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Omnibus proposal of Professional Ethics Division interpretations and rulings ;Ruling No. 64 under ET section 191: Joint investment with a promoter and/or general partner;Joint investment with a promoter and/or general partner;Ruling No. 65 under ET section 191: Member as director of agency for which client raises funds;Member as director of agency for which client raises funds;Ruling no. 66 under ET section 191: Use of CPA designation by member not in public practice;Use of CPA designation by member not in public practice;Interpretation 101-9: Meaning of certain independence terminology and the effect of

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family relationships on independence; Meaning of certain independence terminology and the effect of family relationships on independence; Interpretation 201-2: Prospective financial information; Prospective financial information; Interpretation 201-4: Definition of the term engagement as used in Rule 201--General standards; Definition of the term engagement as used in Rule 201--General standards; Interpretation 502-2, Subsection 5: False, misleading or deceptive acts in advertising or solicitation; False, misleading or deceptive acts in advertising or solicitation; Ruling no. 181 under ET section 591: Sale of a practice--Purchase of accounts; Sale of a practice--Purchase of accounts

American Institute of Certified Public Accountants. Professional Ethics Executive Committee

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EXPOSURE DRAFT

OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

RULING NO. 64 UNDER ET SECTION 191
Joint Investment With a
Promoter and/or General Partner

RULING NO. 65 UNDER ET SECTION 191
Member as Director of Agency for
Which Client Raises Funds

RULING NO. 66 UNDER ET SECTION 191
Use of CPA Designation by Member
Not in Public Practice

INTERPRETATION 101-9
Meaning of Certain Independence
Terminology and the Effect of
Family Relationships on Independence

INTERPRETATION 201-2
Prospective Financial Information

INTERPRETATION 201-4
Definition of the Term Engagement
as Used in Rule 201—General Standards

INTERPRETATION 502-2, SUBSECTION 5
False, Misleading or Deceptive Acts
in Advertising or Solicitation

RULING NO. 181 UNDER ET SECTION 591
Sale of a Practice—Purchase of Accounts

JUNE 13, 1986

Prepared by the AICPA Professional Ethics Executive Committee
For comment from persons interested in independence and behavioral standards matters

Comments should be received by September 12, 1986, and addressed to
Herbert A. Finkston, Professional Ethics Division
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036-8775

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*
-



American Institute of Certified Public Accountants

1211 Avenue of the Americas, New York, New York 10036-8775 (212) 575-6200

June 13, 1986

The AICPA Professional Ethics Executive Committee is issuing for review and comment by members and other interested parties this exposure draft containing one proposed interpretation, proposed revisions to three existing interpretations, and four proposed rulings regarding the application of the code of ethics. Copies of these proposed pronouncements and an explanatory preface to each are included.

It should be noted that a summary does not accompany this omnibus exposure draft. The diversity of material precluded use of a single summary at the beginning of the exposure draft; rather, the type of information that a summary contains is included in the "Explanation" preceding each proposed interpretation or ruling. It is believed that the reader will thus be able to consider the proposed pronouncements with clearer focus on the particular issues.

If the proposed interpretations and rulings are approved for publication by the Professional Ethics Executive Committee after the exposure period is concluded and comments are evaluated, each pronouncement will become effective on the last day of the month in which it is published in the Journal of Accountancy, except as otherwise stated in the pronouncement.

Comments or suggestions on these proposed pronouncements will be appreciated. Responses should be typed on the appropriate page in the enclosed mailer. They must be received at the AICPA by September 12, 1986. All written replies to this exposure draft will become part of the public record of the AICPA and will be available for inspection at the office of the AICPA after October 31, 1986, for a period of one year.

Please send comments to

Herbert A. Finkston
Professional Ethics Division
AICPA
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Sincerely,

Leonard A. Dopkins
Chairman
Professional Ethics Executive Committee

Herbert A. Finkston
Director
Professional Ethics Division

PROPOSED RULING NO. 64 UNDER ET SECTION 191

EXPLANATION

On May 17, 1985, the Executive Committee of the Professional Ethics Division issued an omnibus exposure draft that included proposed Ethics Ruling No. 64 entitled "Joint Investment With a Promoter and/or General Partner." In response to member comments, proposed Ruling No. 64 is now being re-exposed in a revised form.

Ethics Ruling No. 64 was developed to illustrate that a member's limited partnership investment in a nonclient limited partnership controlled by the same promoter and/or general partner as the member's audit (or other services requiring independence) client limited partnership would cause an impairment of independence under certain circumstances.

Ruling No. 62 under ET section 191 provides guidance for joint investments when both the member and client are limited partners but does not focus on the relationship that involves the client (or an officer, director, or principal owner thereof) functioning as the promoter or general partner. Interpretation 101-8, ET section 101, also does not specifically focus on this relationship or on partnerships in general, but some of the concepts are similar.

The exposed ruling specifically provided that a member's limited partnership investment in a nonclient limited partnership controlled by the same promoter and/or general partner as the member's audit client would not impair the member's independence provided the partner's investment in the limited partnership was acquired prior to the establishment of the client relationship and the member's investment was immaterial to the member. However, the ruling provided that the member's subsequent investment in a related partnership whether or not material would impair the member's independence with respect to the promoter and each affiliated limited partnership. This conclusion was reached on the basis that the related partnerships are affiliates controlled by the promoter and/or general partner, who exercises significant influence over each partnership.

In reviewing the comments received from the membership, the Ethics Executive Committee noted a concern with the effect on independence of such investments whether acquired by the member prior or subsequent to the establishment of the client relationship. Therefore, the Ethics Executive Committee has agreed to re-expose Ethics Ruling No. 64 with appropriate modification.

Proposed Ruling No. 64, "Joint Investment With a Promoter and/or General Partner," has been developed by the AICPA Professional Ethics Division to clarify independence requirements and thereby assist members in their application. The proposed ruling provides an example to illustrate that a member's limited partnership investment in a nonclient limited partnership controlled by the same promoter and/or general partner as his or her audit (or other services requiring independence) client limited partnership would cause the member's firm's independence to be subject to question and therefore to be impaired.

The dominant position of a promoter and/or general partner in a limited partnership provides an exceptional ability to control the partnership and to influence a limited partner's investment. Thus, if a member's investment is subject to significant influence from the same promoter and/or general partner through a related partnership being audited (or receiving other services requiring independence) by the member or member's firm, the expectation of professional judgment, objectivity, integrity, and independence from the member or member's firm appears vulnerable to compromise, and appearance of independence would be questionable.

The proposed ruling proscribes such material (to the member's net worth) and immaterial member investments in limited partnerships with audit (or other services requiring independence) clients (or an officer, director, or principal owner thereof) whether acquired by the member prior or subsequent to the establishment of the client relationship.

TEXT OF PROPOSED RULING

Ruling No. 64 Under ET Section 191: Joint Investment With a Promoter and/or General Partner

Question—A private, closely held entity functions as a promoter of closely held real estate limited partnerships and continues to be associated with Limited Partnerships A and B as the general partner. A member's firm has been asked to provide a service requiring independence for a new related Limited Partnership C with the same promoter and/or general partner. The member's firm does not audit the private, closely held entity or Limited Partnerships A and B. One of the firm's partners has an immaterial (to partner's net worth) limited partnership interest in Limited Partnership A. Would the member's firm be independent for purposes of providing services to Limited Partnership C?

Answer—Independence of the member's firm would be impaired with respect to Limited Partnership C. The partner's investment in Limited Partnership A would impair the member's firm's independence with respect to the promoter and/or general partner and each affiliated limited partnership. Limited Partnership A is an affiliate controlled by the promoter entity; therefore, an investment, whether or not material, would impair independence.

See Ruling No. 63 for the definition of the word "promoter." (For those members owning immaterial investments of the type described above on the ruling's regular effective date, this ruling becomes effective for engagements commenced one year following such effective date; however, earlier application is encouraged.)

PROPOSED RULING NO. 65 UNDER ET SECTION 191

EXPLANATION

Members are often asked to serve on the board of directors of not-for-profit organizations involved in charitable or civic functions. During the period of their service as directors, many such members are requested by the not-for-profit organization to perform a service requiring independence for a fund-raising foundation established with the sole purpose of raising funds for the not-for-profit organization.

The Professional Ethics Executive Committee has concluded that in such situations the financial relationship between the not-for-profit organization and its fund-raising component is so close that a member's service in a position of significant influence with respect to the organization receiving the funding would pose an unacceptable threat to the member's integrity, objectivity, and independence with respect to the fund-raising entity.

Ruling No. 65 under ET section 191 has been developed to advise members that under rule 101 of the AICPA Code of Professional Ethics the appearance of a member's independence would be considered to be impaired with respect to the foundation because of a member's service on the board of directors of an organization receiving funding from the foundation.

TEXT OF PROPOSED RULING

Ruling No. 65 Under ET Section 191: Member as Director of Agency for Which Client Raises Funds

Question—May a member perform an audit of a fund-raising foundation that functions solely to raise funds for an agency if the member serves on the board of directors of the agency?

Answer—A member's independence would be considered to be impaired with respect to a fund-raising foundation if the member serves on the board of directors of the entity for whose sole benefit the foundation exists. However, if the position is purely honorary and the member restricts participation to the use of the member's name, independence would not be considered impaired in accord with Interpretation 101-1.

PROPOSED RULING NO. 66 UNDER ET SECTION 191

EXPLANATION

The Professional Ethics Division has received a number of inquiries from Institute members not in public practice regarding the appropriate use of the CPA designation under the Institute's ethics code.

To provide guidance to members not in public practice on the use of the CPA designation, the Professional Ethics Executive Committee proposes, subject to member comment, to issue Ruling No. 66 under ET section 191 of the AICPA Code of Professional Ethics.

The ruling is issued pursuant to Rule of Conduct 102, *Integrity and Objectivity*, which states, in pertinent part, "a member shall not knowingly misrepresent facts...." Ruling No. 66 provides that the use of the CPA designation by a member who is not in public practice in a manner to imply that the member is independent of the employer will be considered a knowing misrepresentation of fact.

The ruling goes on to specify that a member not in public practice may use the CPA designation in connection with financial statements issued for internal and external distribution provided that the following conditions exist:

- a. Such CPA designation appears on the employer's letterhead.
- b. The member's employment status or title is clearly indicated.
- c. The member neither makes reference to an examination, nor to generally accepted auditing standards, nor states that the member has reviewed the financial statements. When a member states that the financial statements have been compiled, the member should specifically make reference to a lack of independence.

The ruling also discusses use of the CPA designation on correspondence and business cards of the member not in public practice. Correspondence may contain the member's CPA designation provided that the correspondence appears on or with the employer's letterhead and the member's employment status or title is clearly indicated. Business cards should clearly display the member's employer and the member's employment status or title.

The thrust of this ruling is to protect the public interest regarding the independence status of members not in public practice issuing financial statements. If adopted, Ruling No. 66 will supersede current Ruling No. 2 under ET section 291, *Opinion by Member Not in Public Practice*.

TEXT OF PROPOSED RULING

Ruling No. 66 Under ET Section 191: Use of CPA Designation by Member Not in Public Practice

Question—A member who is not in public practice wishes to use the CPA designation in connection with financial statements and correspondence of the member's employer.* The member also wishes to obtain business cards which indicate both the member's title and CPA designation. Would such use of the CPA designation violate the Code of Ethics?

*As set forth under section 92 of the Code entitled "Applicability of Rules," nothing in this interpretation should inhibit a member from performing his or her statutory duties as a governmental auditor.

Answer—The use of the CPA designation by a member who is not in public practice in a manner to imply that the member is independent of the employer will be considered a knowing misrepresentation of fact. Therefore, such a member may use the CPA designation in connection with financial statements issued for internal and external distribution provided that—

- a.* Such CPA designation appears on the employer's letterhead; and,
- b.* The member's employment status or title is clearly indicated; and,
- c.* The member neither makes reference to an examination, nor to generally accepted auditing standards, nor states that the member has reviewed the financial statements. When a member states that the financial statements have been compiled, the member should specifically make reference to a lack of independence.

The correspondence of a member who is not in public practice may contain the member's CPA designation provided that the correspondence appears on or with the employer's letterhead and the member's employment status or title is clearly indicated.

Business cards of a member who is not in public practice that indicate the member's CPA designation should clearly display the member's employer and the member's employment status or title.

PROPOSED REVISION OF CURRENT INTERPRETATION 101-9

EXPLANATION

Currently, Interpretation 101-9 of the Code of Professional Ethics provides that for the 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 the member’s association with the client.

Many members have commented that this exception to Rule 101B was too broad, that is, the exception included partners of a firm as well as professional employees. Therefore, the Ethics Executive Committee is proposing to limit the exception to professional employees not participating in the engagement.

Furthermore, the definition of “he and his firm” formerly included all full- and part-time professional employees participating in the engagement. The executive committee has noted concern with respect to situations where professional employees who are located in an office participating in a significant portion of an engagement had a position of significant influence or a position equivalent to that of a member of that client’s management. Therefore, the committee recommends that Interpretation 101-9 be amended to proscribe such relationships.

Finally, the committee agreed that nondependent stepchildren should be considered as close relatives for the purposes of Rule 101.

TEXT OF PROPOSED REVISION OF CURRENT INTERPRETATION

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

He and His Firm

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

1. An individual member performing professional services requiring independence.
2. The proprietor or all partners or shareholders.
3. All full- and part-time professional employees* participating in the engagement.
4. All full- and part-time managerial employees* located in an office participating in a significant portion of the engagement.

*Refers to employees irrespective of their functional classification (for example, audit, tax, management advisory services).

5. 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 (4) or by two or more of such persons if they choose to act together.

For purposes of Rule 101B, “he and his firm” does not include an employee solely because he was formerly associated with the client in any capacity described in Rule 101B if such employee 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.

Likewise, for the purposes of Rule 101B, “he and his firm” includes a professional employee who is associated with the client in any capacity described in Rule 101B if the professional employee is located in an office participating in a significant portion of the engagement.

Managerial Employee

A managerial employee is a professional employee who either—

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

The organizations of firms vary; therefore, whether an 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. The following are some, but not necessarily all, of the responsibilities that suggest that an employee has a management position:

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. Responsibility for client relationships (for example, negotiating and collecting fees for engagements, marketing the firm’s services)
4. Responsibility for such administrative functions as assignment of personnel to engagements, hiring, and training of personnel
5. Existence of profit sharing as a significant feature of total compensation

Significant Influence

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

1. Is connected with the entity as a promoter, underwriter, or voting trustee.
2. Is connected with the entity in a policymaking position related to the entity’s primary operating, financial, or accounting policies, such as chief executive officer, chief operating officer, chief financial officer, chief accounting officer, and the key assistants who can influence their decisions.
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 other than honorary.
5. Meets the criteria established in paragraph 17 of Accounting Principles Board Opinion No. 18 [AC section I82.104], The Equity Method of Accounting for Investments in Common Stock, 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 Persons

The term “he and his firm” includes spouses (whether or not dependent) and dependent persons (whether or not related) for all purposes of complying with Rule 101 subject to the following exception.

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 person 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. 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.

Generally, a person’s activities would be considered audit sensitive if such activities are normally an element of or subject to significant internal accounting controls. For example, the following positions, which are not intended to be all-inclusive, would normally be considered audit sensitive (even though not positions of significant influence): cashier, internal auditor, general accounting clerk, purchasing agent, or inventory warehouse supervisor.

Nondependent Close Relatives

The term “he and his firm” excludes nondependent close relatives of the persons described in (1) through (4) 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, stepchildren, 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, shareholder, or professional employee, any of whom are participating in the engagement, has a close relative who (a) can exercise significant influence over 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 that 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, any of whom are located in an office participating in a significant portion of the engagement, has a close relative who can exercise significant influence over the operating, financial, or accounting policies of the client.

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 or dependent person relationships. In situations involving assessment of the association of any relative or dependent person with a client, members must consider whether the strength of personal and business relationships between the member and the relative or dependent person, 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.

PROPOSED REVISION OF CURRENT INTERPRETATION 201-2

EXPLANATION

In October 1985, the Auditing Standards Board issued the *Statement on Standards for Accountants' Services on Prospective Financial Information*. Footnote 1 to that statement provides that "the accountant should refer to Rule 201 E of the AICPA Code of Professional Ethics and the related Interpretation 201-2 because this rule and interpretation are applicable to all engagements a member performs involving prospective financial information including those engagements that are not covered by the provisions of this statement."

In connection with the issuance of the prospective financial information standards, the Professional Ethics Executive Committee proposes the revision of current Interpretation 201-2.

The revision of Interpretation 201-2 covers prospective financial information prepared for internal use only, partial presentations of prospective financial information (as defined in the prospective financial information standard) and other matters not covered by that standard.

The proposed interpretation provides that in circumstances where a member submits, to his client or others, prospective financial information covered by the interpretation that is reasonably expected to be used by another (third) party, the member should disclaim any inference that the prospective results will be achieved and should fully disclose the major assumptions made, the character of the work performed, and the degree of responsibility taken.

The proposed interpretation also provides that when a member's name is associated with prospective financial information intended for internal use only that is not reasonably expected to be used by another (third) party, such information should contain a disclaimer regarding any inference that the prospective results will be achieved and should state that it is for internal use only.

Whether or not a member's name is associated with prospective financial information is a judgment to be made by the member under the facts and circumstances of a particular situation.

TEXT OF PROPOSED REVISION OF CURRENT INTERPRETATION

Interpretation 201-2: Prospective Financial Information

Rule 201 does not prohibit a member from preparing or assisting a client in the preparation of prospective financial information. The authoritative *Statement on Standards for Accountants' Services on Prospective Financial Information*, entitled *Financial Forecasts and Projections*, sets forth standards and provides guidance to members concerning performance and reporting for engagements to examine, compile, or apply agreed-upon procedures to prospective financial statements.

This interpretation covers prospective financial information prepared for internal use only, partial presentations of prospective financial information (as defined in the statement), and other matters that have not been covered by the authoritative statement.

When a member submits, to his client or others, prospective financial information covered by this interpretation that is, or reasonably might be, expected to be used by another (third) party, the member should disclaim any inference that the prospective results will be achieved. In addition,

there should be full disclosure of the major assumptions made in the preparation of the statements or analyses, the character of the work performed by the member, and the degree of responsibility he is taking.

When a member's name is associated with prospective financial information covered by this interpretation that is intended for internal use only and is not or cannot reasonably be expected to be used by another (third) party, such information should contain a disclaimer regarding any inference that the prospective results will be achieved and should state that it is for internal use only.

PROPOSED INTERPRETATION 201-4

EXPLANATION

Interpretation 201-4 is being proposed by the Professional Ethics Executive Committee to clarify the application of the General Standards under Rule of Conduct 201 to engagements that are the subject of standards issued by the Auditing Standards Board.

Rule 201 requires that engagements be performed competently and with due professional care, that engagements be adequately planned and supervised, and that sufficient relevant data be obtained in relation to an engagement to afford a reasonable basis for the conclusions or recommendations of the member. Rule 201 also requires that a member not permit his name to be used in conjunction with a forecast of future transactions in a manner that may lead to the belief that the forecast will be achieved.

Proposed Interpretation 201-4 states, in effect, that the engagements with respect to which the General Standards of Rule 201 apply include the engagements described in the Statement on Standards for Attestation Engagements, the Statement on Standards for Accountants' Services on Prospective Financial Information, and certain Statements on Auditing Standards, which, while not applicable to audits of financial statements, are applicable to other types of engagements.

TEXT OF PROPOSED INTERPRETATION

Interpretation 201-4: Definition of the Term Engagement as Used in Rule 201—General Standards

The term "engagement" as used in Rule 201 includes (1) any engagement during which a member is required to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party, (2) any engagement that requires a member to comply with a statement on auditing standards in the performance of that engagement, or (3) any engagement involving prospective financial statements that are, or reasonably might be, expected to be used by another (third) party in which a member either (a) submits such statements that he has assembled or assisted in assembling to his client or others or (b) reports on such statements.

To assure compliance with the General Standards A through D in Rule 201, a member who performs an engagement of the type described in (1) above should follow the Statement on Standards for Attestation Engagements. Similarly, a member who performs an engagement of the type described in (2) above should follow the applicable Generally Accepted Auditing Standards and the related Statements on Auditing Standards. To assure compliance with General Standards A through E in Rule 201, a member who performs an engagement described in (3) above should follow the Statement on Standards for Accountants' Services on Prospective Financial Information.

PROPOSED REVISION OF CURRENT INTERPRETATION 502-2, SUBSECTION 5

EXPLANATION

Professional Ethics Executive Committee proposes to delete from the Ethics Code Interpretation 502-2, subsection 5, Testimonials and Endorsements. Rule of Conduct 502 and Interpretation 502-2, subsection 5, read as follows:

502-2—False, Misleading or Deceptive Acts. 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—

5. Contain testimonials or endorsements.

The current Interpretation 502-2, subsection 5, provides that an advertisement containing a testimonial or endorsement is either false, misleading, or deceptive by its nature. The only issue for determination is whether an advertisement contained a testimonial or endorsement. The deletion of Interpretation 502-2, subsection 5, would result in the Ethics Division continuing to investigate complaints about advertising containing testimonials or endorsements where the complainant asserts that the testimonial or endorsement is false, misleading, or deceptive with respect to its content.

The Ethics Executive Committee is proposing that Interpretation 502-2, subsection 5, be removed from the Ethics Code because the Interpretation as presently worded extends Rule of Conduct 502 beyond its current prohibition of false, misleading, or deceptive advertising by declaring that advertising containing testimonials or endorsements is prohibited because testimonials or endorsements are false, misleading, or deceptive in and of themselves.

The Ethics Executive Committee will continue studying the use of testimonials and endorsements in advertising and intends to issue guidance on the subject in the event it is decided that Interpretation 502-2, subsection 5, be removed from the Code.

TEXT OF PROPOSED REVISION OF CURRENT INTERPRETATION

Interpretation 502-2, Subsection 5: False, Misleading or Deceptive Acts in Advertising or Solicitation (material in bold type is proposed to be deleted)

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. Consist of self-laudatory statements that are not based on verifiable facts.
4. Make comparisons with other CPAs that are not based on verifiable facts.
5. **Contain testimonials or endorsements.**
6. 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.
7. Contain any representations that would be likely to cause a reasonable person to misunderstand or be deceived.

PROPOSED RULING NO. 181 UNDER ET SECTION 591

EXPLANATION

Rule 503 of the AICPA Code of Professional Ethics provides that “a member shall not pay a commission to obtain a client....This rule shall not prohibit payment for the purchase of an accounting practice....”

Many members have inquired of the AICPA Professional Ethics Division about whether Rule 503 would proscribe the use of an account broker to facilitate such transactions. In developing Ruling No. 181, the Professional Ethics Executive Committee has concluded that the use of an account broker to facilitate the sale or a purchase of a practice or portion thereof would not be proscribed by Rule 503 because in substance the transaction is the same whether or not an account broker has been used to bring the parties together.

Ruling No. 181 is being promulgated to clarify the application of Rule 503 in the circumstances described above.

TEXT OF PROPOSED RULING

Ruling No. 181 Under ET Section 591: Sale of a Practice—Purchase of Accounts

Question—A member enters into a contract with another practitioner to purchase a portion of the latter’s practice. The purchase price will be computed based upon a percentage of the annual fees the member will receive from certain clients over a three-year period. An account broker has been used to arrange the transaction. Would such an arrangement be prohibited under Rule 503 of the Code?

Answer—Rule 503 does not prohibit a member from purchasing a practice, a portion of a practice, an individual account, or a portion of an account from another practitioner whether or not an account broker is used or whether the purchase price is based on a percentage of the annual fees accruing from the clients or is computed in some other manner. A purchase price is not considered to constitute payment of a commission under Rule 503 and the manner in which the payment is computed is merely a method of establishing the purchase price.