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Proposed Professional Ethics Division rulings and interpretations ;Proposed ethics ruling under Rule 101;Meaning of the Period of a Professional Engagement;Audits, Reviews, or Compilations and a Lack of Independence;Member Joining Client Credit Union;Proposed Interpretation under Rule 301: Confidential Information and the Purchase, Sale, or Merger of a Practice;Confidential Information and the Purchase, Sale, or Merger of a Practice;Proposed interpretation under Rule 101: Confidential Information and the Purchase, Sale, or Merger of a Practice;Confidential Information and the Purchase, Sale, or Merger of a Practice;

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# Exposure draft (American Institute of Certified Public Accountants), 1989, Aug. 18

American Institute of Certified Public Accountants. Professional Ethics Executive Committee

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# **EXPOSURE DRAFT**

## **PROPOSED PROFESSIONAL ETHICS DIVISION RULINGS AND INTERPRETATIONS**

**PROPOSED ETHICS RULING UNDER RULE 101  
Meaning of the Period of a Professional Engagement**

**PROPOSED ETHICS RULING UNDER RULE 101  
Audits, Reviews, or Compilations and a Lack of Independence**

**PROPOSED ETHICS RULING UNDER RULE 101  
Member Joining Client Credit Union**

**PROPOSED INTERPRETATION UNDER RULE 301  
Confidential Information and the Purchase, Sale, or Merger of a Practice**

**PROPOSED INTERPRETATION UNDER RULE 101  
Independence and Attest Engagements**

**AUGUST 18, 1989**

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

**Comments should be received by November 17, 1989, and addressed to  
Herbert A. Finkston, Professional Ethics Division  
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036-8775**

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*This exposure draft has been sent to—*

- *Practice offices of CPA firms.*
  - *Sampling of members in industry and education.*
  - *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 disclosures of financial activities.*
  - *Persons who have requested copies.*
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August 18, 1989

This exposure draft contains five proposed pronouncements issued by the Professional Ethics Executive Committee for review and comment by the Institute's membership and other interested parties. The text of and an explanatory preface to each pronouncement are included in this exposure draft.

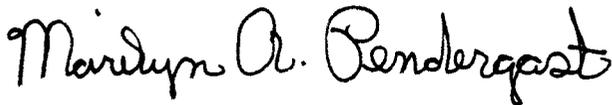
A summary does not accompany this exposure draft because of the diversity of material included. Instead, the type of information a summary would contain is included in the "Explanation" preceding each proposal. The reader will thus be able to consider the proposed pronouncements with clearer focus on the particular issues.

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

Comments or suggestions on those proposed pronouncements will be appreciated. Responses should be typed under the appropriate heading on the enclosed self-mailer comment form. They must be received at the AICPA by November 17, 1989. 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 December 15, 1989, 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,



Marilyn A. Pendergast  
Chairman  
AICPA Professional Ethics Executive Committee



Herbert A. Finkston  
Director  
Professional Ethics Division

## PROPOSED ETHICS RULING UNDER RULE 101

[*Explanation*]

Rule 101 and interpretation 101-1 specify transactions, interests, or relationships that impair independence, if they exist during various time periods. One of the time periods referred to in interpretation 101-1 is: "The period of a professional engagement." Inquiries have been received by the Professional Ethics Executive Committee asking for a definition of that term. The committee proposes to define the period of a professional engagement as commencing when the member is engaged to perform the professional service and continuing until the relationship is terminated by the member or the client.

[*Text of Proposed Ruling Under Rule 101*]

### **Meaning of the Period of a Professional Engagement**

*Question*—Under rule 101 and its interpretations, a member's independence is considered to be impaired if the member or the member's firm has certain financial interests in or management roles with the client during the "period of a professional engagement." What is the period of a professional engagement?

*Answer*—The period of a professional engagement begins when the member or the member's firm is engaged by the client to perform professional services requiring independence and concludes with the notification of the termination of that professional relationship either by the member or the member's firm or by the client.

## PROPOSED ETHICS RULING UNDER RULE 101

[*Explanation*]

The Professional Ethics Executive Committee receives many inquiries from members who are uncertain as to whether they may issue compilations or review reports when the members' independence is impaired with respect to the clients. The committee believes that explicit guidance is needed in the Code and recommends the adoption of the proposed ruling.

[*Text of Proposed Ruling Under Rule 101*]

### **Audits, Reviews, or Compilations and a Lack of Independence**

*Question*—If a member in public practice is not independent with respect to a client, is it permissible under rule 101 for the member to issue an audit, review, or compilation report for the client?

*Answer*—A member may not issue an audit opinion or review report if the member is not independent with respect to the client. A member may issue a compilation report for a client with respect to which the member is not independent. However, the member must specifically disclose his or her lack of independence without giving reasons for the impairment.

## PROPOSED ETHICS RULING UNDER RULE 101

[*Explanation*]

The Professional Ethics Executive Committee is receiving an increasing number of inquiries from members who have the opportunity to join credit unions for which the members provide professional services requiring independence.

Interpretation 101-1-A4 provides that independence is considered to be impaired if a member has any loan to or from the client. However, an exception is made if the member has a loan from a client which

is a financial institution. Such a loan must meet criteria included in the interpretation and must be made under normal lending procedures, terms, and requirements.

After considering the matter, the committee concluded that if a credit union meets the definition of a financial institution as provided in interpretation 101-5, and the loan is consistent with interpretation 101-1-A4, membership in the credit union would not impair the member's and the member's firm's independence.

If the credit union does not meet the definition of a financial institution, or the loans or deposits are not in accordance with the interpretations and rulings of the Code, membership in the client credit union would cause the independence of the member and the member's firm to be impaired.

*[Text of Proposed Ruling Under Rule 101]*

### **Member Joining Client Credit Union**

*Question*—A member and the member's partners and employees have been invited to become members of a credit union for which the member's firm provides professional services requiring independence. Would the membership in the credit union impair the independence of the member and the member's firm with respect to the credit union?

*Answer*—Independence would be considered to be impaired unless: (1) the credit union meets the definition of a financial institution provided in interpretation 101-5, and (2) any loans meet the criteria in interpretation 101-1-A4 and any deposits meet the criteria in ruling no. 70 ET section 191.

## **PROPOSED INTERPRETATION UNDER RULE 301**

*[Explanation]*

Rule 301 provides, in part, that "a member in public practice shall not disclose any confidential client information without the specific consent of the client." In connection with a prospective sale or merger of a member's practice, it is often necessary to disclose confidential client information without obtaining the client's specific consent to do so. However, the committee believes that this should be permitted under rule 301, provided that the member take appropriate action to protect confidential client information. The Professional Ethics Executive Committee believes that an interpretation addressing this issue should be adopted.

*[Text of Proposed Interpretation Under Rule 301]*

### **Confidential Information and the Purchase, Sale, or Merger of a Practice**

Rule 301 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, 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.

## **PROPOSED INTERPRETATION UNDER RULE 101**

*[Explanation]*

This proposal is a modification of a proposal included in an exposure draft dated January 12, 1989. The modification was made in light of the comments received in response to the prior exposure draft and broadens the description of the circumstances in which a member's independence will be considered

to be impaired in a covered attest engagement. Generally, the broadened circumstances involve certain relationships of the member's firm and of its owners, partners, and shareholders.

The Statement on Standards for Attestation Engagements defines an attest engagement as "one in which a member is engaged 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."

The proposed interpretation provides guidance regarding a member's independence with respect to both the subject of the assertion and the assenter for those attest engagements that are not covered by Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, and Statements on Standards for Accountants' Services on Prospective Financial Information.

The Professional Ethics Executive Committee believes that different independence standards should apply to the attest engagements to which the proposed interpretation applies and to attest engagements not covered by the proposal because of important differences that may exist between those two types of attest engagements. For example, the attest engagements covered by the proposal usually are completed in a brief period and often do not involve a continuing relationship with the client. The committee believes this proposal provides sufficient safeguards regarding the appearance of objectivity and integrity with respect to the member's performance of the covered attest engagements.

*[Text of Proposed Interpretation Under Rule 101]*

## **Independence and Attest Engagements**

### **Introduction**

Rule 101, "Independence," provides that "a member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council." The Statement on Standards for Attestation Engagements requires independence in the performance of engagements covered by that Statement.

### *[Definitions]*

**Assertion.** Any declaration, or a set of related declarations taken as a whole, by a party responsible for it.

**Asserter.** The person(s) or entity responsible for an assertion.

**Attest Engagement.** An engagement in which a practitioner is engaged 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.

**Attest Engagement Team.** Includes proprietors, partners, and shareholders who participate in the acceptance or performance of the attest engagement and full- or part-time professional employees who participate in the acceptance or the performance of the attest engagement, including individuals who provide consultation or supervisory services for the attest engagement.

### *[Applicability]*

This interpretation does not apply to attest engagements covered by Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Accountants' Services on Prospective Financial Information, and such other pronouncements as may be determined from time to time by the Professional Ethics Executive Committee.

### **Interpretation**

Independence will be considered to be impaired if, during the period of the attest engagement or at the time the written conclusion is issued—

1. An individual on the attest engagement team or his or her spouse, dependent or firm<sup>1</sup> has a relationship with the assenter that is proscribed by interpretation 101-1 of rule 101.

<sup>1</sup>For the purpose of this interpretation, *firm* shall mean the sole proprietorship, partnership, or professional corporation of which an individual on the attest engagement team is an owner, partner, shareholder, or employee; it does not include owners, partners, shareholders, or employees as individuals.

2. An individual on the engagement team has a nondependent close relative<sup>2</sup> who has either a position of significant influence with, or a financial interest material to the close relative in the assenter.
3. An owner, partner, or shareholder of the firm who is located in an office participating in a significant portion of the attest engagement, or the spouse or dependent of such an owner, partner, or shareholder, has either a position of significant influence with, or a financial interest material to such person in the assenter.
4. The firm, an individual on the attest engagement team (or his or her spouse or dependent), or an owner, partner, or shareholder in an office performing a significant portion of the engagement, contributed to the development of the subject matter of the assertion (the subject) or stands to gain financially directly from the success of the subject.
5. An individual on the attest engagement team knows or could reasonably be expected to know that any owner, partner, or shareholder located in other offices of the firm (a) contributed to the development of the subject or stands to gain financially directly from the success of the subject, or (b) has a position of significant influence with the assenter.

In determining whether a relationship with an assenter is one that is proscribed under interpretation 101-1, the following guidance is provided:

- Interpretation 101-6, “The Effect of Actual or Threatened Litigation on Independence,” is not applicable unless the litigation relates to the attest engagement or is material to the firm or to the financial statements of the assenter.
- Interpretation 101-9, “The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence,” is not applicable because the applicability of this interpretation is stated herein.

In determining whether a relationship with the subject is one that is proscribed, generally, if the firm, an individual on the engagement team or his or her spouse or dependent, or an owner, partner, or shareholder of the firm, contributed to the development of the subject or stands to gain financially directly from the success of the subject, independence will be considered to be impaired. Examples of attest engagements (not intended to be all-inclusive) that require an evaluation of independence include —

- Attesting to an assertion about one or more attributes of a publication. The publication is the subject of the assertion; the publisher, the assenter.
- Attesting to an assertion of the capabilities of a software package. The software package is the subject of the assertion; the developer, the assenter.
- Attesting to an assertion made by an agent about the production capacity of the agent’s client. The agent’s client is the subject of the assertion; the agent, the assenter.

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<sup>2</sup>For the purpose of this interpretation, this term shall mean the same as in interpretation 101-9, “The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence.”