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# Proposed interpretation of 101-9 : the meaning of certain independence terminology and the effect of family relationships on independence ;Meaning of certain independence terminology and the effect of family relationships on independence

American Institute of Certified Public Accountants. Professional Ethics Executive Committee

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# **EXPOSURE DRAFT**

## **PROPOSED INTERPRETATION 101-9**

### **THE MEANING OF CERTAIN INDEPENDENCE TERMINOLOGY AND THE EFFECT OF FAMILY RELATIONSHIPS ON INDEPENDENCE**

**August 11, 1982**

**Prepared by the AICPA Professional Ethics Executive Committee  
For comments from persons interested in independence matters**

**Comments should be received by November 15, 1982, and addressed to  
Herbert A. Finkston, Professional Ethics Division  
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036-8775**

**M829030**

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*This exposure draft has been sent to*

- *practice offices of CPA firms*
  - *members of AICPA Council and technical committee chairmen*
  - *state society and chapter presidents, directors, and committee chairmen*
  - *organizations concerned with regulatory, supervisory, or other public disclosure of financial activities*
  - *persons who have requested copies*
-

August 11, 1982

Since the issuance in 1975 of Interpretation 101-4, The Effect of Family Relationships on Independence, the AICPA Division of Professional Ethics has received numerous inquiries from members regarding certain of its provisions.

Many members have commented, for example, that several provisions seem unduly complex, such as the circumstances in which geographical separation and infrequent contact may mitigate an otherwise presumed independence impairment. Others have expressed the view that certain provisions are unnecessarily restrictive, such as the automatic ascription to a member of the financial interests and business relationships of any relative living in a common household with the member; and situations in which the financial interests of close kin are presumed to impair the member's independence.

Some members also commented that the control procedures listed in the Interpretation, which must be followed to isolate a professional employee from an engagement, are an unnecessary administrative burden, and others have observed that isolation of an employee located in the office of the accounting firm serving a particular client seems to be an inadequate procedure when a management level employee in that office of the firm has a close relative who can significantly influence the operating, financial, or accounting policies of the client.

After considering all of the foregoing issues and the related subject matter of Interpretation 101-7, Application of Rule 101 to Professional Personnel, the AICPA Ethics Executive Committee determined that proposed Interpretation 101-9 should be issued to supersede Interpretations 101-4 and 101-7, subject to the consideration of comments received from members during the exposure period.

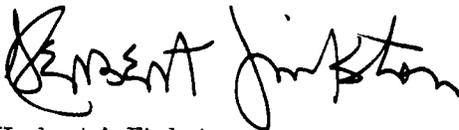
Interpretation 101-4 and 101-7 are included herein as Appendixes A and B.

If proposed Interpretation 101-9 is approved for publication by the ethics executive committee after the exposure period is concluded, it will be effective on the last day of the month in which it is published in the Journal of Accountancy; however, the ethics executive committee has determined that, in that event, members may rely on the provisions of the superseded interpretations for engagements in process at the effective date.

Sincerely,



Frank H. Whitehand  
Chairman  
AICPA Professional Ethics Executive Committee



Herbert A. Finkston  
Director  
AICPA Professional Ethics Division

## PROPOSED INTERPRETATION 101-9

### THE MEANING OF CERTAIN INDEPENDENCE TERMINOLOGY AND THE EFFECT OF FAMILY RELATIONSHIPS ON INDEPENDENCE

This interpretation defines certain terms used in rule 101 and, in doing so, also explains how independence may be impaired through certain family relationships.

#### TERMINOLOGY

##### **Member**

For purposes of rule 101, a “member” is (1) a member as defined in ET section 91 or (2) a person or entity included in the definition of “he and his firm.”

##### **“He and His Firm”**

For purposes of rule 101, “he and his firm” includes —

1. The proprietor of, or all partners or shareholders in, the firm.
2. All full- and part-time professional employees\* participating in the engagement.
3. All full- and part-time managerial employees\* located in an office participating in a significant portion of the engagement.
4. Any entity (for example, partnership, corporation, trust, joint venture, pool, and so forth) whose operating, financial, or accounting policies can be “significantly influenced” (as discussed below) by one of the persons described in (1) through (3) or by two or more of such persons if they choose to act together.

A managerial employee is a professional employee who —

1. Has a position generally similar to that of a partner, including an employee having the final authority to sign, or give final approval to the issuance of, reports in the firm’s name.

2. Has a management position, in contrast with a nonmanagement position, with the firm.

The organizations of firms vary; therefore, whether a professional employee has a management position depends on his normal responsibilities and how he or the position itself is held out to clients and third parties. Some, but not necessarily all, of the responsibilities that suggest that a professional employee has a management position, are —

1. Continuing responsibility for the overall planning and supervision of engagements for specified clients.
2. Authority for determining that an engagement is complete subject to final partner approval if required.
3. General supervisory responsibility for staff personnel assigned to engagements for specified clients.
4. Responsibility for client relationships (for example, negotiating and collecting fees for engagements, marketing the firm’s services).
5. Responsibility for such administrative functions as assignment of personnel to engagements, hiring, and training of personnel.
6. Existence of profit-sharing as a significant feature of total compensation.

For purposes of rule 101B, “he and his firm” does not include an individual solely because he was formerly associated with the client in any capacity described in rule 101B if such individual has disassociated himself from the client and does not participate in the engagement for the client covering any period of his association with the client.

##### **Significant Influence**

A person or entity has the ability to exercise (or can exercise) significant

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

1. Is connected with the entity as a promoter, underwriter, or voting trustee.
2. Is connected with the entity as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer.
3. Is connected with the entity in a capacity equivalent to that of a general partner.
4. Is connected with the entity as a director.
5. Meets the criteria established in paragraph 17 of Accounting Principles Board Opinion 18 (AC section 5131.17) to determine the ability of an investor to exercise such influence.
6. Holds 20 percent or more of the limited partnership interests if the entity is a limited partnership.

The foregoing examples are not necessarily all-inclusive.

#### EFFECT OF FAMILY RELATIONSHIPS

##### **Spouses and Dependent Relatives**

Except as stated in the next two sentences, the term “he and his firm” includes spouses (whether or not dependent) and dependent relatives of the member for all purposes of complying with rule 101. The exception is that the independence of the member and his firm will not normally be impaired solely because of employment of a spouse or dependent relative by a client if the employment is in a position that does not allow “significant influence” (as discussed above) over the client’s operating, financial, or accounting policies.

\*Refers to all professional employees irrespective of their functional classification (e.g., audit, tax, management advisory services).

However, if such employment is in a position where the person's activities are "audit sensitive" (even though not a position of significant influence), the member should not participate in the engagement.

### **Nondependent Close Relatives**

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

*Close relatives* are nondependent children, brothers, sisters, grandparents, parents, parents-in-law, and their respective spouses.

The independence of a member and his firm is impaired with respect to the enterprise if—

1. A proprietor, partner, share-

holder, or professional employee *participating in the engagement* has a close relative who (a) can significantly influence the operating, financial, or accounting policies of the client, (b) is otherwise employed in a position where the person's activities are "audit sensitive," or (c) has a financial interest in the client which is material to the close relative and of which the proprietor, partner, shareholder, or professional employee has knowledge.

2. A proprietor, partner, shareholder, or managerial employee *located in an office participating in a significant portion of the engagement* has a close relative who (a) can exercise significant influence over the operating, financial, or accounting policies of the client and (b) has his principal residence or principal place of business in the same geographic area in which that office ordinarily performs professional services.

### **Other Considerations**

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

## APPENDIX A

### Interpretation 101-4 — Effect of family relationships on independence

Rule of Conduct 101 proscribes relationships which impair a member's independence through direct financial interests, material indirect financial interests, or other involvements. Relationships which arise through family bloodlines and marriage give rise to circumstances that may impair a member's independence.

#### 1. Financial and Business Relationships Ascribed to the Member

It is well accepted that the independence of a member may be impaired by the financial interests and business relationships of the member's spouse, dependent children, or any relative living in a common household with or supported by the member. The financial interests or business relationships of such family, dependents or relatives in a member's client are ascribed to the member; in such circumstances the independence of the member or his firm would be impaired under Rule 101.

#### 2. Financial and Business Relationships That may be Ascribed to the Member

##### Close Kin

Family relationships may also involve other circumstances in which the appearance of independence is lacking. However, it is not reasonable to assume that all kinships, *per se*, will impair the appearance of independence since some kinships are too remote. The following guidelines to the effect of kinship on the appearance of independence have evolved over the years:

A presumption that the appearance of independence is impaired arises from a significant financial interest, investment, or business relationship by the following close kin in a member's client: non-dependent children, brothers and sisters, grand-

parents, parents, parents-in-law, and the respective spouses of any of the foregoing.

If the close kin's financial interest in a member's client is material in relationship to the kin's net worth, a third party could conclude that the member's objectivity is impaired with respect to the client since the kinship is so close. In addition, financial interests held by close kin may result in an indirect financial interest being ascribed to the member.

The presumption that the appearance of independence is impaired would also prevail where a close kin has an important role or responsible executive position (e.g., director, chief executive or financial officer) with a client.

Geographical separation from the close kin and infrequent contact may mitigate such impairment except with respect to:

- a. a partner participating in the engagement or located in an office participating in a significant portion of the engagement,
- b. a partner in the same office or one who maintained close personal relationships with partners participating in a significant portion of the engagement,
- c. a partner who, as a result of his administrative or advisory positions, is involved in the engagement, or
- d. a staff member participating in the engagement or located in an office participating in a significant portion of the engagement.

In the case of a professional employee located in an office participating in a significant portion of the engagement, financial and business relationships of close kin will not be ascribed to the employee if the employee is isolated from the engagement. It will be the member's responsibility to establish effective controls to assure that the requirement of isolation from all aspects of the engagement has been met.

Such controls should include the following: that the employee be instructed not to discuss the engagement with anyone participating in it nor to read or have anything to do

with the working papers, correspondence or related files; that a written notice such employee has been so instructed be provided to all personnel in the office and that a signed statement be obtained from the employee that such instructions have been and will be followed.

If a member does not or could not reasonably be expected to have knowledge of the financial interests, investments and business relationships of his close kin, such lack of knowledge would preclude an impairment of objectivity and appearance of independence.

#### 3. Financial and Business Relationships That are not Normally Ascribed to the Member

##### Remote Kin

A presumption that the appearance of independence is impaired would not normally arise from the financial interests and business relationships of remote kin: uncles, aunts, cousins, nephews, nieces, other in-laws, and other kin who are not close.

The financial interests and business relationships of these remote kin are not considered either direct or indirect interests ascribed to the member. However, the presumption of no impairment with remote kin would be negated if other factors indicating a closeness exist, such as living in the same household with the member, having financial ties, or jointly participating in other business enterprises.

##### Summary

Members must be aware that it is impossible to enumerate all circumstances wherein the appearance of a member's independence might be questioned by third parties because of family relationships. In situations involving the assessment of relationships with both close and remote kin, members must consider whether geographical proximity, strength of personal and other business relation-

ships and other factors — when viewed together with financial interests in question — would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to the member's objectivity and appearance of independence.

[As amended, November 30, 1980.]

## **APPENDIX B**

### **Interpretation 101-7 — Application of Rule 101 to professional personnel**

The term "he and his firm" as used in the first sentence of Rule 101 means (1) all partners or shareholders in the firm and (2) all full and part-time professional employees participating in the engagement or located in an office participating in a significant portion of the engagement, except as provided in the following paragraph.

For purposes of Rule 101B, the term "he and his firm" does not include an employee of the firm who was formerly associated with the client in any capacity described in Rule 101B if such individual has completely disassociated himself from the client and does not participate in the engagement for the client covering any period of his association with the client.