise from testifying as a fact witness or defending the results of a professional service that the member performed for the client.

- b. A partner or partner equivalent of the firm who has provided the client with attest services for a prolonged period
 - c. A member who performs insufficient audit procedures when reviewing the results of a nonattest service because the service was performed by the member's firm
 - d. A member of the firm having recently been a director or an officer of the client
 - e. A member of the attest engagement team whose close friend is in a key position at the client
- .17** *Undue influence threat*—Attempts by an attest client's management or other interested parties to coerce the member or exercise excessive influence over the member.
- a. A threat to replace the member or the member's firm over a disagreement with client management on the application of an accounting principle
 - b. Pressure from the client to reduce necessary audit procedures for the purpose of reducing audit fees
 - c. A gift from the client to the member that is other than clearly insignificant to the member
- .18** *Financial self-interest threat*—Potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client.
- a. Having a direct financial interest or material indirect financial interest in the client
 - b. Having a loan from the client, from an officer or director of the client, or from an individual who owns 10 percent or more of the client's outstanding equity securities
 - c. Excessive reliance on revenue from a single attest client
 - d. Having a material joint venture or other material joint business arrangement with the client
- .19** *Management participation threat*—Taking on the role of client management or otherwise performing management functions on behalf of an attest client.
- a. Serving as an officer or director of the client
 - b. Establishing and maintaining internal controls for the client
 - c. Hiring, supervising, or terminating the client's employees
- .20** *Safeguards*—Controls that eliminate or reduce threats to independence. Safeguards range from partial to complete prohibitions of the threatening circumstance to procedures that counteract the potential influence of a threat. The nature and extent of the safeguards to be applied depend on many factors, including the size of the firm and whether the client is a public interest entity. To be effective, safeguards should eliminate or reduce the threat to an acceptable level.

Solely for the purpose of this conceptual framework, the following entities are considered to be public interest entities: (a) all listed entities^{fn 5} and (b) any entity for which an audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to an audit of listed entities (for example, requirements of the Securities and Exchange Commission, the Public Company Accounting Oversight Board, or other similar regulators or standard setters).^{fn 6 fn 7}

- .21** The effectiveness of a safeguard depends on many factors, including those listed here:
- a. The facts and circumstances specific to a particular situation
 - b. The proper identification of threats
 - c. Whether the safeguard is suitably designed to meet its objectives
 - d. The party or parties that will be subject to the safeguard
 - e. How the safeguard is applied
 - f. The consistency with which the safeguard is applied
 - g. Who applies the safeguard
- .22** There are three broad categories of safeguards. The relative importance of a safeguard depends on its appropriateness in light of the facts and circumstances.
- a. Safeguards created by the profession, legislation, or regulation
 - b. Safeguards implemented by the attest client
 - c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements
- .23** Examples of various safeguards within each category are presented in the following paragraphs. The examples are not intended to be all-inclusive and, conversely, the examples of safeguards implemented by the attest client and within the firm's own systems and procedures may not all be present in each instance. In addition, threats may be sufficiently mitigated through the application of other safeguards not specifically identified herein.

^{fn 5} Including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body. [Footnote revised September 2011, effective November 30, 2011.]

^{fn 6} Members may wish to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered may include (a) the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders; (b) size; and (c) number of employees. [Footnote added September 2011, effective November 30, 2011.]

^{fn 7} Members should refer to the independence regulations of authoritative regulatory bodies when a member performs attest services and is required to be independent of the client under such regulations. [Footnote added September 2011, effective November 30, 2011.]

- .24** *Examples of safeguards created by the profession, legislation, or regulation*
- a. Education and training requirements on independence and ethics rules for new professionals
 - b. Continuing education requirements on independence and ethics
 - c. Professional standards and monitoring and disciplinary processes
 - d. External review of a firm's quality control system
 - e. Legislation governing the independence requirements of the firm
 - f. Competency and experience requirements for professional licensure
- .25** *Examples of safeguards implemented by the attest client that would operate in combination with other safeguards*
- a. The attest client has personnel with suitable skill, knowledge, and/or experience who make managerial decisions with respect to the delivery of nonattest services by the member to the attest client
 - b. A tone at the top that emphasizes the attest client's commitment to fair financial reporting
 - c. Policies and procedures that are designed to achieve fair financial reporting
 - d. A governance structure, such as an active audit committee, that is designed to ensure appropriate decision making, oversight, and communications regarding a firm's services
 - e. Policies that dictate the types of services that the entity can hire the audit firm to provide without causing the firm's independence to be considered impaired
- .26** *Examples of safeguards implemented by the firm*
- a. Firm leadership that stresses the importance of independence and the expectation that members of attest engagement teams will act in the public interest
 - b. Policies and procedures that are designed to implement and monitor quality control in attest engagements
 - c. Documented independence policies regarding the identification of threats to independence, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate the threats or reduce them to an acceptable level
 - d. Internal policies and procedures that are designed to monitor compliance with the firm's independence policies and procedures
 - e. Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and attest clients

- f.* The use of different partners, partner equivalents, and engagement teams that have separate reporting lines in the delivery of permitted nonattest services to an attest client, particularly when the separation between reporting lines is significant
- g.* Training on, and timely communication of, a firm's policies and procedures, and any changes to them, for all partners and professional staff
- h.* Policies and procedures that are designed to monitor the firm's, partner's, or partner equivalent's reliance on revenue from a single client and, if necessary, cause action to be taken to address excessive reliance
- i.* Designating someone from senior management as the person who is responsible for overseeing the adequate functioning of the firm's quality control system
- j.* A means of informing partners and professional staff of attest clients and related entities from which they must be independent
- k.* A disciplinary mechanism that is designed to promote compliance with policies and procedures
- l.* Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution
- m.* Policies and procedures relating to independence communications with audit committees or others charged with client governance
- n.* Discussing independence issues with the audit committee or others responsible for the client's governance
- o.* Disclosures to the audit committee (or others responsible for the client's governance) regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged
- p.* The involvement of another professional accountant who (i) reviews the work that is done for an attest client or (ii) otherwise advises the attest engagement team (This individual could be someone from outside the firm or someone from within the firm who is not otherwise associated with the attest engagement.)
- q.* Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant
- r.* Rotation of senior personnel who are part of the attest engagement team
- s.* Policies and procedures that are designed to ensure that members of the attest engagement team do not make or assume responsibility for management decisions for the attest client
- t.* The involvement of another firm to perform part of the attest engagement
- u.* The involvement of another firm to reperform a nonattest service to the extent necessary to enable it to take responsibility for that service

- v. The removal of an individual from an attest engagement team when that individual's financial interests or relationships pose a threat to independence
- w. A consultation function that is staffed with experts in accounting, auditing, independence, and reporting matters who can help attest engagement teams (i) assess issues when guidance is unclear or when the issues are highly technical or require a great deal of judgment and (ii) resist undue pressure from a client when the engagement team disagrees with the client about such issues
- x. Client acceptance and continuation policies that are designed to prevent association with clients that pose an unacceptable threat to the member's independence
- y. Policies that preclude audit partners or partner equivalents from being directly compensated for selling nonattest services to the audit client

[Issued April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised September 2011, effective November 30, 2011. Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.]

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

In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board and the U.S. Securities and Exchange Commission (SEC) if the member's report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member's report will be filed with the DOL, the Government Accountability Office (GAO) if law, regulation, agreement, policy or contract requires the member's report to be filed under GAO regulations, and any organization that issues or enforces standards of independence that would apply to the member's engagement. Such organizations may have independence requirements or rulings that differ from (for example, may be more restrictive than) those of the AICPA.

.02 101-1—Interpretation of Rule 101

Independence shall be considered to be impaired if:

A. During the **period of the professional engagement**^{fn*} a **covered member**

1. Had or was committed to acquire any direct or material indirect financial interest in the **client**.
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 client and
 - (i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or
 - (ii) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
 - (iii) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.
3. Had a **joint closely held investment** that was material to the covered member.
4. Except as specifically permitted in Interpretation No. 101-5, "Loans From Financial Institution Clients and Related Terminology" [sec. 101 par. .07], had any **loan** to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

^{fn*} Terms shown in **boldface** type upon first usage in this interpretation are defined in section 92, *Definitions*. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

- B. During the period of the professional engagement, a **partner** or professional employee of the **firm**, his or her **immediate family**, or any group of such persons acting together owned more than 5 percent of a client's outstanding equity securities or other ownership interests.
- C. During the period covered by the **financial statements** or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n)
 - 1. Director, officer, or employee, or in any capacity equivalent to that of a member of management;
 - 2. Promoter, underwriter, or voting trustee; or
 - 3. Trustee for any pension or profit-sharing trust of the client.

Transition Period for Certain Business and Employment Relationships

A business or employment relationship with a client that impairs independence under Interpretation No. 101-1, "Interpretation of Rule 101" [sec. 101 par. .02(C)], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under Rule 101 [sec. 101 par. .01], and its interpretations and rulings as of November 2001, and the individual severed that relationship on or before May 31, 2002.

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

A firm's independence would be impaired if a covered member who was formerly ^{fn 1} (a) employed by a client or (b) 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

- a. fails to disassociate himself or herself from the client prior to becoming a covered member. Disassociation includes the following:
 - i. 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 his or her portion of the cost of participation on a current basis.
 - ii. 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-

^{fn 1} This provision applies once the individual has terminated his or her relationship with the client and is no longer employed by, or otherwise associated with, the client. See item (C) of Interpretation No. 101-1, "Interpretation of Rule 101" [par. .02], for matters involving a partner or professional employee who is simultaneously employed by, or otherwise associated with, the client and the firm. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

based compensation arrangements,^{fn 2} deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan.^{fn 3}

When the covered member does not participate on the attest engagement team or 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 penalty^{fn 4} significant to the benefits is imposed upon such liquidation or transfer.

- iii. Disposing of any direct or material indirect financial interests in the client.
 - iv. Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under Interpretation No. 101-5 [par. .07].
 - v. Assessing other relationships with the client to determine if such relationships create threats to independence that would require the application of safeguards to reduce the threats to an acceptable level.
- 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

The revisions to the section “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client” of Interpretation No. 101-1 [par. .02] will be effective on June 1, 2011. Early application is permitted.

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

A covered member’s immediate family is subject to Rule 101 [par. .01] and its interpretations and rulings. When materiality of a financial interest is identified as a factor affecting independence in these interpretations and rulings, the immediate family member and the covered member’s interests should be combined.

^{fn 2} As defined in the Financial Accounting Standards Board *Accounting Standards Codification* glossary under the term *share-based payment arrangements*. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

^{fn 3} When the member is a former employee of a governmental unit that is one of the sponsors of an employee benefit plan, the member may continue to participate in the governmental plan if his or her current employer is also one of the sponsors of the plan. In such circumstances, a covered member’s participation in the plan will not impair independence, provided that the plan is offered to all employees in comparable employment positions and the covered member has no influence or control over the investment strategy, benefits, or other management activities associated with the plan and is required to continue his or her participation in the plan as a condition of employment. See Ethics Ruling No. 107, “Participation in Health and Welfare Plan Sponsored by Client,” of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .214–.215], for further information. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

^{fn 4} 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. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

The following exceptions address situations in which independence will not be considered impaired. Notwithstanding the following exceptions, the independence requirement in Interpretation No. 101-1 [par. .02(B)] applies.

Permitted Employment

An individual in a covered member's immediate family may be employed by an attest client in a position other than a key position.

Employee Benefit Plans Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a plan that is an attest client or that is sponsored by an attest client, other than a client's share-based compensation arrangement or nonqualified deferred compensation plan, provided that

- a. the plan is offered to all employees in comparable employment positions;
- b. the immediate family member does not serve in a position of governance (for example, board of trustees) for the plan; and
- c. the immediate family member does not 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.

An immediate family member of a covered member may hold a direct or material indirect financial interest in an attest client through participation in a plan,^{fn 5} provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement;
2. such investment is an unavoidable consequence^{fn 6} of such participation; and
3. in the event that a plan option to invest in a nonattest client becomes available, the immediate family member selects such option and disposes of any direct or material indirect financial interests in the attest client as soon as practicable but no later than 30 days after such option becomes available.^{fn 7}

^{fn 5} Excluding share-based compensation arrangements and nonqualified deferred compensation plans. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

^{fn 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. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

^{fn 7} When 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 does 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 this exception. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

Share-Based Compensation Arrangements

Share-Based Compensation Arrangements Resulting in Beneficial Financial Interests^{fn 8} in Attest Clients

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement, such as an employee stock ownership plan (ESOP), that results in his or her holding a beneficial financial interest in an attest client, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement.
2. the immediate family member does not serve as a trustee for the share-based compensation arrangement and does not have the ability to supervise or participate in the selection of the investment options, if any, that are available to participants.
3. when the beneficial financial interests are distributed or the immediate family member has the right to dispose of the shares, the immediate family member
 - a. 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
 - b. exercises his or her put option to require the employer to repurchase the beneficial financial interests as soon as permitted by the terms of the share-based compensation arrangement.^{fn 9} Any repurchase obligation due to the immediate family member arising from exercise of the put option that is outstanding for more than 30 days would need to be immaterial to the covered member during the payout period.
4. benefits payable from the share-based compensation arrangement to the immediate family member upon termination of employment, whether through retirement, death, disability, or voluntary or involuntary termination, are funded by investment options other than the employer's financial interests, and any unfunded benefits payable are immaterial to the covered member at all times during the payout period.

Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement resulting in a right to acquire shares in an attest client, such as an employee stock option plan^{fn 10} or restricted stock rights plan, provided that

^{fn 8} See Interpretation No. 101-15, "Financial Relationships" [par. .17], for an explanation of when a financial interest is beneficially owned. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

^{fn 9} See footnote 7. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

^{fn 10} See Interpretation No. 101-15 [par. .17] for guidance on stock option plans. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement and
2. the immediate family member exercises or forfeits these rights once he or she is vested and the closing market price of the underlying stock equals or exceeds the exercise price for 10 consecutive days (market period). The exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period. In addition, if the immediate family member exercises his or her right to acquire the shares, he or she should dispose of the shares as soon as practicable but no later than 30 days after the exercise date.^{fn 11} If the employer repurchases the shares, any employer repurchase obligation due to the immediate family member that is outstanding for more than 30 days would need to be immaterial to the covered member during the payout period.

Share-Based Compensation Arrangements Based Upon Stock Appreciation

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement based on the appreciation of an attest client's underlying shares, provided that

1. the share-based compensation arrangement (for example, a stock appreciation or phantom stock plan) does not provide for the issuance of rights to acquire the employer's financial interests.
2. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement.
3. the immediate family member exercises or forfeits his or her vested compensation rights if the underlying price of the employer's shares equals or exceeds the exercise price for 10 consecutive days (market period). Exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period.
4. any resulting compensation payable to the immediate family member that is outstanding for more than 30 days is immaterial to the covered member during the payout period.

Nonqualified Deferred Compensation Plan

As a result of his or her permitted employment at an attest client, an immediate family member of a covered member may participate in a nonqualified deferred compensation plan, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement;
2. the amount of the deferred compensation payable to the immediate family member is funded through life insurance, an annuity, a trust, or similar vehicle and any unfunded portion is immaterial to the covered member; and
3. any funding of the deferred compensation does not include financial interests in the attest client.

^{fn 11} See footnote 7. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

Effective Date

The revisions to the “Application of the Independence Rules to a Covered Member’s Immediate Family” section of Interpretation No. 101-1 [par. .02] will be effective on June 1, 2011. Early application is permitted.

Application of the Independence Rules to Close Relatives

Independence would be considered to be impaired if

1. an individual participating on the attest engagement team has a **close relative** who had
 - a. a key position with the client or
 - b. a financial interest in the client that
 - (i) the individual knows or has reason to believe was material to the close relative or
 - (ii) enabled the close relative to exercise **significant influence** over the client.
2. an individual in a position to influence the attest engagement or any partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest engagement has a close relative who had
 - a. a key position with the client or
 - b. a financial interest in the client that
 - (i) the individual, partner, or partner equivalent knows or has reason to believe was material to the close relative and
 - (ii) enabled the close relative to exercise significant influence over the client.

Grandfathered Employment Relationships

Employment relationships of a covered member’s immediate family and close relatives with an existing attest client that impair independence under this interpretation and existed as of November 2001, will not be deemed to impair independence provided such relationships were permitted under preexisting requirements of Rule 101 [sec. 101 par. .01], and its interpretations and rulings.

Employment relationships of a partner equivalent’s immediate family and close relatives with an existing attest client that impair independence under this interpretation and existed as of May 31, 2013, will not be deemed to impair independence provided such employment relationships were permitted under preexisting requirements of Rule 101 [sec. 101 par. .01], and its interpretations and rulings.

Other Considerations^{fn §}

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. In the absence of an independence interpretation or ruling under Rule 101, *Independence* [sec. 101 par. .01] that addresses a particular circumstance, a member should evaluate whether that circumstance would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member's and the firm's independence. When making that evaluation, members should refer to the risk-based approach described in the *Conceptual Framework for AICPA Independence Standards* [see section 100-1]. If the threats to independence are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented.^{fn 12}

[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. Revised, effective February 28, 1998, by the Professional Ethics Executive Committee. Revised, November 2001, effective May 31, 2002, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective July 31, 2002, by the Professional Ethics Executive Committee. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee. Revised, April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, August 2009, effective October 31, 2009, by the Professional Ethics Executive Committee. Revised, March 2010, effective June 1, 2011, by the Professional Ethics Executive Committee. Revised March 2013, revisions effective for engagements covering periods beginning on or after December 15, 2014.]

[.03] [101-1][Formerly paragraph .02 renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly Interpretation No. 101-1, renumbered as 101-4 and moved to paragraph .06, April 1992.]

.04 101-2—Employment or association with attest clients. A firm's independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all the following conditions are met:

^{fn §} In April 2006, the Professional Ethics Executive Committee (PEEC) of the AICPA issued the *Conceptual Framework for AICPA Independence Standards (Conceptual Framework)* [section 100-1], which describes the risk-based approach to analyzing independence matters that is used by PEEC when it develops independence standards. Consequently, this interpretation has been revised in the "Other Considerations" section to reflect the issuance of the *Conceptual Framework*. Because the *Conceptual Framework* [section 100-1] is effective April 30, 2007, with earlier application encouraged, the revisions made in the "Other Considerations" section of this interpretation are also effective April 30, 2007, with earlier application encouraged.

^{fn 12} A failure to prepare the required documentation would be considered a violation of Rule 202, *Compliance With Standards* [sec. 202 par. .01], of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may also be adjusted for inflation and interest may be paid on amounts due.
2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.
3. The former partner or professional employee does not participate or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:
 - The individual provides consultation to the firm.
 - The firm provides the individual with an office and related amenities (for example, secretarial and telephone services).
 - The individual's name is included in the firm's office directory.
 - The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.
4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.
5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.
6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

Responsible members within the firm should implement procedures for compliance with the preceding conditions when firm professionals are employed or associated with attest clients.

With respect to conditions 4, 5, and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the

positions he or she held at the firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure.^{fn 13}

Considering Employment or Association With the Client

When a member of the attest engagement team or an individual in a position to influence the attest engagement intends to seek or discuss potential employment or association with an attest client, or is in receipt of a specific offer of employment from an attest client, independence will be impaired with respect to the client unless the person promptly reports such consideration or offer to an appropriate person in the firm, and removes himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought. When a covered member becomes aware that a member of the attest engagement team or an individual in a position to influence the attest engagement is considering employment or association with a client, the covered member should notify an appropriate person in the firm.

The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under Rule 102 [sec. 102 par. .01]. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and the individual involved.

[Replaces previous Interpretation No. 101-2, *Retired Partners and Firm Independence*, August, 1989, effective August 31, 1989. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

.05 101-3—Nonattest Services. Before a member or his or her firm (member) performs nonattest services (for example, tax or consulting services) for an attest client,^{fn 14} the member should determine that the requirements described in this interpretation have been met. In cases where the requirements of this interpretation 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, except as noted in the following paragraph.

A member's independence would not be impaired if the member performed nonattest services that would have impaired independence during the period covered by the financial statements, provided that all the following conditions exist:

- a. The nonattest services were provided prior to the period of the professional engagement.

^{fn 13} An inadvertent and isolated failure to meet conditions 4, 5, and 6 would not impair independence provided that the required procedures are performed promptly upon discovery of the failure to do so, and all other provisions of the interpretation are met. [Footnote added, effective April 30, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 14} 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. 19, *Compilation and Review Engagements* [paragraph .21 of AR section 80]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010. Footnote revised March 2013.]

- b. The nonattest services related to periods prior to the period covered by the financial statements.
- c. The financial statements for the period to which the nonattest services relate were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm).

Cumulative Effect on Independence When Providing Nonattest Services

This interpretation includes various examples of nonattest services that individually would not impair independence because the safeguards contained in the general requirements of this interpretation reduce the self-review and management participation threats to an acceptable level. However, performing multiple nonattest services can increase the significance of these threats as well as other threats to independence.

Before agreeing to perform nonattest services, the member should evaluate whether the performance of multiple nonattest services in the aggregate creates a significant threat to the member's independence that cannot be reduced to an acceptable level by the application of the safeguards contained in the general requirements of this interpretation.

In situations where a member determines that threats are not at an acceptable level, safeguards in addition to the general requirements of this interpretation should be applied to eliminate the threats or reduce them to an acceptable level. If no safeguards are available to eliminate or reduce the threats to an acceptable level, independence would be impaired.

For purposes of this interpretation, the member is not required to consider the possible threats created due to the provision of nonattest services by other network firms within the member's firm's network.

[This section, "Cumulative Effect on Independence When Providing Nonattest Services," is effective for engagements covering periods beginning on or after December 15, 2014.]

Activities Related to Attest Services

Performing attest services often involves communication between the member and client management regarding (a) the client's selection and application of accounting standards or policies and financial statement disclosure requirements, (b) the appropriateness of the client's methods used in determining the accounting and financial reporting, (c) adjusting journal entries that the member has prepared or proposed for client management consideration, and (d) the form or content of the financial statements. These communications are considered a normal part of the attest engagement and would not constitute performing a nonattest service subject to this interpretation.

However, the member should exercise judgment in determining whether his or her involvement has become so extensive that it would constitute performing a separate service that would be subject to the interpretation's "General Requirements for Performing Nonattest Services" section. For example, activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the attest engagement and, therefore, constitute a nonattest service. Such activities would not impair independence provided the requirements of this interpretation are met.

[The revisions to the "Activities Related to Attest Services" section that require activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations to be subject to this interpretation are effective for engagements covering periods beginning on or after December 15, 2014.]

Engagements Subject to Independence Rules of Certain Regulatory Bodies

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the SEC, the GAO, the DOL, the Public Company Accounting Oversight Board [PCAOB], and state boards of accountancy) when 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 assume management responsibilities for the attest client.
2. Before performing nonattest services, the member should determine that the client has agreed to
 - a. Assume all management responsibilities
 - b. Oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience. The member should assess and 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 reperform the services.
 - c. Evaluate the adequacy and results of the services performed.
 - d. Accept responsibility for the results of the services.

To avoid assuming management responsibilities when providing nonattest services to the client, the member should be satisfied that management will be able to meet all these criteria, make an informed judgment on the results of the member's nonattest services, and be responsible for making the significant judgments and decisions that are the proper responsibility of management. In cases in which the client is unable or unwilling to assume these responsibilities (for example, the client cannot oversee the nonattest services provided, or is unwilling to carry out such responsibilities 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^{fn 15} 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

^{fn 15} A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202 [sec. 202 par. .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 No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

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

The documentation requirement does not apply to nonattest services performed prior to the client becoming an attest client.^{fn 16}

The preceding general requirements 2–3 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 client-member relationship.

Management Responsibilities

If a member were to assume a management responsibility for an attest client, the management participation threat created would be so significant that no safeguards could reduce the threat to an acceptable level. It is not possible to specify every activity that is a management responsibility. However, management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered a management responsibility and would, therefore, impair independence if performed for an attest client include

- setting policies or strategic direction for the client.
- directing or accepting responsibility for the actions of the client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards.
- authorizing, executing or consummating transactions or otherwise exercising authority on behalf of a client or having the authority to do so.
- preparing source documents^{fn 17} in electronic or other form evidencing the occurrence of a transaction.

^{fn 16} 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 No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 17} 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 No. 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 No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- having custody of client assets.
- deciding which recommendations of the member or other third parties to implement or prioritize.
- reporting to those in charge of governance on behalf of management.
- serving as a client’s stock transfer or escrow agent, registrar, general counsel, or its equivalent.
- accepting responsibility for the management of a client’s project.
- accepting responsibility for the preparation and fair presentation of the client’s financial statements in accordance with the applicable financial reporting framework.
- accepting responsibility for designing, implementing, or maintaining internal control.^[fn 18]
- performing ongoing evaluations of the client’s internal control as part of its monitoring activities.

Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member’s independence. These examples presume that the general requirements in the previous section "General Requirements for Performing Nonattest Services" have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

Impact on Independence of Performance of Nonattest Services

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Bookkeeping	<ul style="list-style-type: none"> • Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client’s general ledger. • Prepare financial statements based on information in the trial balance. • Post client-approved entries to a client’s trial balance. • Prepare a reconciliation (for example, bank, accounts re- 	<ul style="list-style-type: none"> • Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval. • Authorize or approve transactions. • Prepare source documents. • Make changes to source documents without client approval.

^[fn 18] [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010. Footnote deleted, effective August 31, 2012, by the Professional Ethics Executive Committee.]

ceivable, and so forth) that identifies reconciling items for the client's evaluation.

- Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.

Nontax disbursement

- Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.
- Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.^[fn 19]
- Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.
- Accept responsibility to sign or cosign client checks, even if only in emergency situations.
- Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client.
- Approve vendor invoices for payment

Benefit plan administration fn 20

- Communicate summary plan
- Make policy decisions on be-

^[fn 19] [Footnote renumbered by the revision of Interpretation No. 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 No. 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. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 20} When auditing plans subject to the Employee Retirement Income Security Act, Department of Labor regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of Interpretation No. 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 No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

data to plan trustee.

- Advise client management regarding the application or impact of provisions of the plan document.
- Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member's electronic medium, such as an interactive voice response system or Internet connection or other media.
- Prepare account valuations for plan participants using data collected through the member's electronic or other media.
- Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other medium.

Investment—advisory or management

- Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, etc.
- Perform recordkeeping and reporting of client's portfolio balances including providing a comparative analysis of the client's investments to third-party benchmarks.
- Review the manner in which a client's portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client's investment policy statement; (2) meeting the client's investment objectives; and (3) conforming to the cli-

half of client management.

- When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence.
- Make disbursements on behalf of the plan.
- Have custody of assets of a plan.
- Serve a plan as a fiduciary as defined by ERISA.
- Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments.
- Execute a transaction to buy or sell a client's investment.
- Have custody of client assets, such as taking temporary possession of securities purchased by a client.

ent's stated investment styles.

- Transmit a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.

Corporate finance—
consulting or advisory

- Assist in developing corporate strategies.
- Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria.
- Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.
- Assist in drafting an offering document or memorandum.
- Participate in transaction negotiations in an advisory capacity.
- Be named as a financial adviser in a client's private placement memoranda or offering documents.
- Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.
- Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.
- Maintain custody of client securities.

Executive or employee
search

- Recommend a position description or candidate specifications.
- Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).
- Participate in employee hiring or compensation discussions in an advisory capacity.
- Commit the client to employee compensation or benefit arrangements.
- Hire or terminate client employees.

Business risk consulting

- Provide assistance in assessing the client's business risks and
- Make or approve business risk decisions.

control processes.

- Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.

- Present business risk considerations to the board or others on behalf of management.

Information systems—
design, installation or integration

- Install or integrate a client's financial information system that was not designed or developed by the member (for example, an off-the-shelf accounting package).
- Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system.
- Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records.
- Provide training and instruction to client employees on an information and control system.
- Perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings, consistent with management's request.

- Design or develop a client's financial information system.
- Make other than insignificant modifications to source code underlying a client's existing financial information system.
- Supervise client personnel in the daily operation of a client's information system.
- Operate a client's local area network system.

Tax Compliance Services

Tax compliance services addressed by this interpretation are preparation of a tax return,^{fn 21} transmittal of a tax return and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, and authorized representation of clients in administrative proceedings before a taxing authority.

^{fn 21} 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 renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

Preparing a tax return and transmitting the tax return and related tax payment to a taxing authority, in paper or electronic form, would not impair a member's independence provided the member does not have custody or control^{fn 22} over the client's funds and the individual designated by the client to oversee the tax services:

- Reviews and approves the tax return and related tax payment; and,
- If required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

However, signing and filing a tax return on behalf of client management would impair independence, unless the member has the legal authority to do so and:

- a. The taxing authority has prescribed procedures in place for a client to permit a member to sign and file a tax return on behalf of the client (for example, Form 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in I.R.S. Form 8879; or
- b. An individual in client management who is authorized to sign and file the client's tax return provides the member with a signed statement that clearly identifies the return being filed and represents that:
 1. Such individual is authorized to sign and file the tax return;
 2. Such individual has reviewed the tax return, including accompanying schedules and statements, and it is true, correct and complete to the best of his or her knowledge and belief; and
 3. Such individual authorizes the member or another named individual in the member's firm to sign and file the tax return on behalf of the client.

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 23} to resolve a tax dispute would impair a member's independence.

Transition

Independence would not be impaired as a result of the more restrictive requirements of the tax compliance services provisions provided such services are pursuant to engagements commenced prior to Feb-

^{fn 22} 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 renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 23} 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. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

ruary 28, 2007, and completed prior to January 1, 2008, and the member complied with all applicable independence interpretations and rulings in effect on February 28, 2007.

Appraisal, Valuation, and Actuarial Services

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.

Valuations performed in connection with, for example, ESOPs, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence.^{fn 24} However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

Forensic Accounting Services

For purposes of this interpretation, forensic accounting services^{fn 25} are nonattest services that involve the application of special skills in accounting, auditing, finance, quantitative methods and certain areas of the law, and research, and investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings and consist of:

- Litigation services; and
- Investigative services.

Litigation services recognize the role of the member as an expert or consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of the following services:

^{fn 24} 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 No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 25} 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 renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- a. Expert witness services^{fn 26} 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.^{fn 27} Accordingly, if a member conditionally or unconditionally agrees to provide expert witness testimony for a client,^{fn 28} independence would be considered to be impaired.

However, independence would not be considered impaired if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more attest clients of the firm provided that at the outset of the engagement: (1) the member's attest clients constitute less than 20 percent of (i) the members of the group (ii) the voting interests of the group, and (iii) the claim; (2) no attest client within the group is designated as the "lead" plaintiff or defendant of the group; and (3) no attest client has the sole decision-making power to select or approve the expert witness.

While testifying as a fact witness,^{fn 29} a member may be questioned by the trier of fact or counsel as to his or her opinions pertaining to matters within the member's area of expertise. Answering such questions would not impair the member's independence.

- b. Litigation consulting services are those litigation services where a member provides advice about the facts, issues, and strategy of a matter. The consultant does not testify as an expert witness before a trier of fact.

The performance of litigation consulting services would not impair independence provided the

^{fn 26} 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 renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 27} See advocacy threat as defined in the *Conceptual Framework for AICPA Independence Standards* (section 100-1). 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 renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 28} The 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 No. 101-12, "Independence and Cooperative Arrangements with Clients" [par. .14]. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 29} 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 renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

member complies with the general requirements set forth under this interpretation.^{fn 30} However, if the member subsequently agrees to serve as an expert witness, independence would be considered to be impaired.

- c. Other services are those litigation services where a member serves as a trier of fact, special master, court-appointed expert, or arbitrator (including serving on an arbitration panel), in a matter involving a client. These other services create the appearance that the member is not independent. Accordingly, if a member serves in such a role, independence would be considered to be impaired. However, independence would not be considered impaired if a member serves as a mediator or any similar role in a matter involving a client provided the member is not making any decisions on behalf of the parties, but rather is acting as a facilitator by assisting the parties in reaching their own agreement.^{fn 31}

Investigative services include all forensic services not involving actual or threatened litigation such as performing analyses or investigations that may require the same skills as used in litigation services. Such services would not impair independence provided the member complies with the general requirements set forth under this interpretation.

Transition

Independence would not be impaired as a result of the more restrictive requirements of the forensic accounting services provisions, provided such services are pursuant to engagements commenced prior to February 28, 2007, and the member complied with all applicable independence interpretations and rulings in existence on February 28, 2007.

Internal Audit Assistance Services

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as *internal audit outsourcing*. In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational^{fn 32} internal audit activities would impair independence, unless the member takes appropriate steps to be satisfied that the client accepts its respon-

^{fn 30} 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 renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 31} However, the member should consider the requirements of Interpretation No. 102-2, "Conflicts of Interests" [sec. 102 par. .03]. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 32} 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 No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

sibility for^[fn 33] designing, implementing, and maintaining internal control 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.

Designing, implementing, or maintaining the client's monitoring activities are management responsibilities. Accordingly, independence would be impaired if a member accepts responsibility for performing such activities. *Monitoring activities* are procedures performed to assess whether components of internal control are present and functioning. Monitoring can be done through ongoing evaluations, or separate evaluations, or some combination of the two. Ongoing evaluations are generally defined, routine operations built in to the client's business processes and performed on a real-time basis. Ongoing evaluations, including managerial activities and everyday supervision of employees, monitor the presence and functioning of the components of internal control in the ordinary course of managing the business. A member who performs such activities for a client would be considered to be accepting responsibility for maintaining the client's internal control. Accordingly, the management participation threat created by a member performing ongoing evaluations is so significant that no safeguards could reduce the threat to an acceptable level.

Separate evaluations are conducted periodically and generally not ingrained within the business but can be useful in taking a fresh look at whether internal controls are present and functioning. Such evaluations include observations, inquiries, reviews, and other examinations, as appropriate, to ascertain whether controls are designed, implemented, and conducted. The scope and frequency of separate evaluations is a matter of judgment and vary depending on assessment of risks, effectiveness of ongoing evaluations, and other considerations. Because separate evaluations are not built into the client's business process, separate evaluations generally do not create a significant management participation threat to independence.

Members should refer to the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework*, for additional guidance on monitoring activities and distinguishing between ongoing and separate evaluations.

Members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation threat to independence, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall financial statements of the client, as well as the frequency of the internal audit services. If the threat to independence is considered significant, the member should apply safeguards to eliminate or reduce the threat to an acceptable level. If no safeguards could reduce the threat to an acceptable level, then independence would be impaired.

To reduce the threat of assuming a management responsibility, in addition to the general requirements of this interpretation, the member should be satisfied that client management

^[fn 33][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 No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote deleted and subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- designates an ^[fn 34] individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function.
- determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services.
- evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services.
- evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures.

The member may assist the individual responsible for the internal audit function when performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. The member should also be satisfied that those charged with governance are informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide those charged with governance a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The following are examples of activities (in addition to those listed in the "Management Responsibilities" section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Performing separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the client's business process
- Having client management rely on the member's work as the primary basis for the client's assertions on the design or operating effectiveness of internal controls
- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function

^[fn 34][Footnote deleted by the Professional Ethics Executive Committee, January 2005. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.

Attest-Related Services

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

When a member performs internal audit services that would not impair independence under this interpretation and is subsequently engaged to perform an attestation engagement to report on management's assertion regarding the effectiveness of its internal control, independence would not be considered impaired, provided the member is satisfied that client management does not rely on the member's work as the primary basis for its assertion.

[The revisions to the "Internal Audit Services" section made in March 2013 are effective for engagements covering periods beginning on or after December 15, 2013. Early implementation is allowed.]

Transition

Independence would not be impaired as a result of the more restrictive requirements of this interpretation provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.

[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. Revised, effective May 31, 1999, by the Professional Ethics Executive Committee. Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective December 31, 2003 (except for the documentation requirement, which takes effect for any new engagements that begin after December 31, 2004), with earlier application permitted, by the Professional Ethics Executive Committee. Revised, effective October 31, 2004, by the Professional Ethics Executive Committee. Revised, effective January 27, 2005, by the Professional Ethics Executive Committee. Revised, effective February 28, 2007, by the Professional Ethics Executive Committee. Revised, effective July 31, 2007, by the Professional Ethics Executive Committee. Revised, effective August 31, 2012, by the Professional Ethics Executive Committee. Revised March 2013, revisions effective May 31, 2013 (except for the revisions

made to the “Activities Related to Attest Services” and “Internal Audit Services” sections, which are effective as described in the respective sections).]

.06 101-4—Honorary directorships and trusteeships of not-for-profit organization. Partners or professional employees of a firm (individual) 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. An individual who permits his or her name to be used in this manner would not be considered to impair independence under Rule 101 [sec. 101 par. .01] provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or she 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 No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Renumbered as Interpretation No. 101-4 and moved from paragraph .03, April, 1992. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

.07 101-5—Loans from financial institution clients and related terminology. Item (A)(4) of Interpretation No. 101-1 of Rule 101 [sec. 101 par. .02] provides that, except as permitted in this interpretation, independence shall be considered to be impaired if a **covered member**^{fn †} has any **loan** to or from a **client**, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests. This interpretation describes the conditions a covered member (or his or her **immediate family**) must meet in order to apply an exception for a "Grandfathered Loan" or "Other Permitted Loan."

Grandfathered Loans

Unsecured loans that are not material to the covered member's net worth, home mortgages,^{fn 35} and other secured loans^{fn 35} are grandfathered if

1. they were obtained from a **financial institution** under that institution's **normal lending procedures, terms, and requirements**,
2. after becoming a covered member they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement,^{fn 36} and

^{fn †} Terms shown in **boldface** type upon first usage in this interpretation are defined in section 92.

^{fn 35} 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 No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 36} 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 No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subse-

3. they were

- a. obtained from the financial institution prior to its becoming a client requiring independence; or
- b. obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or
- c. obtained prior to February 5, 2001, and met the requirements of previous provisions of this interpretation covering grandfathered loans; or
- d. obtained between February 5, 2001, and May 31, 2002, and the covered member was in compliance with the applicable independence requirements of the SEC during that period; or
- (e.) obtained after May 31, 2002, from a financial institution client requiring independence by a borrower prior to his or her becoming a covered member with respect to that client.

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.

For purposes of applying the grandfathered loans provision when the covered member is a partner in a partnership

- a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered member who is a partner in the partnership on the basis of their legal liability as a limited or general partner if
 - the covered member's interest in the limited partnership, either individually or combined with the interest of 1 or more covered members, exceeds 50 percent of the total limited partnership interest; or
 - the covered member, either individually or together with one or more covered members, can control (as defined in Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 810, *Consolidation*) the general partnership.
- even if no amount of a partnership loan is ascribed to the covered member(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described subsequently.

Other Permitted Loans

This interpretation permits only the following new loans and leases to be obtained from a financial institution client for which independence is required. These loans and leases must be obtained under the in-

quently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

stitution's normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms.

1. Automobile loans and leases collateralized by the automobile
2. Loans fully collateralized by the cash surrender value of an insurance policy
3. Loans fully collateralized by cash deposits at the same financial institution (for example, "pass-book loans")
4. Aggregate outstanding balances from credit cards and overdraft reserve accounts that are reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the SEC.

[Revised, November 30, 1987, by the Professional Ethics Executive Committee. Formerly paragraph .06, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References revised to reflect issuance of AICPA 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. Revised, effective February 28, 1998 by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, November 2002, by the Professional Ethics Executive Committee. Revised, September 2003, by the Professional Ethics Executive Committee. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

- .08 101-6—The effect of actual or threatened litigation on independence.** In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

Litigation between client and member

The relationship between the management of the client and a covered member must be characterized by complete candor and full disclosure regarding all aspects of the client's business operations. In addition, there must be an absence of bias on the part of the covered member so that he or she can exercise professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against a covered member, the covered member and the client's management may be placed in adversarial positions in which the management's willingness to make complete disclosures and the covered member's objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the covered member and the covered member's client or its management are in threatened or actual positions of material adverse interests by reason of threatened or actual litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.
3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

Other third-party litigation

Another type of third-party litigation against the covered 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 covered 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 covered member in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered member and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered member alleges, in his or her 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 covered member ("the plaintiff client"), 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 covered member's firm^{fn 39} or to the plaintiff client.

Effects of impairment of independence

If the covered 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 independence, the covered 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 attest engagement then in progress pending resolution of the issue between the parties.

Termination of impairment

The conditions giving rise to a lack of independence are generally eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between the covered member and cli-

tion No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently revised and renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 39} See footnote 37. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently revised and renumbered by the revision of Interpretation No. 101-1, March 2010.]

ent. The covered member should carefully review the conditions of such resolution to determine that all impairments to the covered member's objectivity have been removed.

[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. Revised, effective September 30, 1995, by the Professional Ethics Executive Committee, by deletion of subhead and paragraph and reissuance as ethics ruling No. 100, *Actions Permitted When Independence is Impaired*, under Rule 101. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[.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 Covered 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 [sec. 191 par. .138–.139 and par. .162–.163].

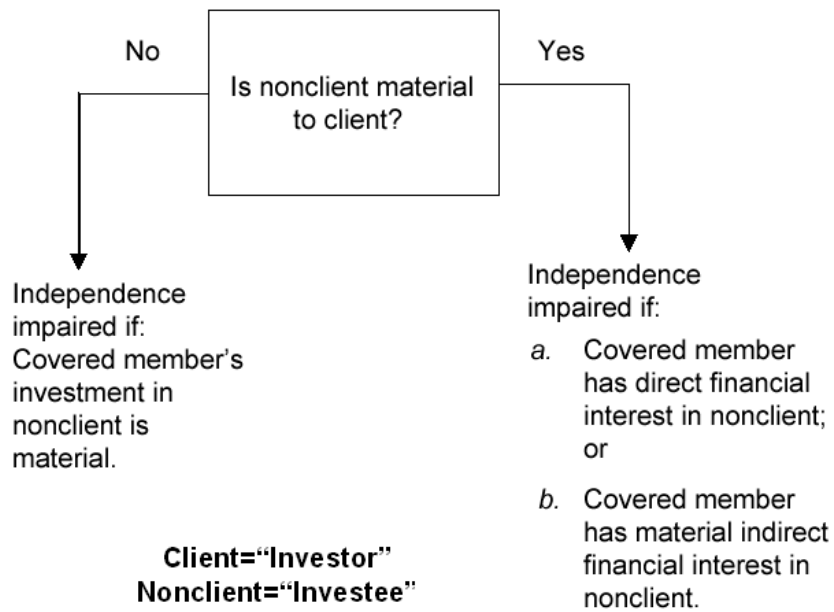
Terminology

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

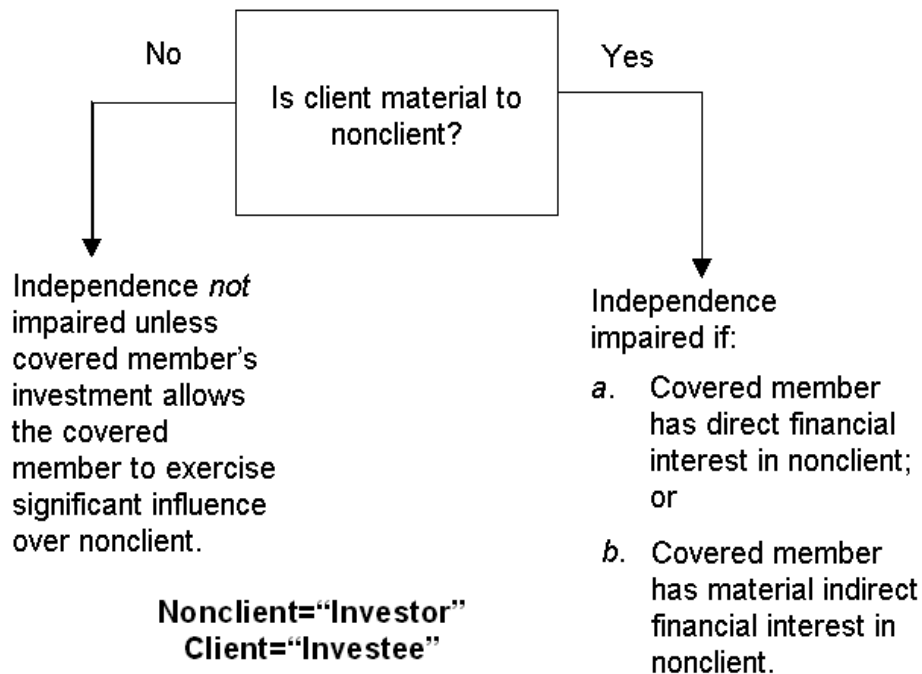
1. *Client*. The term *client* means the person or entity with whose financial statements a covered member is associated.
2. *Significant influence*. The term *significant influence* is as defined in FASB ASC 323-10-15.
3. *Investor*. The term *investor* means (a) a parent, (b) general partner, or (c) 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

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



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



Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered 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 independence.

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

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

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

[.11] [101-9]—[Deleted]

.12 101-10—The effect on independence of relationships with entities included in the governmental financial statements. 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 No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.] For purposes of this interpretation, a financial reporting entity's basic financial statements, issued in conformity with generally accepted accounting principles, include the government-wide financial statements (consisting of the entity's governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures, jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

Auditor of Financial Reporting Entity

A covered member issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity, as defined in paragraph 1 of this interpretation.

However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a member to be independent of that organization.

However, the covered member and his or her immediate family should not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

Auditor of a Major Fund, Nonmajor Fund, Internal Service Fund, Fiduciary Fund, or Component Unit of the Financial Reporting Entity or Other Entity That Should Be Disclosed in the Notes to the Basic Financial Statements

A covered member who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, should be independent with respect to those financial statements that the covered member is reporting upon. The covered member is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered member and his or her immediate family should not hold a key position within the primary government. For purposes of this interpretation, a covered member and immediate family member would not be considered employed by the primary government if the exceptions provided for in paragraph .03 of section 92 are met.^[fns 41-42]

[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 No. 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. Replaces previous Interpretation No. 101-10, "The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements," January 1996, effective January 31, 1996. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]

- .13 101-11—Modified application of Rule 101 for engagements performed in accordance with Statements on Standards for Attestation Engagements.** Rule 101, *Independence* [sec. 101 par. .01], and its interpretations and rulings apply to all attest engagements. However, the following exceptions apply when performing engagements to issue reports in accordance with Statements on Standards for Attestation

^[fns 41-42] [Footnotes deleted by the Professional Ethics Executive Committee, March 2003. Footnotes renumbered by the revision of Interpretation No. 101-2, April 2003. Footnotes subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnotes subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnotes subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnotes subsequently renumbered by the revision of Interpretation No. 101-3, February and July 2007. Footnotes subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

tion Engagements (SSAEs) when independence is required, or the member's compilation report does not disclose a lack of independence:

- Covered members need to be independent with respect to the responsible party(ies).^{fn 43} See the following section for specific guidance for agreed-upon procedures (AUP) engagements performed under SSAEs.
- In circumstances in which the individual or entity that engages the member is not the responsible party, covered members need not be independent of that individual or entity. However, consideration should be given to the requirements of Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* [sec. 102 par. .03], with regard to any relationships that may exist with the individual or entity that engages the member to perform these services.
- Nonattest services that would otherwise impair independence under Interpretation No. 101-3 [sec. 101 par. .05] may be provided to the responsible party(ies) when such services do not relate to the specific subject matter^{fn 44} of the SSAE engagement, provided that the general requirements of Interpretation No. 101-3 [sec. 101 par. .05] are met.

AUP Engagements

When performing an AUP engagement under the SSAEs, only the following covered members and their immediate families are required to be independent with respect to the responsible party(ies), in accordance with Rule 101 [sec. 101 par. .01]:

- Individuals participating on the AUP engagement team
- Individuals who directly supervise or manage the AUP engagement partner or partner equivalent
- Individuals who consult with the attest engagement team regarding technical or industry-related issues specific to the AUP engagement

In addition, independence would be impaired if the firm had a financial relationship covered by item (A) of Interpretation No. 101-1 [sec. 101 par. .02] with the responsible party(ies) that was material to the firm.

Independence will not be impaired if the general requirements of Interpretation No. 101-3 [sec. 101 par. .05] are not met when the member is also providing nonattest services, unless such services relate to the specific subject matter of the AUP engagement.

^{fn 43} For purposes of this interpretation, the term *responsible party* is as defined in the Statement on Standards for Attestation Engagements (SSAEs). [Footnote revised September 2011, effective November 30, 2011. Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote subsequently renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 44} For purposes of this interpretation, the term *subject matter* is as defined in the SSAEs. [Footnote revised and renumbered September 2011, effective November 2011.]

[Revised, February 2012, effective April 30, 2012. Revised September 2011, effective November 30, 2011. Replaces previous Interpretation No. 101-11, "Independence and Attest Engagements," January 1996, effective January 31, 1996. Revised, effective November 30, 2001, by the Professional Ethics Executive Committee. Revised March 2013, revision effective for engagements covering periods beginning on or after December 15, 2014.]

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

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.

In addition, the member's firm should consider the requirements of Rule 302 [sec. 302 par. .01] and Rule 503 [sec. 503 par. .01].

[Effective November 30, 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

- [.15] [101-13]—[Deleted]**

.16 101-14—The effect of alternative practice structures on the applicability of independence rules. determine whether additional independence requirements are necessary to ensure the protection of the public interest.

Because

In many "nontraditional structures," a substantial (the nonattest) portion of a member's practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled (as defined in FASB ASC 810) by the member. All such structures must comply with applicable laws, regulations, and Rule 505, *Form of Organization and Name* [sec. 505 par. .01]. In complying with laws, regulations, and Rule 505 [sec. 505 par. .01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [sec. 505 par. .01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the "traditional firm" engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and subsequent chart provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

The example APS in this interpretation is one where an existing CPA practice ("Oldfirm") is sold by its owners to another (possibly public) entity ("PublicCo"). PublicCo has subsidiaries or divisions such as a bank, insurance company, or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (for example, tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm ("Newfirm") to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space, and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

APS Independence Rules for Covered Members

The term **covered member** in an APS includes both employed and leased individuals. The **firm** in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety. For example, no cov-

^{fn ‡} Terms shown in **boldface** type upon first usage in this interpretation are defined in section 92. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

ered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

Partners of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

APS Independence Rules for Persons and Entities Other Than Covered Members

As stated previously, the independence rules normally extend only to those persons and entities included in the definition of *covered member*. This normally would include only the "traditional firm" (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled (as defined by FASB ASC 810) by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PEEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

1. *Direct Superiors.* Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can *directly control* the activities of such partner or manager. For this purpose, a person who can *directly control* is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the Direct Superior can exercise significant influence^{fn 45}) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. *Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence^{fn 46} are subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety.*

^{fn 45} 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 CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 323-10-15 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 subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 46} 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 CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influ-

2. *Indirect Superiors and Other PublicCo Entities.* Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the **immediate family** of the Indirect Superior.

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

- a. Indirect Superiors and Other PublicCo Entities may not have a relationship contemplated by item (A) of Interpretation No. 101-1 [sec. 101 par. .02] (for example, investments, loans, and so on) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity's financial statements.

ence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

- b. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence^{fn 47} over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.
- c. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.
- d. Except as noted in (c), Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to Rule 101 [sec. 101 par. .01] and its interpretations and rulings in their entirety.

Other Matters

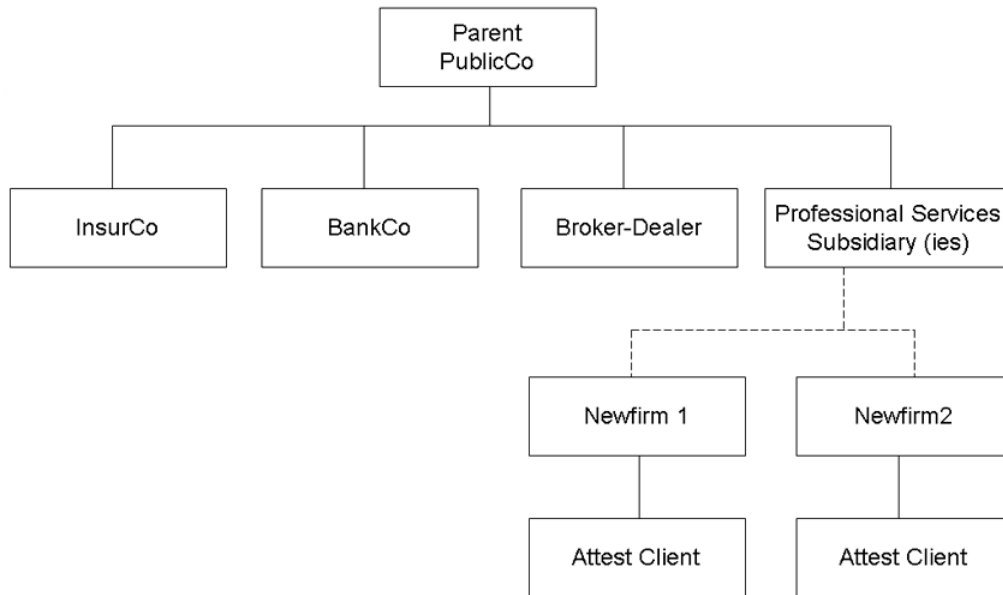
1. An example, using the following chart, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.
2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an **attest engagement** for PublicCo or any of its subsidiaries or divisions.
3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence^{fn 48} over PublicCo.

^{fn 47} 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 CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 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 subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

^{fn 48} 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 CEO, chief operating officer, CFO, or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 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 subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote added, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Footnote renumbered by the revision of Interpretation No. 101-2, April 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, September 2003. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, July 2004. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, April 2006.]

4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation No. 102-2 of Rule 102 [sec. 102 par. .03].

Alternative Practice Structure (APS) Model



[Effective February 28, 1999. Revised, November 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

.17 101-15—Financial relationships.

Financial Interests

Item (A)(1) of Interpretation No. 101-1 [sec. 101 par. .02] states that independence shall be considered to be impaired if, during the period of the professional engagement, a covered member had or was committed to acquire any direct or material indirect financial interest in the client. When reviewing this interpretation, the covered member should also refer to Interpretation No. 101-1 [sec. 101 par. .02] for the application of Rule 101 and its interpretations and rulings to the covered member's immediate family and close relatives.

This interpretation provides definitions of direct and indirect financial interests and further guidance on whether various types of financial interests should be considered to be direct or indirect financial interests and provides certain limited exceptions under which a covered member could hold a direct or mate-

Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of Interpretation No. 101-1, March 2010.]

rial indirect financial interest in an attest client without being considered to have impaired his or her independence.

Definitions

A **financial interest** is an ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

A **direct financial interest** is a financial interest:

1. Owned directly by an individual or entity (including those managed on a discretionary basis by others); or
2. Under the control^{fn 49} of an individual or entity (including those managed on a discretionary basis by others); or
3. Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary:
 - a. Controls the intermediary; or
 - b. Has the authority to supervise or participate in the intermediary's investment decisions.

An **indirect financial interest** is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions.

A financial interest is **beneficially owned** when an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

Unsolicited Financial Interests

Independence would not be considered to be impaired if an unsolicited financial interest in a client is received, such as through gift or inheritance, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the covered member has knowledge of and the right to dispose of the financial interest. In addition, when the covered member becomes aware that he or she will receive or has received a material direct or material indirect financial interest in a client requiring independence but does not have the right to dispose of the financial interest, independence would be considered to be impaired unless the covered member does not participate on the attest engagement team and disposes of the financial interest as soon as practicable but no later than 30 days after the right to dispose exists.

^{fn 49} 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 subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

Mutual Funds

The ownership of shares in a mutual fund is considered to be a direct financial interest in the mutual fund. The underlying investments of a mutual fund are considered to be indirect financial interests.

If the mutual fund is diversified,^{fn 50} a covered member's ownership of 5 percent or less of the outstanding shares of the mutual fund would not be considered to constitute a material indirect financial interest in the underlying investments.

If a covered member owns more than 5 percent of the outstanding shares of a diversified mutual fund, or if the mutual fund is not diversified, the covered member should evaluate the underlying investments of the mutual fund to determine whether the covered member holds a material indirect financial interest in any of the underlying investments.

For example, if a nondiversified mutual fund owns shares in attest client Company A, and

- The mutual fund's net assets are \$10,000,000;
- The covered member owns 1 percent of the outstanding shares of the mutual fund, having a value of \$100,000; and
- The mutual fund has 10 percent of its assets invested in Company A;

the indirect financial interest of the covered member in Company A is \$10,000 and this amount should be measured against the covered member's net worth (including the net worth of his or her immediate family) to determine if it is material.

Retirement, Savings, Compensation, or Similar Plans

- 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:^[fn 51] 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 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.

^{fn 50} 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 subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

^[fn 51] [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011. Footnote deleted and renumbered by the Professional Ethics Executive Committee, March 2010.]

- 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.
- 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.
- Rights to acquire equity interests, restricted stock awards, or other share-based compensation arrangements are considered direct financial interests, regardless of whether such financial interests are vested or exercisable.

The following examples illustrate these concepts:

1. 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 the selection of investment managers or pooled investment vehicles), the underlying investments would be considered to be direct financial interests of the covered member.
2. 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 underlying investments would be considered to be direct financial interests of the covered member.
3. 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 underlying investments would be considered to be indirect financial interests of the covered member.

Also refer to Ethics Ruling No. 107 [sec. 191 par. .214–.215] and the “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” sections of Interpretation No. 101-1 [par. .02].

Section 529 Plans ^{fn 52}

Section 529 plans are sponsored by states or higher education institutions, and may be prepaid tuition plans or savings plans. Both types of plans are established by an account owner for the benefit of a sin-

^{fn 52} 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 subsequently renumbered by revision of Interpretation No. 101–11, November 2011. Footnote renumbered by the revision of Interpretation No. 101-1, April 2006. Footnote subsequently renumbered by the revision of Interpretation No. 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of Interpretation No. 101-1, March 2010.]

gle beneficiary. The account owner may change the beneficiary at any time to another individual who is related to the previous beneficiary.

A covered member who is the account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan but not in the investments of the plan because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the investment performance of the plan or the cost of the education at the future date.

A covered member who is the account owner of a Section 529 savings plan is considered to have a direct financial interest in both the plan and the investments of the plan because he or she decides in which sponsor's Section 529 savings plan to invest and prior to making the investment has access to information about the plan's investments.

If a covered member invests in a Section 529 savings plan that does not hold financial interests in an attest client at the time of the investment, but the plan subsequently invests in an attest client, the covered member should (1) transfer the account to another sponsor's Section 529 savings plan or (2) transfer the account to another account owner who is not a covered member. However, when the transfer of the account will result in a penalty or tax that is significant to the account, the covered member may continue to own the account until the account can be transferred without significant penalty or tax, provided the covered member does not participate on the attest engagement team and is not in a position to influence the attest engagement.

A covered member who is a beneficiary of a Section 529 account is not considered to have a financial interest in the plan or the investments of the plan because he or she does not own the account or possess any of the underlying benefits of ownership and the beneficiary's only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

Before becoming engaged to perform an attest engagement for a government or governmental entity that sponsors a Section 529 plan, covered members that are account owners of a Section 529 plan should consider the guidance in Interpretation No. 101-10 [sec. 101 par. .12].

Trust Investments

When a covered member is a grantor of a trust, the trust and the underlying investments held by the trust are considered to be direct financial interests if the covered member retains the right to amend or revoke the trust, or otherwise has the authority to control the trust or to supervise or participate in the trust's investment decisions. However, where the covered member does not have the authority to amend or revoke the trust or to supervise or participate in the trust's investment decisions, he or she is not considered to have a financial interest in the trust or the underlying investments held by the trust.

When a covered member is a beneficiary of a trust, the trust is considered to be a direct financial interest of the covered member and the underlying investments held by the trust are considered to be indirect financial interests of the covered member. However, if the covered member controls the trust or supervises or participates in the investment decisions of the trust, the underlying investments held by the trust are considered to be direct financial interests of the covered member.

In a blind trust, the grantor is also the beneficiary, but does not supervise or participate in the trust's investment decisions during the term of the trust. However, the investments will ultimately revert to the grantor, and the grantor usually retains the right to amend or revoke the trust. Therefore, both the blind

trust and the underlying investments held in a blind trust are considered to be direct financial interests of the covered member.

See item (A)(2) of Interpretation No. 101-1 [sec. 101 par. .02] and Ethics Ruling No. 11, “Member Designated to Serve as Executor or Trustee,” of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .021–.022], for additional guidance on trustee relationships.

Partnerships

The ownership of a general or limited partnership interest is considered a direct financial interest in the partnership.

The financial interests held by a partnership are considered to be direct financial interests of a covered member that is a general partner because the covered member is in a position to control the partnership or to supervise or participate in the partnership’s investment decisions.

The financial interests held by a limited partnership are considered to be indirect financial interests of a covered member who is a limited partner as long as the covered member does not control the partnership or supervise or participate in the partnership’s investment decisions. However, if the covered member has the ability to replace the general partner or has the authority to supervise or participate in the partnership’s investment decisions, the financial interests of the partnership would be considered to be direct financial interests of the covered member.

See item (A)(3) of Interpretation No. 101-1 [sec. 101 par. .02] for additional guidance on joint closely held investments and Interpretation No. 101-8, “Effect on Independence of Financial Interests in Non-clients Having Investor or Investee Relationships With a Covered Member’s Clients” [sec. 101 par. .10], for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

Limited Liability Companies

The ownership of an interest in a limited liability company (LLC) is considered a direct financial interest in the LLC.

In an LLC, members who are managers control the LLC and have the authority to supervise or participate in the LLC’s investment decisions. Accordingly, if a covered member is a manager of the LLC, the financial interests of the LLC are considered to be direct financial interests of the covered member. If a covered member is a member but not a manager of the LLC, the covered member should look to the operating agreement of the LLC to determine whether he or she can control the LLC or has the authority to supervise or participate in the investment decisions of the LLC. If the covered member does not control the LLC, or have the authority to supervise or participate in the LLC’s investment decisions, the financial interests held by the LLC would be considered to be indirect financial interests of the covered member.

Insurance Products

An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered to be a financial interest. Accordingly, if a covered member owns an insurance policy issued by an attest client, independence is not considered to be impaired, provided the policy does not offer the policy holder an investment option and the policy was purchased

under the insurance company's normal terms, procedures, and requirements. If a mutual insurance company begins the demutualization process, covered members who hold an insurance policy from the company should refer to the guidance contained in the "Unsolicited Financial Interests" section of this interpretation.

Some insurance policies offer an investment option whereby the policy owner may choose to invest part of the cash value in a variety of underlying investments. The underlying investments of this type of insurance policy are considered to be a financial interest, and the covered member should apply the guidance in this interpretation to determine whether the underlying investments are direct or indirect financial interests. For example, if the covered member has the ability to select the underlying investments or the authority to supervise or participate in the investment decisions and the cash value of the insurance policy is invested in a mutual fund, the mutual fund is considered to be a direct financial interest and the underlying investments of the mutual fund are considered to be indirect financial interests.

See item (A)(3) of Interpretation No. 101-1 [sec. 101 par. .02] for additional guidance on joint closely held investments and Interpretation No. 101-8 [sec. 101 par. .10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

[Effective December 31, 2005. Revised March 2010, effective May 31, 2010, by the Professional Ethics Executive Committee.]

[.18] [101-16]—[Reserved]

.19 101-17—Networks and network firms. ^{fn 53}

General

To enhance their capabilities to provide professional services, firms frequently join larger groups, which typically are membership associations that are separate legal entities that are otherwise unrelated to their members. The associations facilitate their members' use of association services and resources; they do not themselves typically engage in public practice or provide professional services to their members' clients or to other third parties. Firms and other entities in the association cooperate with the firms and other entities that are members of the association to enhance their capabilities to provide professional services. For example, a firm may become a member of an association in order to refer work to, or receive referrals from, other association members. That characteristic alone would not be sufficient for the association to constitute a network or for the firm to be considered a network firm. However, an association would be considered a network under this interpretation if one or more additional characteristics of a network are shared, in addition to cooperation among member firms [paragraph .23 of ET section 92]. These additional characteristics are discussed further in this interpretation.

A network firm is required to be independent of financial statement audit and review clients of the other network firms if the use of the audit or review report for the client is not restricted, as defined by professional standards. For all other attest clients, consideration should be given to any threats the firm knows or has reason to believe may be created by network firm interests and relationships. If those threats are

^{fn 53} Members may review the implementation guidance issued by the Ethics Division regarding this Interpretation No. 101-17, "Networks and Network Firms." This guidance may be found on the AICPA Ethics Division website. [Footnote subsequently renumbered by revision of Interpretation No. 101-11, November 2011.]

not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. The independence requirements apply to any entity within the network that meets the definition of a network firm [paragraph .24 of ET section 92].

Whether an association is a network and whether an entity is a network firm should be applied consistently by all members of the association. Due consideration should be given to what a reasonable and informed third party would be likely to conclude after weighing all the specific facts and circumstances. The determination that a firm or other entity or an association of firms or other entities meets the definition of a network firm and a network, as herein defined, is solely for purposes of this interpretation and should not be used or relied upon in any other context. In particular, the determination of whether a firm or other entity is a network firm or an association of firms or other entities is a network for purposes of defining legal responsibilities from one firm to the other, or to third parties, is beyond the scope of this interpretation. The definitions contained herein should not be used or relied upon for that purpose.

Characteristics of a Network

Sharing Common Brand Name

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the members of the association or entities controlled (as defined by FASB ASC 810) by members of the association share the use of a common brand name or share common initials as part of the firm name, the association is considered to be a network.

A firm that does not use a common brand name as part of its firm name but makes reference in its stationery or promotional materials to being a member of an association of firms should carefully consider how it describes that membership and take steps to avoid the perception that it belongs to a network. The firm may wish to avoid such a perception by clearly describing the nature of its membership in the association, for example, by stating on its stationery or promotional material that it is "an independently owned and operated member firm of XYZ Association."

Sharing Common Control

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association are under common control (as defined by FASB ASC 810) with other firms in the association through ownership, management, or other means (for example, by contract), it is considered to be a network. However, compliance with association requirements as a condition of membership does not indicate that members are under common control; rather, it reflects the type of cooperation that is expected when an entity joins the association.

Sharing Profits or Costs

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the firms share profits or costs, the association is considered to be a network. However, the sharing of immaterial costs or costs related to operating the association does not by itself create a network. In addition, the sharing of costs related to the development of audit methodologies, manuals, and training courses does not by itself create a network. Further, an arrangement between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not by itself create a network.

Sharing Common Business Strategy

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association share a common business strategy, the association is considered to be a network. Sharing a common business strategy involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the association's strategy and are held accountable for performance pursuant to that strategy. An entity's ability to pursue an alternative strategy may be limited by the common business strategy because, as a member, it must act in accordance with the common business strategy and, therefore, in the best interest of the association. An entity is not considered to be a network firm merely because it cooperates with another entity solely to market professional services or respond jointly to a request for a proposal for the provision of a professional service.

Sharing Significant Professional Resources

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association share a significant part of professional resources, it is considered to be a network.

Professional resources include

- common systems that enable firms to exchange information, such as client data, billing, and time records;
- partners and staff;
- technical departments to consult on technical or industry specific issues, transactions, or events for assurance engagements;
- audit methodology or audit manuals; and
- training courses and facilities.

The determination of whether the shared professional resources are significant should be made based on both qualitative and quantitative factors.

When the entities within the association do not share a significant amount of human resources or significant client information (for example, client data, billing, and time records) and have the ability to make independent decisions regarding technical matters, audit methodology, training, and the like, the entities are not considered to be sharing a significant part of professional resources.

When the shared professional resources are limited to a common audit methodology, audit manuals, training courses, or facilities, and when they do not include a significant amount of human resources or client or market information, the shared professional resources are not considered significant. However, when the shared professional resources involve the exchange of client information or personnel, such as when staff are drawn from a shared pool, or a common technical department is created within the association to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared professional resources are significant. An entity generally is not deemed a network because it occasionally uses personnel of another member firm to assist with an engagement, such as observing a client's physical inventory count.

Sharing Common Quality Control Policies and Procedures

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association are required to follow common quality control policies and procedures monitored by the association, it is considered to be a network. *Monitoring* is the process comprising an ongoing consideration and evaluation of the firms' systems of quality control, the objective of which is to enable the association to obtain reasonable assurance that the firms' systems of quality control are designed appropriately and operating effectively.

[Effective for engagements covering periods beginning on or after July 1, 2011. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Revised March 2013, and revisions effective May 31, 2013.]

.20 101-18—Application of the independence rules to affiliates.

Introduction

Financial interests in, and other relationships with, entities that are related in various ways to a financial statement attest client may impair independence. This interpretation provides guidance on which entities should be considered an affiliate of a financial statement attest client and subject to the independence provisions of the AICPA Code of Professional Conduct. This interpretation does not apply to a financial statement attest client that would be covered by Interpretation No. 101-10 [sec. 101 par. .12].

Definitions

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

Affiliate. The following entities should be considered affiliates of a financial statement attest client:

- a.* An entity (for example, subsidiary, partnership, or LLC) that a financial statement attest client can control.
- b.* An entity in which a financial statement attest client or an entity controlled by the financial statement attest client has a direct financial interest that gives the financial statement attest client significant influence over such entity and that is material to the financial statement attest client.
- c.* An entity (for example, parent, partnership, or LLC) that controls a financial statement attest client when the financial statement attest client is material to such entity.
- d.* An entity with a direct financial interest in the financial statement attest client when that entity has significant influence over the financial statement attest client, and the interest in the financial statement attest client is material to such entity.
- e.* A sister entity of a financial statement attest client if the financial statement attest client and sister entity are each material to the entity that controls both.
- f.* A trustee that is deemed to control a trust financial statement attest client that is not an investment company.
- g.* The sponsor of a single employer employee benefit plan financial statement attest client.

- h. Any union or participating employer that has significant influence over a multiple or multiemployer employee benefit plan financial statement attest client.
- i. An employee benefit plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client. A financial statement attest client that sponsors an employee benefit plan includes, but is not limited to, a union whose members participate in the plan and participating employers of a multiple or multiemployer plan.
- j. An investment adviser, general partner, or trustee of an investment company financial statement attest client (fund) if the fund is material to the investment adviser general partner or trustee, and they are deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

Control(s) (led). The term *control(s) (led)* is as used in FASB ASC 810 for commercial entities and FASB ASC 958-805-20 for not-for-profit entities.

Financial statement attest client. An entity whose financial statements are audited, reviewed, or compiled when the member's compilation report does not disclose a lack of independence.

Significant influence. The term *significant influence* is as used in FASB ASC 323-10-15.

Application of the Independence Rules to Affiliates

When a client is a financial statement attest client, members should apply the independence provisions of the AICPA Code of Professional Conduct applicable to the client to its affiliates, except in the following situations:

- a. A covered member may have a loan to or from an individual who is an officer, a director, or a 10 percent or more owner of an affiliate of a financial statement attest client unless the covered member knows or has reason to believe that the individual is in such a position with such an affiliate. If the covered member knows or has reason to believe that the individual is an officer, a director, or a 10 percent or more owner of such an affiliate, the covered member should evaluate the effect that the relationship would have on the member's independence by applying the *Conceptual Framework for AICPA Independence Standards* [section 100-1].
- b. A member or his or her firm may provide prohibited nonattest services to entities described under subparagraphs (c)–(j) of the definition of *affiliate*, as defined in the previous “Definitions” section, provided that it is reasonable to conclude that the services do not create a self-review threat with respect to the financial statement attest client because the results of the nonattest services will not be subject to financial statement attest procedures. For any other threats that are created by the provision of the nonattest services that are not at an acceptable level (in particular, those relating to management participation), such threats should be eliminated or reduced to an acceptable level by the application of safeguards.
- c. A firm will only have to apply conditions (1)–(6) of Interpretation No. 101-2, “Employment or Association With Attest Clients” [sec. 101 par. .04], if the former employee, by virtue of his or her employment at an entity described under subparagraphs (c)–(j) of the definition of *affiliate*, as defined in the previous “Definitions” section, would put the employee in a key position with

respect to the financial statement attest client. Individuals in a position to influence the attest engagement and on the attest engagement team who are considering employment with an affiliate of a financial statement attest client will still need to report consideration of employment to an appropriate person in the firm and remove themselves from the financial statement attest engagement, even if the position with the affiliate is not a key position.

- d. Immediate family members and close relatives of a covered member may be employed at an entity described under subparagraphs (c)–(j) of the definition of *affiliate*, as defined in the previous “Definitions” section, in a key position, provided that the position does not put them in a key position with respect to the financial statement attest client.

Other Considerations

A member must expend best efforts to obtain the information necessary to identify a financial statement attest client’s affiliates. If, after expending best efforts, a member is unable to obtain the information to determine which entities are affiliates of a financial statement attest client, the member is required to (a) discuss the matter, including the potential impact on independence, with those charged with governance; (b) document the results of that discussion and the efforts taken to obtain the information; and (c) obtain written assurance from the financial statement attest client that it is unable to provide the member with the information necessary to identify the client’s affiliates.

Effective Date

This interpretation will be effective for engagements covering periods beginning on or after January 1, 2014. Early implementation is allowed.

[Effective November 30, 2011.]

.21 101-19—Permitted employment with client educational institution.

Partners or professional employees of a firm may seek employment as an adjunct faculty member of an educational institution. Partners or professional employees of a firm who provide these types of services to an educational institution that is a client of the firm would not be considered to impair independence with respect to the educational institution, provided that the partner or professional employee

- a. does not hold a key position at the educational institution;
- b. does not participate on the attest engagement team;
- c. is not an individual in a position to influence the attest engagement;
- d. is employed by the educational institution on a part-time and nontenure basis;
- e. does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required; and
- f. does not assume any management responsibilities or set policies for the educational institution.

Upon termination of such employment, the partner or professional employee should comply with the requirements of the “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With A Client” section of Interpretation No. 101-1 [sec. 101 par. .02].

[Effective November 30, 2011.]

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*

- .02 102-1—Knowing Misrepresentations in the Preparation of Financial Statements or Records** A member shall be considered to have knowingly misrepresented facts in violation of Rule 102 [ET sec. 102 par. .01] when he or she knowingly—
- a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records; or
 - b. Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or
 - c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

.03 102-2—Conflicts of Interest for Members in Public Practice

A member in public practice or his or her firm may be faced with a conflict of interest when performing a professional service. In determining whether a professional service, relationship or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the *Integrity and Objectivity* rule [ET sec. 102 par. .01]. For example, threats may be created when

- the member or the member's firm provides a professional service related to a particular matter involving two or more clients whose interests with respect to that matter are in conflict; or
- the interests of the member or the member's firm with respect to a particular matter and the interests of the client for whom the member or the member's firm provides a professional service related to that matter are in conflict.

Certain professional engagements, such as audits, reviews, and other attest services require independence. Independence impairments under the *Independence* rule [ET sec. 101 par. .01], its interpretations, and rulings cannot be eliminated by the safeguards provided in this interpretation or by disclosure and consent.

The following are examples of situations in which conflicts of interest may arise:

- Providing corporate finance services to a client seeking to acquire an audit client of the firm, when the firm has obtained confidential information during the course of the audit that may be relevant to the transaction

- Advising two clients at the same time who are competing to acquire the same company when the advice might be relevant to the parties' competitive positions
- Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction
- Preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets
- Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership
- Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement
- Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest in the business
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client
- Advising a client on the acquisition of a business which the firm is also interested in acquiring
- Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service
- Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm
- Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests
- Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement

Identification of a Conflict of Interest

Before accepting a new client relationship, engagement, or business relationship, a member should take reasonable steps to identify circumstances that might create a conflict of interest including identification of

- the nature of the relevant interests and relationships between the parties involved, and
- the nature of the service and its implication for relevant parties.

The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a member is asked to conduct an engagement for a client in a situation that may become adversarial with respect to another client or the member or member's firm, even though the parties who engage the member may not initially be involved in a dispute. A

member should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a member in identifying actual or potential conflicts of interest that may create significant threats to compliance with the *Integrity and Objectivity* rule prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example clients or potential clients. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a member being able to apply safeguards to eliminate or reduce significant threats to an acceptable level. The process to identify actual or potential conflicts of interest will depend on such factors as

- the nature of the professional services provided,
- the size of the firm,
- the size and nature of the client base, and
- the structure of the firm, for example the number and geographic location of offices.

If the firm is a member of a network, the member is not required to take specific steps to identify conflicts of interest of other network firms; however, if the member knows or has reason to believe that such conflicts of interest may exist or might arise due to interests and relationships of a network firm, the member should evaluate the significance of the threat created by such conflicts of interest as described below.

Evaluation of a Conflict of Interest

When an actual conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both qualitative and quantitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. In evaluating the significance of an identified threat, members should consider both of the following:

- The significance of relevant interests or relationships.
- The significance of the threats created by performing the professional service or services. In general, the more direct the connection between the professional service and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

- Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include

- a. using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
 - b. creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm;
 - c. establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and the physical and electronic separation of confidential information.
- Regularly reviewing the application of safeguards by a senior individual not involved with the client engagement or engagements.
 - Having a member of the firm who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
 - Consulting with third parties, such as a professional body, legal counsel, or another professional accountant.

In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

Disclosure of a Conflict of Interest and Consent

When a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional services. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

Disclosure and consent may take different forms. The following are examples:

- General disclosure to clients of circumstances in which the member, in keeping with common commercial practice, does not provide services exclusively for any one client (for example, in a particular service in a particular market sector) in order for the client to provide general consent accordingly. Such disclosure might be made in a member's standard terms and conditions for the engagement.
- Specific disclosure to affected clients of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the client to make an informed decision with respect to the matter and to provide specific consent.

The member should determine whether the nature and significance of the conflict of interest is such that specific disclosure and specific consent are necessary, as opposed to general disclosure and general consent. For this purpose, the member should exercise professional judgment in evaluating the circumstanc-

es that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

When a member has requested specific consent from a client and that consent has been refused by the client, the member should (a) decline to perform or discontinue professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level, such that consent can be obtained, after applying any additional safeguards, if necessary.

The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a member should remain alert to the requirements of Rule 301, *Confidential Client Information* [ET sec. 301 par. .01], and Interpretation No. 501-9, "Confidential information obtained from employment or volunteer activities," under Rule 501, *Acts Discreditable* [ET sec. 501 par. .10]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct.

When practicing before the IRS or other taxing authorities, members should ensure compliance with any requirements that are more restrictive. For example, Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, provides more restrictive requirements concerning written consent by the client when a conflict of interest exists.

[Replaces previous Interpretation No. 102-2, *Conflicts of Interest*, June 2014, effective September 30, 2014.]

- .04 102-3—Obligations of a Member to His or Her Employer's External Accountant** Under Rule 102 [ET sec. 102 par. .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 sec. 102 par. .01] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services for a client, for an employer, or on a volunteer basis. Although Rule 102 prohibits subordination of judgment to a client, this interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the member's organization.

If a member and his or her supervisor or any other person within the member's organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations, then self-interest, familiarity, and undue influence threats to the member's compli-

ance with Rule 102 may exist.^[fn 1] Accordingly, the member should apply appropriate safeguards so that the member does not subordinate his or her judgment when the member concludes the difference of opinion creates significant threats to the member's integrity and objectivity.

In assessing the significance of any identified threats, the member should form a conclusion, after appropriate research or consultation, about whether the result of the position taken by the supervisor or other person

- a. fails to comply with professional standards, when applicable;
- b. creates a material misrepresentation of fact; or
- c. may violate applicable laws or regulations.

If the member concludes that the position taken is not in compliance with professional standards but does not result in a material misrepresentation of fact or a violation of applicable laws or regulations, then threats would not be considered significant. However, the member should discuss his or her conclusions with the person taking the position.

If the member concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then threats would be considered significant. In such circumstances, the member should discuss his or her concerns with the supervisor. If the difference of opinion is still not resolved, then the member should discuss his or her concerns with the appropriate higher level(s) of management within the member's organization (for example, the supervisor's immediate superior, senior management, and those charged with governance).

If after discussing such concerns with the supervisor and appropriate higher level(s) of management within the member's organization, the member concludes that appropriate action was not taken, then the member should consider, in no specific order, the following safeguards to ensure that threats to the member's compliance with Rule 102 are eliminated or reduced to an acceptable level:

- Determining whether any additional requirements exist under his or her employer's internal policies and procedures for reporting differences of opinion.
- Determining whether any responsibilities exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In considering such communications, the member should be cognizant of his or her obligations under Interpretation No. 501-9, "Confidential Information Obtained From Employment or Volunteer Activities," under Rule 501, *Acts Discreditable* [ET sec. 501 par. .10], and Interpretation No. 102-3, "Obligations of a Member to His or Her Employer's External Accountant," under Rule 102 [ET sec. 102 par. .04].
- Consulting with his or her legal counsel regarding his or her responsibilities.

^[fn 1] [Footnote deleted, effective August 31, 2013, by the Professional Ethics Executive Committee.]

- Documenting his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

If the member concludes that no safeguards can eliminate or reduce the threats to an acceptable level or if the member concludes that appropriate action was not taken, then he or she should consider his or her continuing relationship with the member's organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

Nothing in this interpretation would preclude a member from resigning from the member's organization at any time. However, resignation may not relieve the member of his or her responsibilities in the situation, including any responsibility to disclose to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

A member should use professional judgment and apply similar safeguards, as appropriate, to other situations involving a difference of opinion so that the member does not subordinate his or her judgment.

[Effective November 30, 1993. Revised March 2013, revisions effective May 31, 2013. Revised May 2013, revisions effective August 31, 2013.]

- .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 paragraph .30, and are therefore subject to Rule 102 [ET sec. 102 par. .01]. Rule 102 [ET sec. 102 par. .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.]

- .07 102-6—Professional Services Involving Client Advocacy** A member or a member's firm may be requested by a client—

1. To perform tax or consulting services engagements that involve acting as an advocate for the client.
2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.

Services provided or actions taken pursuant to such types of client requests are professional services [ET sec. 92 par. .30] governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201, *General Standards* [ET sec. 201 par. .01], Rule 202, *Compliance With Standards* [ET sec. 202 par. .01], and Rule 203, *Accounting Principles* [ET sec. 203 par. .01], and interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with Rule 102 [ET sec. 102 par. .01], which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with Rule 101 [ET sec. 101 par. .01] of the Code of Professional Conduct.

Moreover, there is a possibility that some requested professional services involving client advocacy may appear to stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk of impairing the

reputation of the member and his or her firm with respect to independence, integrity, and objectivity. In such circumstances, the member and the member's firm should consider whether it is appropriate to perform the service.

[Effective August 31, 1995.]

.08 102-7—Conflicts of Interest for Members in Business

A member in business may be faced with a conflict of interest when undertaking a professional service. In determining whether a professional service, relationship, or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the *Integrity and Objectivity* rule [ET sec. 102 par. .01]. For example, threats may be created when

- a member undertakes a professional service related to a particular matter involving two or more parties whose interests with respect to that matter are in conflict, or
- the interests of a member with respect to a particular matter and the interests of a party for whom the member undertakes a professional service related to that matter are in conflict.

A party may include an employing organization, a vendor, a customer, a lender, a shareholder, or other party.

The following are examples of situations in which conflicts of interest may arise:

- Serving in a management or governance position for two employing organizations and acquiring confidential information from one employing organization that could be used by the member to the advantage or disadvantage of the other employing organization
- Undertaking a professional service for each of two parties in a partnership employing the member to assist in dissolving their partnership
- Preparing financial information for certain members of management of the employing organization who are seeking to undertake a management buy-out
- Being responsible for selecting a vendor for the member's employing organization when the member or his or her immediate family member could benefit financially from the transaction
- Serving in a governance capacity or influencing an employing organization that is approving certain investments for the company in which one of those specific investments will increase the value of the personal investment portfolio of the member or his or her immediate family member

Identification of a Conflict of Interest

In identifying whether a conflict of interest exists or may be created, a member should take reasonable steps to determine

- the nature of the relevant interests and relationships between the parties involved and

- the nature of the services and its implication for relevant parties.

The nature of the relevant interests and relationships and the services may change over time. The member should remain alert to such changes for the purposes of identifying circumstances that might create a conflict of interest.

Evaluation of a Conflict of Interest

When an actual conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both qualitative and quantitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level.

In evaluating the significance of an identified threat, members should consider the following:

- The significance of relevant interests or relationships.
- The significance of the threats created by undertaking the professional service or services. In general, the more direct the connection between the member and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

- Restructuring or segregating certain responsibilities and duties
- Obtaining appropriate oversight
- Withdrawing from the decision making process related to the matter giving rise to the conflict of interest
- Consulting with third parties, such as a professional body, legal counsel, or another professional accountant

In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

Disclosure of a Conflict of Interest and Consent

When a conflict of interest exists, the member should disclose the nature of the conflict to the relevant parties, including to the appropriate levels within the employing organization and obtain their consent to undertake the professional service. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

When addressing a conflict of interest, a member is encouraged to seek guidance from within the employing organization or from others, such as a professional body, legal counsel, or another professional accountant. When making disclosures and seeking guidance of third parties, the member should remain alert to the requirements of Interpretation No. 501-9, "Confidential information obtained from employment or volunteer activities," under Rule 501, *Acts Discreditable* [ET sec. 501 par. .10]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of employer information may be more restrictive than the requirements contained in the Code of Professional Conduct.

A member may encounter other threats to compliance with the *Integrity and Objectivity* rule. This may occur, for example, when preparing or reporting financial information as a result of undue pressure from others within the employing organization or financial, business or personal relationships that close relatives or immediate family members of the member have with the employing organization. Guidance on managing such threats is covered by Interpretation Nos. 102-1, "Knowing misrepresentations in the preparation of financial statements or records," and 102-4, "Subordination of judgment by a member" [ET sec. 102 par. .02 and .05], under the *Integrity and Objectivity* rule.

[Added June 2014, effective September 30, 2014.]

ET Section 191

Ethics Rulings on Independence, Integrity, and Objectivity

[1.] Acceptance of a Gift

[.001–.002] [Deleted, January 2006.]

2. Association Membership

.003 *Question*—Would independence be considered to be impaired if a member joined a trade association that is a client of the firm?

.004 *Answer*—Independence 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, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[3.] Member as Signer or Cosigner of Checks

[.005–.006] [Deleted, May 1999.]

[4.] Payroll Preparation Services

[.007–.008] [Deleted, May 1999.]

[5.] Member as Bookkeeper

[.009–.010] [Deleted, June 1991.]

[6.] Member's Spouse as Accountant of Client

[.011–.012] [Deleted, November 2001.]

[7.] Member Providing Contract Services

[.013–.014] [Deleted, May 1999.]

8. Member Providing Advisory Services

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

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

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[9.] Member as Representative of Creditor's Committee

[.017–.018] [Deleted, November 2011.]

[10.] Member as Legislator

[.019–.020] [Deleted, November 2011.]

11. Member Designated to Serve 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 a client's stock. Would independence be considered to be impaired with respect to the client?

.022 *Answer*—The mere designation of a *covered* member as executor or trustee would not be considered to impair independence, however, if a covered member actually served in such capacity, independence would be considered to be impaired.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

[12.] Member as Trustee of Charitable Foundation

[.023–.024] [Deleted, November 2011.]

[13.] Member as Bank Stockholder

[.025–.026] [Deleted, November 1993.]

14. Member on Board of Federated Fund-Raising Organization

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

.028 *Answer*—Independence would be considered to be impaired if *any* partner or professional employee of the firm served as a director or officer of the organization and the organization exercised managerial control over the local charities. (See Ethics Ruling No. 93, “Service on Board of Directors of Federated Fund-Raising Organization” [par. .186–.187] under Rule 101, *Independence* [sec. 101 par. .01] for additional guidance.)

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 14, “Member on Board of Directors of United Fund,” April 1991.]

[15.] Retired Partner as Director

[.029–.030] [Deleted, June 1991.]

[16.] Member on Board of Directors of Nonprofit Social Club

[.031–.032] [Deleted, November 2011.]

17. Member of Social Club

.033 *Question*—Would independence be considered to be impaired if a member belongs to a social club (for example, country club, tennis club) that requires him or her to acquire a pro rata share of the club's equity or debt securities?

.034 *Answer*—As long as membership in a club is essentially a social matter, a *covered* member's association with the club would not impair independence because such equity or debt ownership would not be considered to be a direct financial interest within the meaning of Rule 101 [sec. 101 par. .01]. Also see item C of Interpretation No. 101-1, "Interpretation of Rule 101," under Rule 101 [sec. 101 par. .02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 17, *Member as Stockholder in Country Club*, February 1991.]

[18.] Member as City Council Chairman

[.035–.036] [Deleted, June 1991.]

[19.] Member on Deferred Compensation Committee

[.037–.038] [Deleted, November 2011.]

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 that the firm audits. The member also serves on a committee appointed to study the financial status of a state. Would independence be considered to be impaired with respect to a county in that state?

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

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

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

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

.042 *Answer*—Service as director of an entity constitutes participation in management functions that affect the entity’s trust. Accordingly, independence would be considered to be impaired if any partner or professional of the firm served in such capacity.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

[22.] Family Relationship, Brother

[.043–.044] [Deleted, June 1991.]

[23.] Family Relationship, Uncle by Marriage

[.045–.046] [Deleted, June 1991.]

[24.] Family Relationship, Father

[.047–.048] [Deleted, June 1991.]

[25.] Family Relationship, Son

[.049–.050] [Deleted, June 1991.]

[26.] Family Relationship, Son

[.051–.052] [Deleted, June 1991.]

[27.] Family Relationship, Spouse as Trustee

[.053–.054] [Deleted, June 1991.]

[28.] Cash Account With Brokerage Client

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

[29.] Member as Bondholder

[.057–.058] [Deleted, November 2011.]

[30.] Financial Interest by Employee

[.059–060][Deleted, July 1979.]

31. Performance of Services for Common Interest Realty Associations (CIRAs), Including Cooperatives, Condominium Associations, Planned Unit Developments, Homeowners Associations, and Timeshare Developments

.061 *Question*—A member belongs to a common interest realty association (CIRA) as the result of the ownership or lease of real estate. Would independence be considered to be impaired with respect to the CIRA?

.062 *Answer*—Independence would be considered to be impaired if a *covered* member was a member of a CIRA unless all of the following conditions are met:

- a. The CIRA performs functions similar to local governments, such as public safety, road maintenance, and utilities.
- b. The covered member's annual assessment is not material to either the covered member or the CIRA's operating budgeted assessments.
- c. The liquidation of the CIRA or the sale of common assets would not result in a distribution to the covered member.
- d. The CIRA's creditors would not have recourse to the covered member's assets if the CIRA became insolvent.

Also see item C of Interpretation No. 101-1 [sec. 101 par. .02] for additional restrictions related to associations with a client.

If the member has a relationship with a real estate developer or management company that is associated with the CIRA, see Interpretation No. 102-2, “Conflicts of Interest,” under Rule 102, *Integrity and Objectivity* [sec. 102 par. .03], for guidance.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective May 31, 1998, by the Professional Ethics Executive Committee.]

[32.] Mortgage Loan to Member's Corporation

[.063–.064] [Deleted, December 1991.]

[33.] Member as Participant in Employee Benefit Plan

[.065–.066] [Deleted, May 1998.]

[34.] Member as Auditor of Common Trust Funds

[.067–.068] [Deleted, February 1991.]

[35.] Stockholder in Mutual Funds

[.069–.070] [Deleted, December 2005.]

[36.] Participant in Investment Club

[.071–.072] [Deleted, December 2005.]

[37.] Retired Partners as Co-Trustee

[.073–.074] [Deleted, November 1980.]

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 a trust. Would independence be considered to be impaired with respect to the bank or the bank’s trust department?

.076 *Answer*—Independence would not be considered to be impaired, provided the assets in the estate or trust were not material to the total assets of the bank or the bank’s trust department, or both.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

[39.] Member as Officially Appointed Stock Transfer Agent or Registrar

[.077–.078] [Deleted, May 1999.]

[40.] Controller Entering Public Practice

[.079–.080] [Deleted, June 1979.]

41. Financial Services Company Client Has Custody of a Member's Assets

.081 *Question*—A financial services company client (for example, insurance company, investment adviser, broker-dealer, bank, or other depository institution) has custody of a member's assets (other than depository accounts), including retirement plan assets. Would independence be considered to be impaired?

.082 *Answer*—If a covered member's assets were held by a financial services company client, independence would not be considered to be impaired provided the services were rendered under the company's normal terms, procedures, and requirements and any of the covered member's assets subject to the risk of loss were immaterial to the covered member's net worth. Risk of loss may include losses arising from the bankruptcy of or defalcation by the client but would exclude losses due to a market decline in the value of the assets. When considering the materiality of assets subject to the risk of loss, the covered member should consider the following:

- Protection provided by state or federal regulators (for example, state insurance funds)
- Private insurance or other forms of protection (for example, the Securities Investor Protection Corporation) obtained by the financial services company to protect the assets
- Protection from creditors (for example, assets held in a pooled separate account)

For guidance dealing with depository accounts, see Ethics Ruling No. 70, “Member’s Depository Relationship With Client Financial Information” [par. .140–.141].

[Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 41, “Member as Auditor of Mutual Insurance Company,” November, 1990.]

[42.] Member as Life Insurance Policy Holder

[.083–.084] [Deleted, April 1991.]

[43.] Member's Employee as Treasurer of a Client

[.085–.086] [Deleted, June 1991.]

[44.] Past Due Billings

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

[45.] Past Due Fees: Client in Bankruptcy

[.089–.090] [Deleted, November 1990.]

[46.] Member as General Counsel

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

[47.] Member as Auditor of Mutual Fund and Shareholder of Investment Advisor/Manager

[.093–.094] [Deleted, February 1991.]

[48.] Faculty Member as Auditor of a Student Fund

[.095–.096] [Deleted, November 2011.]

[49.] Investor and Investee Companies

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

[50.] Family Relationship, Brother-in-Law

[.099–.100] [Deleted, June 1983.]

[51.] Member Providing Legal Services

[.101–.102] [Deleted, May 1999.]

52. Unpaid Fees

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

.104 *Answer*—Independence is considered to be impaired if, when the report on the client's current year is issued, billed or unbilled fees, or a note receivable arising from such fees, remain unpaid for any professional services provided more than one year prior to the date of the report.

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

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective November 30, 1997, by the Professional Ethics Executive Committee. Replaces previous Ethics Ruling No. 52, "Past Due Fees," November 1990.]

[53.] Member as Auditor of Employee Benefit Plan and Sponsoring Company

[.105–.106] [Deleted, June 1991.]

[54.] Member Providing Appraisal, Valuation, or Actuarial Services

[.107–.108] [Deleted, May 1999.]

[55.] Independence During Systems Implementation

[.109–.110] [Deleted, May 1999.]

[56.] Executive Search

[.111–.112] [Deleted, May 1999.]

[57.] MAS Engagement to Evaluate Service Bureaus

[.113–.114] [Deleted, August 1995.]

[58.] Member as Lessor

[.115–.116] [Deleted, May 1998.]

[59.] Account With Brokerage Client

[.117–.118] [Deleted, November 1987.]

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

.119 *Question*—A member has been asked to audit the financial statements of an employee benefit plan (the plan) that may have one or more participating employer(s). Would independence be considered to be impaired with respect to the plan if the member had financial or other relationships with a participating employer(s)?

.120 *Answer*—Independence would be considered to be impaired with respect to the plan if any partner or professional employee of the firm had significant influence over such employer; was in a key position with the employer; or was associated with the employer as a promoter, an underwriter, or a voting trustee.

When auditing plans subject to the Employee Retirement Income Security Act of 1974 (ERISA), Department of Labor (DOL) regulations must be followed. Currently, DOL regulations are more restrictive than the position taken in this ruling.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18.]

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

[.121–.122] [Deleted, May 1998.]

[62.] Member and Client Are Limited Partners in a Limited Partnership

[.123–.124] [Deleted, April 1991.]

[63.] Review of Prospective Financial Information—Member's Independence of Promoters

[.125–.127] [Deleted, August 1992.]

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

.128 *Question*—A member serves on the board of directors of an organization. A fund-raising foundation functions solely to raise funds for that organization. Would independence be considered to be impaired with respect to the fund-raising foundation?

.129 *Answer*—Independence would be considered to be impaired with respect to the fund-raising foundation if *any* partner or professional employee of the firm served on the organization's board of directors. However, if the directorship were clearly honorary (in accordance with Interpretation No. 101-4, “Honorary Directorships and Trusteeships of Not-for-Profit Organization,” under Rule 101 [sec. 101 par. .06]) independence would not be considered to be impaired.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

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

[.130–.131] [Deleted March 2013, effective May 31, 2013.]

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

[.132–.133] [Deleted, December 2005.]

67. Servicing of Loan

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

.135 *Answer*—No.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Replaces previous Ethics Ruling No. 67, “Servicing of Loan,” November 1993.]

[68.] Blind Trust

[.136–.137] [Deleted, December 2005.]

69. Investment With a General Partner

.138 *Question*—A private, closely held entity is the general partner and controls (as defined in accounting principles generally accepted in the United States of America) limited partnership A. The member has a material financial interest in limited partnership A. The member's firm has been asked to perform an attest engagement for a new limited partnership (B) that has the same general partner as limited partnership A. Would independence be considered to be impaired with respect to limited partnership B?

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

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

70. Member's Depository Relationship With Client Financial Institution

.140 *Question*—A member maintains checking or savings accounts, certificates of deposit, or money market accounts at a client financial institution. Would these depository relationships impair independence?

.141 *Answer*—If an individual is a covered member, independence would not be considered to be impaired 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 or by any other insurer; or
- The uninsured amounts, in the aggregate, were not material to the net worth of the covered member. (When uninsured amounts were considered material, independence would not be considered impaired provided the uninsured balance was reduced to an immaterial amount no later than 30 days from the date the uninsured amount becomes material.)

A firm's depository relationship would not impair its independence provided that the likelihood of the financial institution experiencing financial difficulties was considered to be remote.

[Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, October 2013, to reflect editorial changes necessary.]

71. Use of Nonindependent CPA Firm on an Engagement

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

.143 *Answer*—Yes. The use by Firm B of partners or professional employees from Firm A as part of the attest engagement team would 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 (SASs). Applicable literature contained in the SASs should be consulted.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

72. Member on Advisory Board of Client

.144 *Question*—Would service on a client's advisory board impair independence?

.145 *Answer*—Independence would be considered to be impaired if *any* partner or professional employee of the firm served on the advisory board unless all the following criteria are met: (a) the responsibilities of the advisory board are in fact advisory in nature; (b) the advisory board has no authority to make nor does it appear to make management decisions on behalf of the client; and (c) 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.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[73.] Meaning of the Period of a Professional Engagement

[.146–.147] [Deleted, February 1998.]

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

[.148–.149] [Deleted, April 2012.]

75. Membership in Client Credit Union

.150 *Question*—Does membership in a client credit union impair independence?

.151 *Answer*—A *covered* member's association with a client credit union would not impair independence provided all of the following criteria are met:

1. The covered member individually qualifies to join the credit union (other than by virtue of the professional services provided to the client).
2. Any loans from the credit union to the covered member meet the conditions specified in item A(4) of Interpretation No. 101-1 [sec. 101 par. .02] and are made under normal lending procedures, terms, and requirements (see Interpretation No. 101-5, “Loans from financial institution clients and related terminology” [sec. 101 par. .07]).
3. Any deposits with the credit union meet the conditions specified in Ethics Ruling No. 70 [par. .140–.141] under Rule 101 [sec. 101 par. .01].

Partners and professional employees may be subject to additional restrictions as described in item B of Interpretation No. 101-1 [sec. 101 par. 02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Effective February 28, 1992, earlier application is encouraged.]

[76.] Guarantee of Loan

[.152–.153] [Deleted, December 1991.]

[77.] Individual Considering or Accepting Employment With the Client

[.154–.155] [Deleted, April 2003.]

[78.] Service on Governmental Board

[.156–.157] [Deleted, August 1995.]

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

[.158–.159] [Deleted, December 2005.]

[80.] The Meaning of a Joint Closely Held Business Investment

[.160–.161] [Deleted, November 2001.]

81. Member's Investment in a Limited Partnership

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

.163 *Answer*—

- a. A covered member's LP interest in the LP is a direct financial interest in the LP that would impair independence under Interpretation No. 101-1 item A(1) [sec. 101 par. .02].
- b. The LP is an investee of the client because the client is a general partner in the LP. Therefore, under Interpretation No. 101-8 [sec. 101 par. .10], if the investment in the LP were material to the client, a covered member's financial interest in the LP would impair independence. However, if the client's financial interest in the LP were not material to the client, a covered member's immaterial financial interest in the LP would not impair independence.
- c. If the covered member is a limited partner in the LP, the covered member is considered to have an indirect financial interest in all subsidiaries of the LP. If the indirect financial interest in the subsidiaries were material to the covered member, independence would be considered to be impaired with respect to those subsidiaries under Interpretation No. 101-1 item A(1) [sec. 101 par. .02].

If the covered member or client general partner, individually or together, can control the LP, the LP would be considered a joint closely held investment under section 92 paragraph .17.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

82. Campaign Treasurer

.164 *Question*—A member serves as the campaign treasurer of a mayoral candidate. Would independence be considered to be impaired with respect to (a) the political party with which the candidate is associated, (b) the municipality of which the candidate may become mayor, or (c) the campaign organization?

.165 *Answer*—Independence would not be considered to be impaired with respect to the political party or municipality. However, if *any* partner or professional employee of the firm served as campaign treasurer, independence would be considered to be impaired with respect to the campaign organization.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

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

[.166–.167] [Deleted, January 1996.]

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

[.168–.169] [Deleted, January 1996.]

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, *Confidential Client Information* [sec. 301 par. .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. Conflicts of Interest—Interpretation No. 102-2 [sec. 102 par. .03] provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from all 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 a 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 client's 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–.173] [Deleted, February 1998.]

[87.] Loan Commitment or Line of Credit

[.174–.175] [Deleted, February 1998.]

[88.] Loans to Partnership in Which Members Are Limited Partners

[.176–.177] [Deleted, February 1998.]

[89.] Loan to Partnership in Which Members Are General Partners

[.178–.179] [Deleted, February 1998.]

[90.] Credit Card Balances and Cash Advances

[.180–.181] [Deleted, February 1998.]

91. Member Leasing Property to or From a Client

.182 *Question*—Would independence be considered to be impaired if a member leased property to or from a client?

.183 *Answer*—Independence would not be considered to be impaired if the lease meets the criteria of an operating lease (as described in Generally Accepted Accounting Principles), the terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature, and all amounts are paid in accordance with the terms of the lease.

Independence would be considered to be impaired if a *covered* member had a lease that meets the criteria of a capital lease (as described in generally accepted accounting principles) unless the lease is in compliance with item A(4) of Interpretation Nos. 101-1 [sec. 101 par. .02] and 101-5 [sec. 101 par. .07], because the lease would be considered to be a loan to or from the client.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective May 31, 1998, by the Professional Ethics Executive Committee.]

92. Joint Interest in Vacation Home

.184 *Question*—A member has a joint interest in a vacation home with a client (or one of the client's officers or directors, or any owner who has the ability to exercise significant influence over the client). Would the vacation home constitute a "joint closely held investment" as defined in paragraph .17 of section 92, *Definitions*?

.185 *Answer*—Yes. The vacation home, even if solely intended for the personal use of the owners, would be considered a joint closely held investment as defined in paragraph .17 of section 92 if it meets the criteria described in the aforementioned definition.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

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

.186 *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 local charities receive funds. Some of those charities are clients of the member's firm. Does the member have a conflict of interest under Rule 102 [sec. 102 par. .01]?

.187 *Answer*—Interpretation No. 102-2 [sec. 102 par. .03] provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by the client or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from the appropriate parties, performance of the service shall not be prohibited. (If the service being provided is an attest engagement, consult Ethics Ruling No. 14 [par. .027–.028] under Rule 101 [sec. 101 par. .01]).

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

94. Indemnification Clause in Engagement Letters

.188 *Question*—A member or his or her firm 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 inclusion of such an indemnification clause in engagement letters impair independence?

.189 *Answer*—No.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

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 or his or her firm and a client cause independence to be impaired?

- .191** *Answer*—No. Such an agreement would not cause independence to be impaired since the member (or the firm) and the client would not be in threatened or actual positions of material adverse interests by reason of threatened or actual litigation.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

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 or his or her firm and the client in threatened or actual positions of material adverse interests. Nevertheless, if a *covered* member and the client are in a position of material adverse interests because the ADR proceedings are sufficiently similar to litigation, Interpretation No. 101-6, “The Effect of Actual or Threatened Litigation on Independence,” under Rule 101 [sec. 101 par. .08] should be applied. Such a position would exist if binding arbitration were used.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[97.] Performance of Certain Extended Audit Services

[.194–.195] [Deleted, August 1996.]

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 member’s firm performs an attest engagement for the parent or a subsidiary of the nonclient. Does the loan from the nonclient subsidiary or parent impair independence?

- .197** *Answer*—A covered member’s loan that is not a “grandfathered” or “permitted” loan under Interpretation No. 101-5 [sec. 101 par. .07] from a nonclient subsidiary would impair independence with respect to the client parent. However, a loan from a nonclient parent would not impair independence with respect to the client subsidiary, as long as the subsidiary is not material to its parent.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

99. Member Providing Services for Company Executives

- .198** *Question*—A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in the member recommending to the ex-

executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

- .199** *Answer*—Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102 [sec. 102 par. .01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member should also consider informing the company and the executives of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301 [sec. 301 par. .01].

100. Actions Permitted When Independence Is Impaired

- .200** *Question*—If a member or a member's firm (member) was independent when its report was initially issued, may the member re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired?
- .201** *Answer*—Yes. A member may re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired, provided that no "post-audit work" is performed by the member during the period of impairment. The term "post-audit work," in this context, does not include inquiries of successor 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.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[101.] Client Advocacy and Expert Witness Services

[.202–.203] [Deleted, July 2007.]

102. Indemnification of a Client

- .204** *Question*—As a condition to retaining a member or his or her firm to perform an attest engagement, a client or prospective client requests that the member (or the firm) enter into an agreement providing, among other things, that the member (or the firm) indemnify the client for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to client acts. Would entering into such an agreement impair independence?
- .205** *Answer*—Yes. Such an agreement would impair independence under item A of Interpretation No. 101-1 [sec. 101 par. .02] and item C of Interpretation No. 101-1 [sec. 101 par. .02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[103.] Attest Report on Internal Controls

[.206–.207] [Deleted, November 2011.]

[104.] Operational Auditing Services

[.208–.209] [Deleted, September 2003.]

[105.] Frequency of Performance of Extended Audit Procedures

[.210–.211] [Deleted, September 2003.]

106. Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client

.212 *Question*—Would independence be considered to be impaired if a member or his or her firm had *significant influence*, as defined in section 92 paragraph .31, over an entity that has significant influence over a client?

.213 *Answer*—Independence would be considered to be impaired if any partner or professional of the firm had significant influence over an entity that has significant influence over a client. By having such influence over the nonclient entity, the partner or professional employee would also be considered to have significant influence over the client.

See Interpretation No. 101-8 [sec. 101 par. .10] for further guidance.

[Revised July 2002 to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

107. Participation in Employee Benefit Plan Sponsored by Client

.214 *Question*—A member participates in, or receives benefits from, an employee benefit plan (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 that is a client or is sponsored by a client would impair independence with respect to the client sponsor and the plan, except when the covered member is permitted by the “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client” section of Interpretation No. 101-1 [sec. 101 par. .02] to continue his or her participation in the plan or
- an employee of a governmental organization that 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 that the plan is offered to all employees in comparable employment positions and the covered member
 - is not associated with the plan in any capacity prohibited by item C of Interpretation No. 101-1 [sec. 101 par. .02];
 - 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, a covered member's independence would not be impaired if he or she receives benefits as a result of an immediate family member's participation in a plan that is permitted by the "Application of the Independence Rules to a Covered Member's Immediate Family" section of Interpretation No. 101-1 [sec. 101 par. .02].

[Revised, March 2010, effective May 31, 2010, by the Professional Ethics Executive Committee. Revised, November 2002, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

[108.] Participation of Member, Spouse or Dependent in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client

[.216–.217] [Deleted, November 2001.]

[109.] Member's Investment in Financial Services Products That Invest in Clients

[.218–.219] [Deleted, December 2005.]

110. Member Is Connected With an Entity That Has a Loan to or From a Client

.220 *Question*—A member is associated with an entity as an officer, director, or a shareholder who is able to exercise significant influence over an entity. That entity has a loan to or from a client of the member's firm. Would independence be considered to be impaired with respect to the client?

.221 *Answer*—If a *covered* member has control over the entity (as defined by Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 810, *Consolidation*), the existence of a loan to or from the client would impair independence unless the loan from the client is specifically permitted under Interpretation No. 101-5 of Rule 101 [sec. 101 par. .07].

If *any* partner or professional employee of the firm is connected with the entity as an officer, director, or shareholder who is able to exercise significant influence over the entity, but is unable to control the entity, he or she should consider Interpretation No. 102-2 [sec. 102 par. .03]. Interpretation No. 102-2 provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by the client or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client and other appropriate parties, the rule shall not operate to prohibit the performance of the professional service.

When making the decision as to whether to perform a professional service and in making disclosure to the appropriate parties, the member should consider Rule 301 [sec. 301 par. .01].

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1.]

111. Employee Benefit Plan Sponsored by Client

.222 *Question*—A member or his or her firm provides asset management or investment services that may include having custody of assets, performing management functions, or making management decisions for

an employee benefit plan (the plan) sponsored by a client. Would independence be considered to be impaired with respect to the plan and the client sponsor?

- .223** *Answer*—The performance of investment management or custodial services for a plan would be considered to impair independence with respect to the plan. Independence would also be considered to be impaired with respect to the client sponsor of a defined benefit plan if the assets under management or in the custody of the member are material to the plan or the client sponsor.

Independence would not be considered to be impaired with respect to the client sponsor of a defined contribution plan, provided the member does not make any management decisions or perform management functions on behalf of the client sponsor or have custody of the sponsor's assets.

[Deleted effective November 30, 2011. Reestablished and effective October 31, 2012, until the earlier of January 1, 2014, or adoption of Interpretation No. 101-18.]

112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services

- .224** *Question*—A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by FASB ASC 810) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients. Does Rule 102 [sec. 102 par. .01], require the member to disclose the use of the third-party service provider to the client?

- .225** *Answer*—Yes. The concept of integrity set forth in Rule 102 [sec. 102 par. .01] and section 54, *Article III—Integrity*, requires a member to be honest and candid. Clients might not have an expectation that a member would use a third-party service provider to assist the member in providing the professional services. Accordingly, before disclosing confidential client information to a third-party service provider, a member should inform the client, preferably in writing, that the member may use a third-party service provider. This disclosure does not relieve the member from his or her obligations under Ethics Ruling No. 1, “Use of a Third-Party Service Provider to provide Professional Services to Clients or Administrative Support Services to the Member,” of section 391, *Ethics Rulings on Responsibilities to Clients* [sec. 391 par. .001–.002]. If the client objects to the member's use of a third-party service provider, the member should provide the professional services without using the third-party service provider or the member should decline the engagement.

A member is not required to inform the client when he or she uses a third-party service provider to provide administrative support services (for example, record storage, software application hosting, or authorized e-file tax transmittal services) to the member.

See Ethics Ruling No. 12, “Applicability of General and Technical Standards When Using a Third-Party Service Provider,” of section 291, *Ethics Rulings on General and Technical Standards* [sec. 291 par. 023–.024]; and Ethics Ruling No. 1 of section 391 [sec. 301 par. .001–.002] for additional responsibilities of the member when using a third-party service provider.

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

113. Acceptance or Offering of Gifts or Entertainment

.226 *Question*—Would objectivity or integrity be considered to be impaired if a member offers or accepts gifts or entertainment to or from a client (or an individual in a key position with a client or an individual owning 10 percent or more of the client’s outstanding equity securities or other ownership interests), or a customer or vendor of the member’s employer (or a representative of the customer or vendor)?

.227 *Answer*—Objectivity would be considered to be impaired unless the gift or entertainment is reasonable in the circumstances.

The member should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Relevant facts and circumstances would include, but are not limited to:

- The nature of the gift or entertainment
- The occasion giving rise to the gift or entertainment
- The cost or value of the gift or entertainment
- The nature, frequency, and value of other gifts and entertainment offered or accepted
- Whether the entertainment was associated with the active conduct of business either directly before, during, or after the entertainment
- Whether other clients, customers, or vendors also participated in the entertainment
- The individuals from the client, customer, or vendor and the member’s firm or employer who participated in the entertainment

In addition, a member would be presumed to lack integrity if he or she accepted or offered gifts or entertainment that he or she knew or was reckless in not knowing would violate the member, client, customer, or vendor’s policies or applicable laws and regulations.

See Ethics Ruling No. 114, “Acceptance or Offering of Gifts and Entertainment to or From an Attest Client” [par. .228–.229], under Rule 101 [sec. 101 par. .01], for guidance applicable to the offer or acceptance of gifts or entertainment to or from an attest client.

114. Acceptance or Offering of Gifts and Entertainment to or From an Attest Client

.228 *Question*—Would independence be considered to be impaired if a member or the member’s firm offers or accepts gifts or entertainment to or from an attest client, an individual in a key position with an attest client, or an individual owning 10 percent or more of the attest client’s outstanding equity securities or other ownership interests (collectively, an attest client)?

.229 *Answer*—Independence would be considered to be impaired if the member’s firm or a member on the attest engagement team or in a position to influence the attest engagement accepts a gift from an attest client, unless the value is clearly insignificant to the recipient. Independence would not be considered to be impaired if a covered member accepts entertainment from an attest client, provided the entertainment is reasonable in the circumstances.

Independence would not be considered to be impaired if a covered member offers gifts or entertainment to an attest client, provided the gift or entertainment is reasonable in the circumstances.

See Ethics Ruling No. 113, “Acceptance or Offering of Gifts or Entertainment” [par. .226–.227], under Rule 102 [sec. 102 par. .01], for criteria a member should consider in determining whether the gifts or entertainment would be considered reasonable in the circumstances.

ET Section 200

GENERAL STANDARDS—ACCOUNTING PRINCIPLES

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*

- .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]

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

[.02] [202-1]—[Deleted]

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.]

(See appendix A, *Council Resolution Designating Bodies to Promulgate Technical Standards.*)

Interpretations under Rule 203

—*Accounting Principles*

.02 203-1—Departures from generally accepted accounting principles Reference to generally accepted accounting principles (GAAP) in Rule 203, *Accounting Principles* [sec. 203 par. .01], means those accounting principles promulgated by bodies designated by council, which are listed in appendix A, *Council Resolution Designating Bodies to Promulgate Technical Standards*. In the establishment of such principles, it is difficult to anticipate all circumstances to which such principles might be applied. There is a strong presumption that adherence to GAAP would, in nearly all instances, result in financial statements that are not misleading. Rule 203 [sec. 203 par. .01] recognizes that, upon occasion, there may be unusual circumstances when the literal application of GAAP 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 [sec. 203 par. .01] is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle within GAAP would be regarded generally by reasonable persons as producing misleading financial statements.

Examples of events that may justify a departure from GAAP 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 are examples of circumstances that would not ordinarily be regarded as unusual in the context of Rule 203 [sec. 203 par. .01].

[Revised, February 2012, effective April 30, 2012, by the Professional Ethics Executive Committee.]

.03 203-2—Status of FASB, GASB and FASAB interpretations Council is authorized under Rule 203 [sec. 203 par. .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 *Accounting Standards Codification*TM (ASC) constitutes accounting principles as contemplated in Rule 203 [sec. 203 par. .01]. Council has also designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities pursuant to Rule 203 [sec. 203 par. .01]. Council has also designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities pursuant to Rule 203 [sec. 203 par. .01].

In determining the existence of a departure from an accounting principle as established in FASB ASC and encompassed by Rule 203 [sec. 203 par. .01], or the existence of a departure from an accounting principle established by a Statement of Governmental Accounting Standards or a Statement of Federal Accounting Standards encompassed by Rule 203 [sec. 203 par. .01], the division of professional ethics will construe such codification or statements, in the light of any interpretations thereof issued by FASB, GASB, or FASAB.

[As amended, April 30, 2000. Revised, June 2009.]

[.04] [203-3]—[Deleted]

.05 203-4—Responsibility of employees for the preparation of financial statements in conformity with GAAP Rule 203 [sec. 203 par. .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 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 [sec. 203 par. .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 [sec. 203 par. .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.]

.06 203-5—Financial statements prepared pursuant to financial reporting frameworks other than GAAP Reference to GAAP in Rule 203 [sec. 203 par. .01] means those accounting principles promulgated by bodies designated by council, which are listed in appendix A. Financial statements prepared pursuant to other accounting principles would be considered financial reporting frameworks other than GAAP within the context of Rule 203 [sec. 203 par. .01].

However, Rule 203 [sec. 203 par. .01] does not preclude a member from preparing or reporting on financial statements that have been prepared pursuant to financial reporting frameworks other than GAAP, such as (a) financial reporting frameworks generally accepted in another country, including jurisdictional variations of International Financial Reporting Standards (IFRSs) such that the entity's financial statements do not meet the requirements for full compliance with IFRSs as promulgated by the International Accounting Standards Board; (b) financial reporting frameworks prescribed by an agreement or a contract; or (c) an other comprehensive basis of accounting, including statutory financial reporting provisions required by law or a U.S or foreign governmental regulatory body to whose jurisdiction the entity is subject.

In such circumstances, however, the financial statements or reports should not purport that the financial statements are in accordance with GAAP and the financial statements or reports on those financial statements, or both, should make clear the financial reporting framework(s) used.

[Added, February 2012, effective April 30, 2012, by the Professional Ethics Executive Committee.]

ET Section 291

Ethics Rulings on General and Technical Standards

[1.] Association of Name With Unaudited Statements When Member Is Not Independent

[.001–.002] [Deleted, September 1995.]

[2.] Opinion by Member Not in Public Practice

[.003–.004] [Deleted, December 1986.]

[3.] Controller, Preparation of Financial Statements

[.005–.006] [Deleted, May 1995.]

[4.] Two-Year Opinion—Prior Year Previously Unaudited

[.007–.008] [Deleted, May 1995.]

[5.] Interim Financial Statements

[.009–.010] [Deleted, October 1995.]

[6.] Letterhead

[.011–.012] [Deleted, September 1995.]

[7.] Non-CPA Partner

[.013–.014] [Transferred to sec. 591 par. .379–.380 as Ethics Ruling No. 190, 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 the member's competence. The member plans to retain a contract programming organization as a subcontractor to provide additional qualified manpower. What procedures should the member consider in making the selection of a subcontractor?

.016 *Answer*—When selecting subcontractors the member has a responsibility to ensure 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, from other CPAs, and from other customers of the subcontractor; the subcontractor's professional reputation and recognition; published materials (articles and books authored); and the member's personal evaluation of the subcontractor.

9. Supervision of Technical Specialist on Management Consulting Services Engagements

.017 *Question*—A member would like to add to the member's 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 the member's 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.

10. Submission of Financial Statements by a Member in Public Practice

.019 *Question*—A member in public practice is also a stockholder, partner, director, officer, or employee of an entity and in this capacity submits the entity's financial statements to third parties. What are the ethical considerations?

.020 *Answer*—If the member submits the financial statements in his or her capacity as a stockholder, partner, director, officer, or employee to a third party, the member should clearly communicate, preferably in writing, the relationship of the member to the entity and should not imply that the member is independent of the entity [sec. 191 par. .130–.131]. In addition, if the communication states affirmatively that the financial statements are presented in conformity with generally accepted accounting principles, the member is subject to Rule 203, *Accounting Principles* [sec. 203 par. .01], of the Code of Professional Conduct.

If the member prepares financial statements as a member in public practice and/or submits them using the member's public practitioner's letterhead or other identification, the member should comply with applicable standards, including any requirement to disclose a lack of independence.

[Revised, effective July 31, 2002, by the Professional Ethics Executive Committee.]

[11.] Applicability of Rule 203 to Members Performing Litigation Support Services

[.021–.022] [Deleted, November 2011.]

12. Applicability of General and Technical Standards When Using a Third-Party Service Provider

.023 *Question*—What responsibility does a member in public practice have for complying with the general and technical standards under Rule 201, *General Standards* [sec. 201 par. .01], and Rule 202, *Compliance With Standards* [sec. 202 par. .01], when using an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients?

.024 *Answer*—Using a third-party service provider to assist the member in providing professional services to clients does not in any way relieve the member from his or her responsibilities to comply with the requirements of Rules 201 [sec. 201 par. .01] and 202 [sec. 202 par. .01]. Accordingly, the member re-

mains responsible for the adequate oversight of all services performed by the third-party service provider and for ensuring that all professional services are performed with professional competence and due professional care. In addition, the member must adequately plan and supervise the professional services provided by the third-party service provider, obtain sufficient relevant data to support his or her work product and comply with all technical standards applicable to the professional services.

This ruling does not extend the member's responsibility for planning and supervising the work of a third-party service provider beyond the requirements of applicable professional standards, which may vary depending upon the nature of the member's engagement.

See Ethics Ruling No. 112, "Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services," of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .224–.225], and Ethics Ruling No. 1, "Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member," of section 391, *Ethics Rulings on Responsibilities to Clients* [sec. 391 par. .001–.002], for additional responsibilities of the member when using a third-party service provider.

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

ET Section 300

RESPONSIBILITIES TO CLIENTS

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 [ET section 202.01] and 203 [ET section 203.01], (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

[.02] [301-1]—[Deleted]

[.03] [301-2]—[Deleted]

.04 301-3—Confidential information and the purchase, sale, or merger of a practice Rule 301 [ET section 301.01] 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 [ET section 301.01], 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.]

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 [ET sec. 302 par. .01] and provides examples of the application of the rule. When practicing before the IRS or other taxing authorities, members should ensure compliance with any requirements that are more restrictive.

Definition of Terms

- (a) Preparation of an original or amended tax return or claim for tax refund includes giving advice on events that 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 expectation 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 regarding the propriety of the deduction; rather the claim is filed to correct an omission.

[Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

ET Section 391

Ethics Rulings on Responsibilities to Clients

1. Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member

.001 *Question*—A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined in Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*) or an individual not employed by the member (a “third-party service provider”) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients or for providing administrative support services to the member (for example, record storage, software application hosting, or authorized e-file tax transmittal services). Does Rule 301, *Confidential Client Information* [sec. 301 par. .01], require the member to obtain the client’s consent before disclosing confidential client information to the third-party service provider?

.002 *Answer*—No. Rule 301 [sec. 301 par. .01] is not intended to prohibit a member in public practice from disclosing confidential client information to a third-party service provider used by the member for purposes of providing professional services to clients or for administrative support purposes. However, before using such a service provider, the member should enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the information and be reasonably assured that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential information to others. The nature and extent of procedures necessary to obtain reasonable assurance depends on the facts and circumstances, including the extent of publicly available information on the third-party service provider’s controls and procedures to safeguard confidential client information.

In the event the member does not enter into a confidentiality agreement with a third-party service provider, specific client consent should be obtained before the member discloses confidential client information to the third-party service provider.

See Ethics Ruling No. 112, “Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services,” of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .224–.225], and Ethics Ruling No. 12, “Applicability of General and Technical Standards When Using a Third-Party Service Provider,” of section 291, *Ethics Rulings on General and Technical Standards* [sec. 291 par. .023–.024], for additional responsibilities of the member when using a third-party service provider.

[Revised, effective July 1, 2005, except for professional services performed pursuant to agreements in existence on June 30, 2005, that are completed by December 31, 2005, by the Professional Ethics Executive Committee. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011.]

2. Disclosure of Client Information to Third Parties

.003 *Question*—A member has received a request from a third party (for example, a trade association, member of academia, or surveying or benchmarking organization) to disclose client information or intends to

use such information for the member's own purposes (for example, publication of benchmarking data or studies) in a manner that may result in the client's information being disclosed to others without the client being specifically identified. May the member comply with such a request or use client information for such purposes without violating Rule 301 [sec. 301 par. .01]?

- .004** *Answer*—A member would be in violation of Rule 301 [sec. 301 par. .01] if the information is considered to be confidential client information, unless the member has the clients' specific consent, preferably in writing, for the disclosure or use of such information. The disclosure or use of information that is available to the public is not subject to Rule 301 [sec. 301 par. .01]. The member should be cautious in the disclosure or use of the information so as not to disclose client information that may go beyond what is available to the public or that the client has agreed may be disclosed.

Accordingly, before disclosing confidential client information to a third party or using such information for the member's own purposes when the use of such information results in disclosure of confidential client information to others, the member should obtain the client's specific consent, preferably in writing, about the nature of the information that may be disclosed, the type of third party to whom it may be disclosed, and its intended use.

A member is not prohibited from marketing his or her services or advising a third party, such as a current or prospective client, of information based on his or her expertise or knowledge obtained from prior experiences with clients (for example, the nature of services provided to other clients or common practices within a client's industry). However, in cases when such information may be identifiable to one or more clients, specific consent, preferably in writing, would be required from such client(s). Prior to disclosing confidential client information to a third party, the member should consider whether a contractual agreement with the third party to maintain the confidentiality, or limit the use, of the information is necessary.

In addition, the member should consider whether federal, state, or local statutes, rules, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in this ethics ruling.

See Ethics Ruling No. 12 of section 291 [sec. 291 par. .023–.024], and Ethics Ruling No. 1, “Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member,” of this section [sec. 391 par. .001–.002] for guidance when disclosing confidential client information to a third party used to assist the member in providing professional services to clients that will not result in disclosure to others.

[Revised September 2011, effective November 30, 2011.]

3. Information to Successor Accountant About Tax Return Irregularities

- .005** *Question*—A member withdrew from an engagement on discovering irregularities in his or her client's tax return. May he or she reveal to the successor accountant why the relationship was terminated?
- .006** *Answer*—Rule 301 [sec. 301 par. .01] 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 or she 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 or her status and obligations in the matter.

[4.] Prior Client Relationship

[.007–.008] [Deleted August 1989]

[5.] Records Retention Agency

[.009–.010] [Deleted October 2004]

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 or her 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 [sec. 301 par. .01] 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 [sec. 301 par. .01] 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 Ethics Ruling No. 7, *Revealing Names of Employer's Clients*, effective August 31, 1989.]

[8.] Fee as Percentage of Bond Issue

[.015–.016] [Deleted June 1991]

[9.] Finder's Fee

[.017–.018] [Deleted June 1991]

[10.] Fee as Expert Witness

[.019–.020] [Deleted June 1991]

[11.] Fee Contingent on Mortgage Commitment

[.021–.022] [Deleted June 1991]

[12.] Fee as Percentage of Tax Savings

[.023–.024] [Deleted June 1991]

[13.] Contingent Fees to Fire Adjuster

[.025–.026] [Deleted June 1991]

14. Use of Confidential Information on Management Consulting Service Engagements

.027 *Question*—In the course of performing a feasibility study a nonclient 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 301 [sec. 301 par. .01] regarding confidential client information is not directly applicable to the circumstances described; however, Rule 501, *Acts Discreditable* [sec. 501 par. .01], 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 nonclient sources, and such information must remain confidential, the terms of the engagement with the client should specify that the confidences of outside nonclient 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 or her 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 or her 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 or her using a newly developed electronic ticketing system for his or her business. A recent study made for another client leads the member's firm to believe that the system would not be desirable for him or her. Must the firm state its reservations at the risk of disclosing information acquired while performing an assignment for a client competitor?

.030 *Answer*—Rule 301 [sec. 301 par. .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 [sec. 301 par. .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 [sec. 301 par. .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, *Contingent Fees* [sec. 302 par. .01], and 503, *Commissions and Referral Fees* [sec. 503 par. .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 [sec. 301 par. .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. *Conflicts of Interest*—Interpretation 102-2, “Obligations of a Member to His or Her Employer’s External Accountant” [sec. 102 par. .03], provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from all appropriate parties, performance of the service shall not be prohibited.

In view of the preceding 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 a 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 client's 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 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .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, *Integrity and Objectivity* [sec. 102 par. .01], and Interpretation 102-2 [sec. 102 par. .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 [sec. 301 par. .01]?

.040 *Answer*—No. Rule 301 [sec. 301 par. .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.

21. Member Providing Services for Company Executives

.041 *Question*—A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in the member recommending to the executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

.042 *Answer*—Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102 [sec. 102 par. .01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member should also consider informing the company and the executives

of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301 [sec. 301 par. .01].

[22.] Member Removing Client Files From an Accounting Firm

[.043–.044] [Deleted December 1998]

23. Disclosure of Confidential Client Information in Legal or Alternative Dispute Resolution Proceedings

.045 *Question*—A member discloses confidential client information to the member's attorney or a court or in documents or proceedings in connection with an actual or threatened lawsuit or alternative dispute resolution proceedings relating to that client. Would the member be in violation of the Rule 301 [sec. 301 par. .01] of the Code of Professional Conduct?

.046 *Answer*—No. Rule 301 [sec. 301 par. .01] is not included to prohibit a member from disclosing the information necessary to initiate, pursue or defend himself or herself in such proceedings.

This ruling is not intended to prohibit a member's compliance with applicable federal or state laws or regulations.

24. Investment Advisory Services

.047 *Question*—A member or member's firm ("member") provides investment advisory services for an attest client for a fee based on a percentage of the client's investment portfolio. Would the member be considered to be in violation of Rule 302 [sec. 302 par. .01]?

.048 *Answer*—Yes. However, the fee would not be contingent upon portfolio performance and, therefore, would not be in violation of Rule 302 [sec. 302 par. .01] if all of the following conditions are met:

1. The fee is determined as a specified percentage of the client's investment portfolio.
2. The dollar amount of the portfolio on which the fee is based is determined at the beginning of each quarterly period (or longer period of time as may be agreed upon) and is adjusted only for additions or withdrawals made by the client during the period.
3. The fee arrangement is not renewed with the client more frequently than on a quarterly basis.

When performing such services, the member should also consider Rule 101, *Independence* [sec. 101 par. .01], especially Interpretation 101-3, "Performance of Nonattest Services" [sec. 101 par. .05].

25. Commission and Contingent Fee Arrangements With Nonattest Client

.049 *Question*—A member or member's firm (member) provides for a contingent fee investment advisory services, or refers for a commission products or services of a nonclient or a nonattest client, to the owners, officers, or employees of an attest client or to a nonattest client employee benefit plan sponsored by an attest client. Would the member be considered to be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01]?

.050 *Answer*—No. The member would not be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01] provided that, with respect to Rule 503 [sec. 503 par. .01], the member discloses the commission to the owners, officers, or employees or to the employee benefit plan. The member should also consider the applicability of Interpretation 102-2 [sec. 102 par. .03], and his or her professional responsibility to clients under Rule 301 [sec. 301 par. .01].

ET Section 400

RESPONSIBILITIES TO COLLEAGUES

[Reserved.]

ET Section 500

OTHER RESPONSIBILITIES AND PRACTICES

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*

.02 501-1—Response to requests by clients and former clients for records

Terminology

The following terms are defined subsequently solely for use with this interpretation:

- The term *client* includes current and former clients.
- *Client-provided records* are accounting or other records belonging to the client that were provided to the member by, or on behalf of, the client, including hard copy or electronic reproductions of such records.
- *Member-prepared records* are accounting or other records that the member was not specifically engaged to prepare and that are not in the client's books and records or are otherwise not available to the client, with the result that the client's financial information is incomplete. Examples include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries), and supporting schedules and documents that are proposed or prepared by the member as part of an engagement (for example, an audit).
- *Member's work products* are deliverables as set forth in the terms of the engagement, such as tax returns.
- *Member's working papers* are all other items prepared solely for purposes of the engagement and include items prepared by the
 - member, such as audit programs, analytical review schedules, and statistical sampling results and analyses, and
 - client, at the request of the member and reflecting testing or other work done by the member.

Interpretation

Members must comply with the rules and regulations of authoritative regulatory bodies, such as the member's state board(s) of accountancy, when the member performs services for a client and is subject to the rules and regulations of such regulatory body. For example, a member's state board(s) of accountancy may not permit a member to withhold certain records notwithstanding fees due to the member for the work performed. Failure to comply with the more restrictive provisions contained in the rules and regulations of the applicable regulatory body concerning the return of certain records would constitute a violation of this interpretation.

Client-provided records in the member's custody or control should be returned to the client at the client's request.

Unless a member and the client have agreed to the contrary, when a client makes a request for member-prepared records or a member's work products that are in the custody or control of the member or the member's firm (member) that have not previously been provided to the client, the member should respond to the client's request as follows:^{fn 1}

- Member-prepared records relating to a completed and issued work product should be provided to the client, except that such records may be withheld if there are fees due to the member for the specific work product.
- Member's work products should be provided to the client, except that such work products may be withheld
 - if there are fees due to the member for the specific work product;
 - if the work product is incomplete;
 - for purposes of complying with professional standards (for example, withholding an audit report due to outstanding audit issues); or
 - if threatened or outstanding litigation exists concerning the engagement or member's work.

Once the member has complied with these requirements, he or she is under no ethical obligation to comply with any subsequent requests to again provide such records or copies of such records. However, if subsequent to complying with a request, a client experiences a loss of records due to a natural disaster or an act of war, the member should comply with an additional request to provide such records.

Member's working papers are the member's property and need not be provided to the client under provisions of this interpretation; however, such requirements may be imposed by state and federal statutes and regulations, and contractual agreements.

In connection with any request for client-provided records, member-prepared records or a member's work products, the member may

- charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records and require that such fee be paid prior to the time such records are provided to the client,
- provide the requested records in any format usable by the client, and
- make and retain copies of any records returned or provided to the client.

The member is not required to convert records that are not in electronic format to electronic format or to convert electronic records into a different type of electronic format. However, if the client requests records in a specific format, and the records are available in such format within the member's custody and control, the client's request should be honored. In addition, the member is not required to provide the

^{fn 1} The member is under no obligation to retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed.

client with formulas, unless the formulas support the client's underlying accounting or other records, or the member was engaged to provide such formulas as part of a completed work product.

Where a member is required to return or provide records to the client, the member should comply with the client's request as soon as practicable but, absent extenuating circumstances, no later than 45 days after the request is made. The fact that the statutes of the state in which the member practices grants the member a lien on certain records in his or her custody or control does not relieve the member of his or her obligation to comply with this interpretation.

[Revised, February 2012, effective April 30, 2012, by the Professional Ethics Executive Committee. Revised, effective February 28, 2011. Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, effective April 30, 2006, by the Professional Ethics Executive Committee.]

- .03 501-2—Discrimination and harassment in employment practices** Whenever a member is finally determined by a court of competent jurisdiction to have violated any of the antidiscrimination laws of the United States or any state or municipality thereof, including those related to sexual and other forms of harassment, or has waived or lost his or her right of appeal after a hearing by an administrative agency, the member will be presumed to have committed an act discreditable to the profession in violation of Rule 501, *Acts Discreditable* [sec. 501 par. .01].

[Revised, effective November 30, 1997, by the Professional Ethics Executive Committee.]

- .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 or she is obligated to follow such requirements. Failure to do so is an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01], unless the member discloses in his or her 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 shall be considered to have committed an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01] when, by virtue of his or her negligence, such member—

- a. Makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity; or
- b. Fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry; or
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

- .06 501-5—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies** 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

the preparation of financial statements or related information, or in performing attest or similar services for entities subject to their jurisdiction. For example, the Securities and Exchange Commission (SEC), Federal Communications Commission, state insurance commissions, and other regulatory agencies, such as the Public Company Accounting Oversight Board, have established such requirements.

If a member prepares financial statements or related information (for example, management's discussion and analysis) for purposes of reporting to such bodies, commissions, or regulatory agencies, the member should follow the requirements of such organizations in addition to generally accepted accounting principles. If 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). A material departure from such requirements is an act discreditable to the profession, unless the member discloses in the financial statements or his or her report, as applicable, that such requirements were not followed and the reasons therefore.

[Effective August 31, 1989. Revised, effective October 31, 2000, by the Professional Ethics Executive Committee. Revised, effective April 30, 2004, by the Professional Ethics Executive Committee.]

- .07 501-6—Solicitation or disclosure of CPA examination questions and answers** A member who solicits or knowingly discloses the May 1996 or later Uniform CPA Examination question(s) or answer(s), or both, without the written authorization of the AICPA shall be considered to have committed an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01].

[Effective January 31, 1996. Revised May 1996, by the Professional Ethics Executive Committee.]

- .08 501-7—Failure to file tax return or pay tax liability** A member who fails to comply with applicable federal, state, or local laws or regulations regarding the timely filing of his or her personal tax returns or tax returns of the member's firm, or the timely remittance of all payroll and other taxes collected on behalf of others, may be considered to have committed an act discreditable to the profession in violation of Rule 501 [sec. 501 par. .01].

[Effective May 31, 1999.]

- .09 501-8—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnification and limitation of liability provisions in connection with audit and other attest services** Certain governmental bodies, commissions, or other regulatory agencies (collectively, *regulators*) have established requirements through laws, regulations, or published interpretations that prohibit entities subject to their regulation (*regulated entity*) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators or that provide that the existence of such provisions causes a member to be disqualified from providing such services to these entities. For example, federal banking regulators, state insurance commissions, and the SEC have established such requirements.

If a member enters into, or directs or knowingly permits another individual to enter into, a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the member should not include, or knowingly permit or direct another individual to include, an indemnification or limitation of liability provision that would cause the regulated entity or a member to be in violation of such requirements or that would cause a member to be disqualified from providing such services to the regulated entity. A member who enters into, or directs or knowingly permits another individual to enter into, such an agreement for the performance of audit or other attest services that would cause the regulated entity or a member to be in violation of such requirements, or that would cause a

member to be disqualified from providing such services to the regulated entity, would be considered to have committed an act discreditable to the profession.

Members should also consult Ethics Ruling No. 94, “Indemnification Clause in Engagement Letters,” of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* [sec. 191 par. .188–.189] and Ethics Ruling No. 102, “Indemnification of a Client,” of ET section 191 [sec. 191 par. .204–.205] under Rule 101, *Independence*, for guidance related to use of indemnification clauses in engagement letters and the impact on a member’s independence.

[Effective July 31, 2008.]

- .10 501-9—Confidential information obtained from employment or volunteer activities** A member should maintain confidentiality of his or her employer’s or firm’s (employer) confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship (for example, discussions with the employer’s vendors, customers, or lenders). This includes, but is not limited to, any confidential information pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the member is working in a volunteer capacity. For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the member may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

A member should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or a close or immediate family member. The member should also take reasonable steps to ensure that staff under his or her control or others within the employing organization and persons from whom advice and assistance is obtained are aware of the confidential nature of the information.

When a member changes employment, a member should not use confidential employer information acquired as a result of the prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain confidentiality of an employer’s confidential information continues even after the end of the relationship between a member and the employer. However, the member is entitled to use experience and expertise gained through prior employment relationships.

A member would be considered to have committed an act discreditable to the profession if the member discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the member may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

The following are examples when members are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the employer.
- b. Disclosure is required by law, for example, to
 - i. comply with a validly issued and enforceable subpoena or summons or
 - ii. inform the appropriate public authorities of violations of law that have been discovered.

- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
 - i. initiate a complaint with, or respond to any inquiry made by, the professional ethics division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;
 - ii. protect the professional interests of a member in legal proceedings;
 - iii. comply with professional standards and other ethics requirements; or
 - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the employer's confidential complaint hotline or those charged with governance.

Members should also consider Interpretation 102-4, "Subordination of Judgment by a Member," under Rule 102, *Integrity and Objectivity* [sec. 102 par. .05], for additional guidance.

- d. Disclosure is permitted on behalf of the employer to
 - i. obtain financing with lenders;
 - ii. deal with vendors, clients, and customers; or
 - iii. deal with the employer's external accountant, attorneys, regulators, and other business professionals.

In deciding whether to disclose confidential employer information, relevant factors to consider include, but are not limited to, the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable (when the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, professional judgment should be used in determining the type of disclosure to be made, if any)
- b. Whether the parties to whom the communication may be addressed are appropriate recipients

A member may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information.

[Effective November 30, 2011.]

- .11 501-10—False, misleading, or deceptive acts in promoting or marketing professional services** A member in business who promotes or markets his or her abilities to provide professional services or makes claims about his or her experience or qualifications in a manner that is false, misleading, or deceptive will be considered to have committed an act discreditable to the profession, in violation of Rule 501 [sec. 501 par. .01]. A false, misleading, or deceptive promotion includes any claim or representation that would be likely to cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body.

[Effective November 30, 2011.]

.12 501-11—Use of the CPA credential A member should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A member who fails to follow the accountancy laws, rules, and regulations regarding the use of the CPA credential in all the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of Rule 501 [sec. 501 par. .01].

[Added March 2013, effective May 31, 2013.]

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

[.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.

.07 502-6—Use of the CPA credential A member should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A member who fails to follow the accountancy laws, rules, and regulations regarding the use of the CPA credential in all the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of Rule 502 [sec. 502 par. .01].

[Added March 2013, effective May 31, 2013.]

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

[.02] [503-1]—[Deleted]

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 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.

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

[As amended January 14, 1992 and October 28, 1997. Revised May 15, 2000.]

(See Appendix B.)

Interpretations Under Rule 505

—*Form of Organization and Name*

[.02] [505-1]—[Deleted]

.03 505-2—Application of rules of conduct to members who own a separate business A member in public practice may own an interest in 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 paragraph .06 in section 92, *Definitions*). If the member, individually or collectively with his or her firm or members of his or her firm, controls the separate business (as defined in Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*), the entity and all its owners (including the member) and employees must comply with all of the provisions of the Code of Professional Conduct. For example, in applying Rule 503, *Commissions and Referral Fees* [sec. 503 par. .01], if one or more members individually or collectively can control the separate business, such business would be subject to Rule 503 [sec. 503 par. .01], its interpretations, and rulings. With respect to an attest client, Rule 101, *Independence* [sec. 101 par. .01], and all its interpretations and rulings would apply to the separate business, its owners, and employees.

If the member, individually or collectively with his or her firm or members of his or her firm, does not control the separate business, the provisions of the code would apply to the member for his or her actions but not apply to the entity, its other owners, and employees. For example, the entity could enter into a contingent fee arrangement with an attest client of the member or accept commissions for the referral of products or services to such attest client.

[Replaces previous Interpretation No. 505-2, with the same title, March 1993, effective March 31, 1993. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of Interpretation No. 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee. Revised, March 2011, by the Professional Ethics Executive Committee, effective May 31, 2011. Revised March 2013, revisions effective May 31, 2013.]

.04 505-3—Application of rule 505 to alternative practice structures Rule 505, *Form of Organization and Name* [sec. 505 par. .01], states, “A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.” The Council Resolution (the Resolution) requires, among other things, that a majority of the financial interests in a firm engaged in attest services (as defined therein) be owned by CPAs. In the context of alternative practice structures (APS) in which (1) the majority of the financial interests in the attest firm is owned by CPAs and (2) all or substantially all of the revenues are paid to another entity in return for services and the lease of employees, equipment, and office space, questions have arisen as to the applicability of Rule 505 [sec. 505 par. .01].

The overriding focus of the Resolution is that CPAs remain responsible, financially and otherwise, for the attest work performed to protect the public interest. The Resolution contains many requirements that were developed to ensure that responsibility. In addition to the provisions of the Resolution, other requirements of the Code of Professional Conduct and bylaws ensure that responsibility:

- a. Compliance with all aspects of applicable state law or regulation
- b. Enrollment in an AICPA-approved practice monitoring program
- c. Compliance with the independence rules prescribed by Rule 101, *Independence* [sec. 101 par. .01]
- d. Compliance with applicable standards promulgated by Council-designated bodies (Rule 202, *Compliance With Standards* [sec. 202 par. .01]) and all other provisions of the Code, including section 91, *Applicability*

Taken in the context of all the above-mentioned safeguards of the public interest, if the CPAs who own the attest firm remain financially responsible, under applicable law or regulation, the member is considered to be in compliance with the financial interests provision of the Resolution.

[Effective December 31, 1998. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, June 2009.]

- .05 505-4—Misleading Firm Names** Rule 505 [sec. 505 par. .01] prohibits a member from practicing public accounting under a firm name that is misleading. A firm name would be considered misleading if the name contains any representation that would be likely to cause a reasonable person to misunderstand, or be confused about, the legal form of the firm or who the owners or members of the firm are, such as a reference to a type of organization or an abbreviation thereof that does not accurately reflect the form under which the firm is organized.

In addition, the member should consider the rules and regulations of his or her state board(s) of accountancy concerning misleading firm names that may be more restrictive than the requirements contained in this ethics interpretation.

[Effective August 31, 2012, by the Professional Ethics Executive Committee.]

- .06 505-5—Common Network Brand in Firm Name** Firms within a network sometimes share the use of a common brand or share common initials as part of the firm name. The sharing of a common brand name or common initials of a network as part of the member's firm name would not be considered misleading, provided the firm is a *network firm*, as defined in paragraph .24 of section 92.

The sharing of a common brand name or common initials of a network as the entire name of the member's firm would not be considered misleading, provided the firm is a *network firm*, as defined in paragraph .24 of section 92, and shares one or more of the following characteristics with other firms in the network:

- Common control (as defined in Financial Accounting Standards Board *Accounting Standards Codification* 810, *Consolidation*) among the firms through ownership, management, or other means
- Profits or costs, excluding costs of operating the network; costs of developing audit methodologies, manuals, and training courses; and other costs that are immaterial to the firm

- Common business strategy that involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the network's strategy and are held accountable for performance pursuant to that strategy
- Significant part of professional resources
- Common quality control policies and procedures that firms are required to implement and that are monitored by the network

Members should refer to Interpretation No. 101-17, "Networks and Network Firms," under Rule 101, *Independence* [ET sec. 101 par. .19], for independence requirements applicable to network firms.

[Effective August 31, 2012, by the Professional Ethics Executive Committee.]

ET Section 591

Ethics Rulings on Other Responsibilities and Practices

[1.] Retention of Records

[.001–.002] [Superseded by Interpretation No. 501-1.]

[2.] Fees: Collection of Notes Issued in Payment

[.003–.004] [Deleted, November 2011.]

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 or she is employed by such a firm, what are his or her responsibilities under the Rules of Conduct?

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

[4.] Association Employee

[.007–.008] [Deleted, March 1978.]

[5.] Association as an Agent

[.009–.010] [Deleted, March 1978.]

[6.] Associations, Speaking Engagements

[.011–.012] [Deleted, March 1978.]

[7.] Trading Pool

[.013–.014] [Deleted, March 1978.]

[8.] Change of Control of Client Company

[.015–.016] [Deleted, September 1981.]

[9.] Charity Solicitation by Phone

[.017–.018] [Deleted, March 1978.]

[10.] Church Bulletin

[.019-.020] [Deleted, March 1978.]

[11.] Attorney, Clients

[.021-.022] [Deleted, March 1978.]

[12.] Confirmation Requests

[.023-.024] [Deleted, March 1978.]

[13.] Confirmation Stickers

[.025-.026] [Deleted, March 1978.]

[14.] Estate Planning

[.027-.028] [Deleted, March 1978.]

[15.] Golf Outing

[.029-.030] [Deleted, March 1978.]

[16.] Letter on Behalf of Client

[.031-.032] [Deleted, March 1978.]

[17.] Letterhead for Estate Practice

[.033-.034] [Deleted, March 1978.]

[18.] Letterhead for Promotional Material

[.035-.036] [Deleted, March 1978.]

[19.] Mailings to Accountants

[.037-.038] [Deleted, March 1978.]

[20.] Trade Association Analysis

[.039-.040] [Deleted, September 1981.]

[21.] Trade Association Survey

[.041-.042] [Deleted, September 1981.]

[22.] Management Consultant

[.043–.044] [Deleted, March 1978.]

[23.] Tax Work Obtained Through Bookkeeper

[.045–.046] [Deleted, March 1978.]

[24.] Advertising on Tax Broadcast

[.047–.048] [Deleted, March 1978.]

[25.] Alumni Magazine Announcement

[.049–.050] [Deleted, March 1978.]

[26.] Brochure Showing Use of Equipment

[.051–.052] [Deleted, March 1978.]

[27.] Client Publishing Article on Member's Software Program

[.053–.054] [Deleted, March 1978.]

[28.] Business Card on Newsletter

[.055–.056] [Deleted, March 1978.]

[29.] Computer Print-Out

[.057–.058] [Deleted, March 1978.]

[30.] Charitable Contribution

[.059–.060] [Deleted, March 1978.]

[31.] Congratulatory Message

[.061–.062] [Deleted, March 1978.]

[32.] Copyright for Wheel Computer and Tax Withholding Tables

[.063–.064] [Deleted, March 1978.]

[33.] Course Instructor

[.065–.066] [Deleted, November 2011.]

[34.] Course Promotional Circular

[.067–.068] [Deleted, March 1978.]

[35.] CPA-Author Credits

[.069–.070] [Deleted, March 1978.]

[36.] CPA-Author of Book Review

[.071–.072] [Deleted, March 1978.]

[37.] CPA-Authored Articles

[.073–.074] [Deleted, March 1978.]

[38.] CPA Title, Controller of Bank

[.075–.076] [Deleted March 2013, effective May 31, 2013.]

[39.] CPA Title Imprinted on Checks

[.077–.078] [Deleted, March 1978.]

[40.] CPA Title in Campaign for School Board Membership

[.079–.080] [Deleted, March 1978.]

[41.] CPA Title in Lecture Ad

[.081–.082] [Deleted, March 1978.]

[42.] CPA Title in Political Endorsement

[.083–.084] [Deleted, March 1978.]

[43.] CPA Designation in Speaker's Qualifications

[.085–.086] [Deleted, March 1978.]

[44.] CPA Designation of Speaker Named in Tax Forum Ad

[.087–.088] [Deleted, March 1978.]

[45.] CPA Title on Agency Letterhead

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

[46.] CPA Title on Employment Agency Letterhead

[.091–.092] [Deleted, March 1978.]

[47.] Low-Income Taxpayers

[.093–.094] [Deleted, March 1978.]

[48.] CPA Title on Public Official's Match Folder

[.095–.096] [Deleted, March 1978.]

[49.] CPA Designation on Research Reports

[.097–.098] [Deleted, March 1978.]

[50.] Data Processing Program Ad in Technical Publications

[.099–.100] [Deleted, March 1978.]

[51.] Directories in Elevator

[.101–.102] [Deleted, March 1978.]

[52.] Directory, Alphabetical

[.103–.104] [Deleted, March 1978.]

[53.] Directory, Chamber of Commerce Buyer's Guide

[.105–.106] [Deleted, March 1978.]

[54.] Directory, Trade Association

[.107–.108] [Deleted, March 1978.]

[55.] Directory Listing, Bank Auditors

[.109–.110] [Deleted, March 1978.]

[56.] Directory Listing, Change in Telephone Number Announcements

[.111–.112] [Deleted, March 1978.]

[57.] Directory Listing, Fraternity

[.113–.114] [Deleted, March 1978.]

[58.] Directory Listing, "Lawyer-CPA-Tax Attorney"

[.115-.116] [Deleted, March 1978.]

[59.] Directory Listing, Membership Designation

[.117-.118] [Deleted, March 1978.]

[60.] Directory Listing, Multiple

[.119-.120] [Deleted, March 1978.]

[61.] Directory Listings

[.121-.122] [Deleted, March 1978.]

[62.] Directory Listing, Partners' Names

[.123-.124] [Deleted, March 1978.]

[63.] Directory Listing, White Pages

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

[64.] Directory, Trade Association

[.127-.128] [Deleted, March 1978.]

[65.] Distribution of Firm Bulletin to Publisher

[.129-.130] [Deleted, March 1978.]

[66.] Distribution of Firm Literature

[.131-.132] [Deleted, March 1978.]

[67.] Firm Publications: Annual Financial Report

[.133-.134] [Deleted, March 1978.]

[68.] Employment Ads: "Situations Wanted"

[.135-.136] [Deleted, March 1978.]

[69.] Firm Name in Staff Training Manual

[.137-.138] [Deleted, March 1978.]

[70.] CPA Title on License Plates

[.139–.140] [Deleted, March 1978.]

[71.] Firm Name on Bowling Shirts

[.141–.142] [Deleted, March 1978.]

[72.] Firm Name on Desk Calendars

[.143–.144] [Deleted, March 1978.]

[73.] Firm Name on EDP Publication

[.145–.146] [Deleted, March 1978.]

[74.] Firm Name on Tax Booklet

[.147–.148] [Deleted, September 1981.]

[75.] Greeting Cards to Clients

[.149–.150] [Deleted, March 1978.]

[76.] Letterhead

[.151–.152] [Deleted, March 1978.]

[77.] Letterhead: Academic Degrees

[.153–.154] [Deleted, March 1978.]

[78.] Letterhead: Lawyer-CPA

[.155–.156] [Deleted March 2013, effective May 31, 2013.]

[79.] Letterhead: Tax Specialization

[.157–.158] [Deleted, March 1978.]

[80.] Management Letter

[.159–.160] [Deleted, March 1978.]

[81.] Medicare Booklet

[.161–.162] [Deleted, March 1978.]

[.163–.164] [Deleted, November 1997.]

[83.] Nonpractitioner in Sales Brochure

[.165–.166] [Deleted, March 1978.]

[84.] Paid for by Others, Member's Testimonial Letter

[.167–.168] [Deleted, March 1978.]

[85.] Paid for by Others, Member's Testimonial Letter

[.169–.170] [Deleted, March 1978.]

[86.] Paid for by Others, Name in Client Ad

[.171–.172] [Deleted, August 1989.]

[87.] Paid for by Others, Radio Program Dedication

[.173–.174] [Deleted, March 1978.]

[88.] Political Endorsement

[.175–.176] [Deleted, March 1978.]

[89.] Postage Meter Machines

[.177–.178] [Deleted, March 1978.]

[90.] Open House

[.179–.180] [Deleted, March 1978.]

[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.] Press Release on Society Chapter Meeting

[.185–.186] [Deleted, March 1978.]

[94.] Professorship Named After CPA

[.187–.188] [Deleted, March 1978.]

[95.] Qualifications as Attachment to Report

[.189–.190] [Deleted, March 1978.]

[96.] Resume for Lender's Information

[.191–.192] [Deleted, March 1978.]

[97.] Seminar Announcement

[.193–.194] [Deleted, March 1978.]

[98.] Signs on Office Premises

[.195–.196] [Deleted, March 1978.]

[99.] Signs on Office Premises

[.197–.198] [Deleted, March 1978.]

[100.] Specialization on Business Card

[.199–.200] [Deleted, March 1978.]

[101.] Specialization, Acquisitions & Mergers

[.201–.202] [Deleted, June 1982.]

[102.] Specialization: "Tax Accountant" Designation by Nonpractitioner

[.203–.204] [Deleted, March 1978.]

[103.] Recruiting Ad in Employment Guide or Career Opportunity Guide

[.205–.206] [Deleted, March 1978.]

[104.] Staff Recruiting in University Publication

[.207–.208] [Deleted, March 1978.]

[105.] Announcement Card: Elected to Vice Presidency

[.209–.210] [Deleted, March 1978.]

[106.] Information Under Telephone Directory Heading

[.211–.212] [Deleted, March 1978.]

[107.] Member as Consultant for Client's Customers

[.213–.214] [Deleted, March 1978.]

[108.] Member Interviewed by the Press

[.215–.216] [Deleted, November 2011.]

[109.] Compensation From Nonpractitioners

[.217–.218] [Deleted, June 1991.]

[110.] Computer Service Franchise

[.219–.220] [Deleted, June 1991.]

[111.] Purchase of Bookkeeping Practice

[.221–.222] [Deleted, June 1991.]

[112.] Referral

[.223–.224] [Deleted, June 1991.]

[113.] Member's Spouse as Insurance Agent

[.225–.226] [Deleted, June 1991.]

[114.] Member's Firm Paying Employee Bonuses

[.227–.228] [Deleted, June 1991.]

[115.] Actuary

[.229–.230] [Deleted, December 1992.]

[116.] Bank Director

[.231–.232] [Superseded, June 1976.]

[117.] Consumer Credit Company Director

[.233–.234] [Deleted, November 2011.]

[118.] Employment Agency

[.235–.236] [Deleted, March 1978.]

[119.] Finance Company

[.237–.238] [Deleted, March 1978.]

[120.] Insurance Broker

[.239–.240] [Deleted, March 1978.]

[121.] Insurance Salesman

[.241–.242] [Deleted, March 1978.]

[122.] Investment Advisor

[.243–.244] [Deleted, March 1978.]

[123.] Loan Broker

[.245–.246] [Deleted, March 1978.]

[124.] Mutual Fund Salesman

[.247–.248] [Deleted, March 1978.]

[125.] Private Investor in Business and Real Estate

[.249–.250] [Deleted, March 1978.]

[126.] Real Estate Broker

[.251–.252] [Deleted, March 1978.]

[127.] State Controller

[.253–.254] [Deleted, August 1989.]

[128.] State Secretary of Revenue

[.255–.256] [Deleted, March 1978.]

[129.] Travel Agency

[.257–.258] [Deleted, March 1978.]

[130.] Collection Agent

[.259–.260] [Deleted, March 1978.]

[131.] Bookkeeping Service as Feeder

[.261–.262] [Deleted, March 1978.]

[132.] Tax Practice: Conflict of Interest

[.263–.264] [Deleted, August 1989.]

[133.] Member Employed by Incorporated Law Firm

[.265–.266] [Deleted, March 1978.]

[134.] Association of Accountants Not Partners

[.267–.268] [Deleted, August 2012.]

[135.] Association of Firms Not Partners

[.269–.270] [Deleted, April 2012.]

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 him or herself a practice of his or her own as a CPA?

.276 *Answer*—Rule 505 [sec. 505 par. .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–.278] [Deleted, December 1998.]

[140.] Political Election

[.279–.280] [Deleted, November 2011.]

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.] Retired Partners

[.283–.284] [Deleted, March 1978.]

[143.] Partnership With Non-CPA

[.285–.286] [Deleted, March 1978.]

[144.] Title: Partnership Roster

[.287–.288] [Deleted, November 2011.]

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 [sec. 505 par. .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 or her name to appear in the title of a newly created firm.

[146.] Membership Designation

[.291–.292] [Deleted, September 1999.]

[147.] Firm Designation

[.293–.294] [Deleted, November 1989.]

[148.] Firm Designation

[.295–.296] [Deleted, November 1989.]

[149.] Data Processing: Accounting and Bookkeeping Assistance

[.297–.298] [Deleted, March 1978.]

[150.] Data Processing: Billing Service

[.299–.300] [Deleted, March 1978.]

[151.] Data Processing: Computer Center

[.301–.302] [Deleted, March 1978.]

[152.] Data Processing: Computer Center

[.303–.304] [Deleted, March 1978.]

[153.] Data Processing: Computer Center

[.305–.306] [Deleted, March 1978.]

[154.] Data Processing: Computer Center, Service Bureau as Client

[.307–.308] [Deleted, March 1978.]

[155.] Data Processing: Computer Corporation

[.309–.310] [Deleted, December 1992.]

[156.] Data Processing: Consultant to Service Bureaus

[.311–.312] [Deleted, December 1992.]

[157.] Data Processing: Employee Not in Practice

[.313–.314] [Deleted, March 1978.]

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

[.315–.316] [Deleted, December 1998.]

[159.] Data Processing: Fees Paid to Other CPAs

[.317–.318] [Deleted, June 1991.]

[160.] Data Processing: Forwarding Fees

[.319–.320] [Deleted, March 1978.]

[161.] Time-Sharing Computer Programs Developed by Member's Firm

[.321–.322] [Deleted, March 1978.]

[162.] CPA Designation on Professional Organization Letterhead

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

[163.] Distribution of Firm Publications to News Media

[.325–.326] [Deleted, March 1978.]

[164.] Nonclients on Firm Publication Mailing List

[.327–.328] [Deleted, March 1978.]

[165.] Sale of Firm Publications

[.329–.330] [Deleted, March 1978.]

[166.] Announcement of Member's Withdrawal from Firm

[.331–.332] [Deleted, March 1978.]

[167.] Member Receiving Payment for Referral of Client to Others

[.333–.334] [Deleted, June 1991.]

[168.] Audit Guides Issued by Governmental Agencies

[.335–.336] [Superseded by Interpretation No. 501-3.]

[169.] Firm Publications, Distribution to Client's Board of Directors

[.337–.338] [Deleted, March 1978.]

[170.] Sponsor's Announcement of Member's Participation in Educational Seminar

[.339–.340] [Deleted, March 1978.]

[171.] CPA Designation on Professional Organization or Corporation Letterhead

[.341–.342] [Deleted, March 1978.]

[172.] Outside Review of Firm Publication

[.343–.344] [Deleted, March 1978.]

[173.] Use of Credit Cards for Payment of Professional Services

[.345–.346] [Deleted, March 1978.]

[174.] Directory Listing, White Pages

[.347–.348] [Deleted, March 1978.]

[175.] Bank Director

[.349–.350] [Replaced by Ethics Ruling No. 85, “Bank Director,” of section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (sec. 191 par. .170–.171) and Ethics Ruling No. 18, “Bank Director,” of section 391, *Ethics Rulings on Responsibilities to Clients* (sec. 391 par. .035–.036)]

[176.] Member's Association With Newsletters and Publications

[.351–.352] [Deleted, November 2011.]

[177.] Data Processing: Billing Services

[.353–.354] [Deleted, November 2011.]

[178.] Location of Separate Business

[.355–.356] [Deleted, December 1992.]

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

[.357–.358] [Deleted, November 2011.]

[180.] Side Business Which Offers Services of a Type Performed by CPAs

[.359–.360] [Deleted, November 1993.]

[181.] Sale of a Practice—Purchase of Accounts

[.361–.362] [Deleted, June 1991.]

[182.] Termination of Engagement Prior to Completion

[.363–.364] [Deleted, April 2006.]

183. Use of the AICPA Personal Financial Specialist Designation

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

.366 *Answer*—It is permissible under Rule 502 [sec. 502 par. .01] for the designation PFS 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, *Contingent Fees* [sec. 302 par. .01], and 503, *Commissions and Referral Fees* [sec. 503 par. .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 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 [sec. 503 par. .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 [sec. 503 par. .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 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .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, *Integrity and Objectivity* [sec. 102 par. .01], and Interpretation No. 102-2, "Conflicts of Interest," under Rule 102 [sec. 102 par. .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 [sec. 503 par. 01] in connection with this payment?

.376 *Answer*—Yes. Paragraph .02 of section 91, *Applicability*, 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 [sec. 503 par. .01] provides that, if a member or the member's firm performs for a client a service described in Rule 503 [sec. 503 par. .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 [sec. 503 par. .01] and during the period covered by any historical financial statements 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 [sec. 503 par. .01], Rule 503 [sec. 503 par. .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 [sec. 503 par. .01] during a period in which the commission was received would constitute a violation of Rule 503 [sec. 503 par. .01].

189. Requests for Records Pursuant to Interpretation 501-1

.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 records pursuant to Interpretation No. 501-1, “Response to Requests by Clients and Former Clients for Records,” under Rule 501, *Acts Discreditable* [sec. 501 par. .02]. Does the member have to comply with all such requests?

.378 *Answer*—In providing professional services to individuals, partnerships, or corporations, a member will usually 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 who has provided the records to the individual designated or held out as the client's representative has no obligation to provide such records to other individuals associated with the client.

[Revised, effective April 30, 2006, by the Professional Ethics Executive Committee.]

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 or her 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 paragraphs .013–.014 of section 291, April 1995.]

191. Member Removing Client Files From an Accounting Firm

.381 *Question*—If the relationship of a member who is not an owner of a firm is terminated, may he or she take or retain originals or copies from the firm's client files or proprietary information without the firm's permission?

.382 *Answer*—No, except where permitted by contractual arrangement.

[Revised, effective December 31, 1998, by the Professional Ethics Executive Committee.]

192. Commission and Contingent Fee Arrangements With Nonattest Client

.383 *Question*—A member or member's firm (member) provides for a contingent fee investment advisory services, or refers for a commission products or services of a nonclient or a nonattest client, to the owners, officers, or employees of an attest client or to a nonattest client employee benefit plan sponsored by an attest client. Would the member be considered to be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01]?

.384 *Answer*—No. The member would not be in violation of either Rule 302 [sec. 302 par. .01] or Rule 503 [sec. 503 par. .01] provided that, with respect to Rule 503 [sec. 503 par. .01], the member discloses the commission to the owners, officers, or employees or to the employee benefit plan. The member should also consider the applicability of Interpretation No. 102-2 under Rule 102 [sec. 102 par. 03], and his or her professional responsibility to clients under Rule 301, *Confidential Client Information* [sec. 301 par. .01].

ET Appendix A

Council Resolution Designating Bodies to Promulgate Technical Standards

[As amended January 12, 1988; Revised April 1992, October 1999, May 2004, October 2007, May 2008, October 2012, and May 2013.]

Federal Accounting Standards Advisory Board

RESOLVED: That the Federal Accounting Standards Advisory Board, with respect to its statements of federal accounting standards and concepts adopted and issued in March of 1993 and subsequently, in accordance with its rules of procedure, the memorandum of understanding and public notice designating the FASAB's standards and concepts as having substantial authoritative support, 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 federal governmental entities pursuant to rule 203 [ET section 203.01].

[Added by Council, October 1999.]

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 [ET section 203.01] and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 [ET section 202.01] 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 [ET section 203.01] 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 governmental 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 [ET section 203.01], and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 [ET section 202.01].

Public Company Accounting Oversight Board

WHEREAS: The Public Company Accounting Oversight Board (PCAOB) has been established pursuant to the Sarbanes-Oxley Act of 2002 (the Act), and

WHEREAS: The PCAOB has authority under the Act to establish or adopt, or both, by PCAOB rule, auditing and related attestation standards, quality control, ethics, independence and other standards relating to the preparation and issuance of audit reports for issuers as defined in the Act.

RESOLVED: That the PCAOB be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish standards relating to the preparation and issuance of audit reports for entities within its jurisdiction as defined by the Act pursuant to rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, May 2004.]

International Accounting Standards Board

RESOLVED: That the International Accounting Standards Board (IASB) is hereby designated as the body to establish professional standards with respect to international financial accounting and reporting principles pursuant to Rule 202 [ET section 202.01] and Rule 203 [ET section 203.01]; and

BE IT FURTHER RESOLVED: That the Council shall reassess, no sooner than three years but no later than five years after the effective date of this resolution, whether continued recognition of the IASB as the body designated to establish professional standards with respect to international financial accounting and reporting principles under Rule 202 [ET section 202.01] and Rule 203 [ET section 203.01] is appropriate.

[Added by Council, May 18, 2008; readopted by Council, May 19, 2013.]

AICPA COMMITTEES AND BOARDS

WHEREAS: The membership of the Institute has adopted rules 201 [ET section 201.01] and 202 [ET section 202.01] 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 [ET section 201.01] and 202 [ET section 202.01] 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 with respect to standards relating to the preparation and issuance of audit reports not included within the resolution on the Public Company Accounting Oversight Board, the AICPA auditing standards board is hereby designated as the body authorized under rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate auditing, attestation, and quality control 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 of the financial statements in published financial reports containing financial statements.

[Revised May 2004.]

Management Consulting Services Executive Committee

RESOLVED: That the AICPA management consulting services executive committee is hereby designated to promulgate standards under rules 201 [ET section 201.01] and 202 [ET section 202.01] 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 [ET section 201.01] and 202 [ET section 202.01] 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 [ET section 201.01] and 202 [ET section 202.01] to promulgate attestation standards in their respective areas of responsibility.

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

Tax Executive Committee

RESOLVED: That the Tax Executive Committee is hereby designated as the body authorized under AICPA Rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate professional practice standards with respect to tax services.

[Added by Council, October 1999.]

Forensic and Valuation Services Executive Committee

RESOLVED: That the Forensic and Valuation Services Executive Committee is hereby designated as the body to promulgate professional standards with respect to forensic and valuation services under Rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, October 2007.]

Personal Financial Planning Executive Committee

RESOLVED: That the Personal Financial Planning Executive Committee is hereby designated as the body to promulgate professional standards with respect to personal financial planning services under Rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, October 2012.]

ET Appendix B

Council Resolution Concerning Rule 505—Form of Organization and Name

[As adopted May 23, 1994; revised May 1997, May 2000, May 2006, and August 2011.]

A. RESOLVED: That with respect to a member engaged in the practice accounting in a firm or organization that performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards (SASs), (2) any review of a financial statement performed in accordance with the Statements on Standards for Accounting and Review Services (SSARSs), or (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements, or that holds itself out as a firm of CPAs or uses the term "certified public accountant(s)" or the designation "CPA" in connection with its name, the characteristics of such a firm or organization under Rule 505, *Form of Organization and Name* [sec. 505 par. .01], are as set forth subsequently.

1. A majority of the ownership of the firm in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the firm or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the firm or its affiliates is against the public interest and continues to be prohibited.
2. There must be a CPA who has ultimate responsibility for all the services described in (A), compilation services, and other engagements governed by SASs or SSARSs and non-CPA owners could not assume ultimate responsibility for any such services or engagements.
3. 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.
4. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, 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. Further, a member may be held responsible for the acts of all persons associated with him or her in the practice of public accounting whom the member has the authority or capacity to control.
5. 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, within a reasonable period of time, to the firm or to other qualified owners if the owner ceases to be actively engaged in the firm or its affiliates.
6. Non-CPA owners would not be eligible for regular membership in the AICPA unless they meet the requirements in subparagraph 2.2.1 of BL section 220, *2.2 Requirements for Admission to Membership* [BL sec. 220 par. .01].^{fn 1}

^{fn 1} The change to this appendix is an administrative change to conform to subparagraph 2.2.1 of BL section 220, *2.2 Requirements for Admission to Membership* [BL sec. 220 par. .01], of the Bylaws of the American Institute of Certified Public Accountants.

B. RESOLVED: The characteristics of all other firms or organizations are deemed to be whatever is legally permissible under applicable law or regulation except as otherwise provided in paragraph (C).

C. RESOLVED: That with respect to a member engaged in the practice of public accounting in a firm or organization that is not within the description of a firm or organization set forth in paragraph (A), but who performs compilations of financial statements performed in accordance with SSARSs, the characteristics of such a firm or organization under Rule 505 [sec. 505 par. .01] are as set forth subsequently.

1. There must be a CPA who has ultimate responsibility for any financial statement compilation services provided by the firm and by each business unit performing such compilation services and non-CPA owners could not assume ultimate responsibility for any such services.
2. Any compilation report must be signed individually by a CPA, and may not be signed in the name of the firm or organization.

ET RULES COMPLIANCE GUIDE

ET Guide for Complying With Rules 102–505

Notice to Readers

This guide is designed as educational and reference material for the members of the AICPA and others interested in the subject. It is not an authoritative document. It does not establish policy positions, standards, or preferred practices. This guide is distributed with the understanding that the AICPA is not rendering any ethical or legal advice.

This Code of Professional Conduct (Code) cannot address every possible relationship or circumstance a member may need to address in order to comply with the rules. Accordingly, in achieving compliance with the rules, members may need to make decisions unrelated to independence regarding relationships or circumstances that are not explicitly addressed by the interpretations and rulings. This guide describes an approach that members can use to evaluate those relationships or circumstances. Although use of this guide is not required by the Code, use of this guide often will be a prudent step in achieving compliance with the rules.

Introduction

- .01 Members who provide professional services may hold various positions. For example, a member may be a salaried employee, a partner, a director (executive or nonexecutive), an owner-manager, a volunteer, or a consultant working for an employer, a firm, or for one or more clients. The legal relationship between the member, the employer, the firm, or the client does not affect the member's responsibility to comply with the ethical requirements of the AICPA Code of Professional Conduct (Code).
- .02 The Code provides members with principles for properly fulfilling their ethical responsibilities. The Rules of Conduct (the rules) set out in the Code govern the performance of professional services by members. The bylaws of the AICPA require that all members comply with these rules. Other sections of the Code contain additional authoritative guidance set forth in interpretations and rulings, which address the application of the rules to specific situations that members may encounter when providing professional services. ET section 100-1, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), provides authoritative guidance for members when making decisions on independence matters that are not explicitly addressed by the Code under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 100), and its interpretations and rulings.
- .03 The Code cannot address every possible relationship or circumstance a member may need to address in order to comply with the rules. Accordingly, in achieving compliance with the rules, members may need to make decisions unrelated to independence regarding relationships or circumstances that are not explicitly addressed by the interpretations and rulings. This guide describes an approach that members can use to evaluate those relationships or circumstances, and members are encouraged to use it for that purpose. Although use of this guide is not required by the Code, it can assist members in complying with the rules in those situations. Therefore, use of this guide will often be a prudent step in achieving compliance with the rules. Under no circumstances, however, may this guide be used to justify noncompliance with the rules, interpretations, and rulings in the Code.

Definitions

- .04 Acceptable level.** A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that compliance with the rules is not compromised.
- .05 Safeguards.** Actions or other measures that eliminate threats or reduce them to an acceptable level.
- .06 Threats.** The risk that relationships or circumstances could compromise a member's compliance with the rules.

Rules of Conduct Covered by This Guide

- .07** In addition to Rule 101, the bylaws of the AICPA require that members comply with the following rules:
 - a. Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 100)
 - b. Rule 201, *General Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
 - c. Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
 - d. Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
 - e. Rule 301, *Confidential Client Information* (AICPA, *Professional Standards*, vol. 2, ET sec. 300)
 - f. Rule 302, *Contingent Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 300)
 - g. Rule 501, *Acts Discreditable* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
 - h. Rule 502, *Advertising and Other Forms of Solicitation* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
 - i. Rule 503, *Commissions and Referral Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
 - j. Rule 505, *Form of Organization and Name* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)

Each of these rules (that is, Rules 102–505), along with its related authoritative interpretations and rulings, can be accessed by selecting the link preceding the name of each rule in the preceding list.

Threats and Safeguard Approach

- .08** The Code cannot address every situation in which a relationship or circumstance creates an unacceptable threat to a member's compliance with rules 102–505. Accordingly, the threats and safeguard approach^{fn 1} described in this section can assist a member in complying with the rules when the guidance in the interpretations and rulings in the Code do not explicitly address the situation encountered. This method in-

^{fn 1} The Professional Ethics Executive Committee uses the threats and safeguard approach described in this guide when it develops ethics interpretations and rulings. Accordingly, reference to this guide may assist AICPA members and others in understanding the basis for those interpretations and rulings.

volves identifying threats to compliance with the rules and evaluating the significance of those threats. If the threats are not at an acceptable level, the threats and safeguards approach involves determining whether safeguards are available to eliminate the threats or reduce them to an acceptable level and, if so, applying such safeguards or, if not, avoiding the situation that creates the threats. Threats are identified and evaluated both individually and in the aggregate because they can have a cumulative effect on a member's compliance with the rules of conduct.

- .09** *Identifying Threats.* The relationships or circumstances encountered by a member in various engagements and work assignments will often create different threats to complying with the rules. When a relationship or circumstance is encountered that is not specifically addressed by the interpretations or rulings in the Code, under this approach, members would determine whether the relationship or circumstance creates one or more threats, such as those identified in paragraph .13. The existence of a threat does not mean that the member is not in compliance with the rules; rather, the significance of the threat would be evaluated.
- .10** *Evaluating the Significance of a Threat.* In evaluating the significance of a threat that has been identified in order to determine whether it is at an acceptable level, the standard of acceptable level is whether a reasonable and informed third party, weighing all the specific facts and circumstances, would be likely to conclude that the threat would compromise the member's compliance with the rules. Qualitative as well as quantitative factors are relevant when evaluating the significance of a threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. If the evaluation supports a conclusion that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the threat would not compromise a member's compliance with the rules, the threat is at an acceptable level. In that case, no further evaluation under this framework would be necessary.
- .11** *Identifying and Applying Safeguards.* If the evaluation of the significance of an identified threat results in the member concluding that the threat is not at an acceptable level, safeguards would need to be applied in order to eliminate the threat or reduce it to an acceptable level. When identifying appropriate safeguards to apply, one safeguard may eliminate or reduce multiple threats, but in some cases multiple safeguards may be necessary to eliminate or reduce one threat to an acceptable level. Determining the nature of the safeguards to be applied requires the exercise of judgment because the effectiveness of safeguards will vary, depending on the circumstances. Again, the issue is whether a reasonable and informed third party, who has weighed all the specific facts and circumstances, would be likely to conclude the level of threat is acceptable. A threat has been reduced to an acceptable level by safeguards if, after application of the safeguards, a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that compliance with the rules is not compromised.
- .12** Some threats identified may be so significant that no safeguards will eliminate the threats or reduce them to an acceptable level. If a significant threat cannot be eliminated or reduced to an acceptable level by the application of safeguards, or if a member is unable to implement appropriate safeguards, providing the specific professional service will in all likelihood result in the member's noncompliance with the rules. Although declining or discontinuing the service would prevent this result, depending on the facts and circumstances, it might be prudent for the member to also consider whether to resign from the client or the employer.

Threats and Safeguards

Threats

.13 Many threats fall into the following categories:

- a. **Self-review threat.** The threat that a member will not appropriately evaluate the results of a service performed by the member, or by an individual in the member's firm or employing organization, that the member will rely upon in forming a judgment as part of providing another service.
- b. **Advocacy threat.** The threat that a member will promote a client or employer's position or opinion to the point that his or her objectivity is compromised.
- c. **Adverse interest threat.** The threat that a member will not be objective because the member's interests are in opposition to the interests of a client or employer.
- d. **Familiarity threat.** The threat that because of a long or close relationship with a client or employer, a member will become too sympathetic to their interests or too accepting of their work.
- e. **Undue influence threat.** The threat that a member will subordinate his or her judgment to that of an individual associated with a client, employer, or other relevant third party because of the individual's (1) reputation or expertise, (2) aggressive or dominant personality, or (3) attempts to coerce or exercise excessive influence over the member.
- f. **Self-interest threat.** The threat that a member will act in a manner that is adverse to the legitimate interests of his or her firm, employer, client, or the public, as a result of the member or his or her immediate or close family member's financial interest in or other relationship with a client or the employer.

.14 The types of threats that are created will generally be the same for all members, although the circumstances that create threats will differ depending on whether the member is in public practice, business and industry, government, or academia. In addition, due to the nature of services provided by some members, such as employees of a governmental audit organization, the threats those members face can arise from the same or similar types of circumstances as for members in public practice.

Following are some examples of how threats may impact a member's compliance with certain of the rules:

- a. If a member is being pressured to become associated with misleading information, there is an undue influence threat to compliance with Rule 102 and Rule 201.
- b. If a member is reviewing work he or she previously performed that will be relied upon as part of providing a current professional service and the member discovers a significant error in the previous work, there is a self-interest threat to compliance with Rule 102 and Rule 201.
- c. If a member's firm provides nonattest services to an audit client where a member's brother-in-law is the CFO, there are self-interest and familiarity threats to compliance with Rule 102.
- d. If a member is directed to complete a task within an unrealistic time frame, there is an undue influence threat to compliance with Rule 102 and Rule 201.

- e. If a member has charged his or her employer with violating certain labor laws, there is an adverse interest threat to compliance with Rule 102.
- f. If the revenue received from a single client is significant to the firm, a self-interest threat to compliance with Rule 102 may be created.

Safeguards

.15 Safeguards fall into two broad categories:

- a. Safeguards created by the profession, legislation, or regulation
- b. Safeguards in the work environment

In addition, a member in public practice also may be able to consider safeguards implemented by the client in combination with the preceding safeguards when evaluating the significance of a threat.

- **.16** To be effective, safeguards should eliminate a threat or reduce to an acceptable level the threat's potential to compromise the member's compliance with the rules. The effectiveness of safeguards depends on many factors, including the following:
The facts and circumstances of a particular situation
- The proper identification of threats
- Whether the safeguard is suitably designed to meet its objectives
- The party or parties that will be subject to the safeguard
- How the safeguard is applied
- The consistency with which the safeguard is applied
- Who applies the safeguard

.17 Certain safeguards may not need to be implemented by the member because they are already in place either by the member's firm (concurring partner review) or through the existence of professional requirements (peer review), legislation (preapproval of allowable nonaudit services by audit committees), or regulation (quality control reviews performed by a federal Office of Inspector General for OMB Circular A-133 engagements). Such safeguards may be effective in eliminating or reducing threats to an acceptable level and, therefore, may be considered in applying the framework approach.

.18 Other safeguards that may be effective in eliminating or reducing threats to an acceptable level are those in a member's work environment. For example, work environments with strong internal controls can be very effective in eliminating or reducing the self-review, adverse interest, and self-interest threats. Additionally, the undue influence threat can be reduced when leadership of a firm or the organization that employs the member stresses the importance of ethical behavior and implements policies and procedures to empower and encourage employees to communicate to senior individuals within the firm or organization about any ethical issues that concern them without fear of retribution.

Ethical Conflict Resolution

- .19** An ethical conflict arises when a member encounters obstacles to following an appropriate course of action due to internal or external pressures or because of conflicts within the professional standards. For example, a member may have encountered a fraud, the reporting of which could breach the member's responsibility to maintain client confidentiality. Once encountered, a member may be required to take steps to resolve the ethical conflict in order to comply with the rules.
- .20** To resolve an ethical conflict, a member should consider the following factors and select the course of action that will best enable him or her, after weighing the consequences of each, to comply with the rules:
- a.* Relevant facts and circumstances, including applicable rules, laws, or regulations
 - b.* Ethical issues involved
 - c.* Established internal procedures
 - d.* Alternative courses of action
- .21** Before pursuing this course of action, the member may want to consult with appropriate persons within the firm or the organization that employs the member. If the conflict remains unresolved after pursuing the selected course of action, the member should consider consulting with those individuals for help in reaching a resolution.
- .22** The member also may wish to obtain advice from an appropriate professional body or legal counsel. The member should consider documenting the substance of the issue and details of any discussions held or decisions made concerning that issue.
- .23** If, after exhausting all reasonable possibilities, the ethical conflict remains unresolved, the member will in all likelihood be in noncompliance with the rules if he or she remains associated with the matter creating the conflict. Accordingly, the member may determine that, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the client, firm, or organization that employs the member.

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