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Proposal of Professional Ethics Division: Proposed interpretation 501-8 under rule 501: "Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnication and limitation of liability agreements with a client"; Exposure draft (American Institute of Certified Public Accountants), 2007, December 3

American Institute of Certified Public Accountants. Professional Edthics Executive Committee

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EXPOSURE DRAFT

PROPOSAL OF PROFESSIONAL ETHICS DIVISION

PROPOSED INTERPRETATION 501-8 UNDER RULE 501: “Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnification and limitation of liability agreements with a client”

December 3, 2007

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 February 3, 2008, and addressed to
Lisa A. Snyder, Director, Professional Ethics Division,
AICPA, 1211 Avenue of the Americas, 19th Floor,
New York, NY 10036 or via e-mail to lsnyder@aicpa.org.**

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December 3, 2007

This exposure draft contains an important proposal for review and comment by the AICPA's membership and other interested parties regarding a pronouncement for possible adoption by the Professional Ethics Executive Committee (PEEC). The text and an explanation of the proposed pronouncement is included in this exposure draft.

After the exposure period is concluded and the PEEC has evaluated the comments, the PEEC may decide to publish the proposed pronouncement as exposed for comment or as modified based on comments received and redeliberations by the PEEC. Once published, the pronouncement becomes effective on the last day of the month in which it is published in the *Journal of Accountancy*, except as may otherwise be stated in the pronouncement.

Your comments are an important part of the standard-setting process. Please take this opportunity to comment. Responses must be received at the AICPA by February 3, 2008. All written replies to this exposure draft will become part of the public record of the AICPA.

All comments received will be considered by the PEEC at an open meeting that will be announced in the *CPA Letter* and posted to the Professional Ethics Division's Web site.

Please send comments to Lisa A. Snyder, Director, AICPA Professional Ethics Division, AICPA, 1211 Avenue of the Americas, 19th Floor, New York, NY 10036 or via e-mail to lsnyder@aicpa.org. Comments submitted electronically are encouraged and would be appreciated.

Sincerely,

Bruce P. Webb
Chair
AICPA Professional Ethics Executive Committee

Lisa A. Snyder
Director
AICPA Professional Ethics Division

Professional Ethics Executive Committee (2007–2008)

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PROPOSED INTERPRETATION 501-8, “FAILURE TO FOLLOW REQUIREMENTS OF GOVERNMENTAL BODIES, COMMISSIONS, OR OTHER REGULATORY AGENCIES ON INDEMNIFICATION AND LIMITATION OF LIABILITY AGREEMENTS WITH A CLIENT,” UNDER RULE 501, ACTS DISCREDITABLE

[Explanation]

In September 2005 and September 2006, the Professional Ethics Executive Committee (PEEC, or committee) issued exposure drafts containing proposed ethics interpretations under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101), addressing the impact that certain indemnification and limitation of liability provisions in client engagement letters would have on a member’s independence. The comment letters received on these proposals contained diverse views with no clear consensus amongst stakeholders.

Before determining how to proceed on this issue, the committee agreed it would be helpful to better understand the various rules and laws on the use of these provisions within the United States as well as abroad. Accordingly, the committee commissioned research to study and compile the rules and laws of various state boards of accountancy, banking and insurance regulators, as well as regulators and legislators abroad regarding the use of these provisions. The results of the research indicated that:

- Of the state boards of accountancy contacted, no state board rule or accountancy act provision permits or prohibits the use of indemnification and limitation of liability provisions.
- The state banking and insurance regulators contacted were generally opposed to the use of indemnification and limitation of liability provisions and follow the model rule of their national association, which prohibits the use of indemnification provisions.
- As a general matter, both Commonwealth and European law appear to disfavor the use of limitation of liability clauses. However, the law in the United Kingdom was recently amended to permit the use of such agreements in defined circumstances. The research also noted various auditor liability reform initiatives taking place in Canada and the European Union, which could impact the subject.

As a result of the diverse feedback received on its earlier proposals and the recent auditor liability reform initiatives in both the United States and abroad, which could impact the subject, including the U.S. Treasury Department’s new Advisory Committee on the Auditing Profession, the committee has decided not to issue a revised proposal under Rule 101, *Independence*, at the present time. However, the committee believes it would be prudent to issue guidance reminding members that certain regulators prohibit the use of various indemnification and limitation of liability provisions and, therefore, entering into such an agreement with a client who is subject to such regulators’ requirements would be considered an act discreditable to the profession. Accordingly, the committee is proposing an interpretation under Rule 501, *Acts Discreditable* (AICPA, *Professional Standards*, vol. 2, ET sec. 501), that would require members to comply with the requirements of such regulators on the use of these provisions when providing audit or other attest services that are required by such regulators.

Once the legislative efforts concerning auditor liability reform are concluded, the committee will continue to monitor events on this subject both nationally and internationally and consider what, if any, additional guidance may be appropriate.

PROPOSED INTERPRETATION 501-8, “FAILURE TO FOLLOW REQUIREMENTS OF GOVERNMENTAL BODIES, COMMISSIONS, OR OTHER REGULATORY AGENCIES ON INDEMNIFICATION AND LIMITATION OF LIABILITY AGREEMENTS WITH A CLIENT,” UNDER RULE 501, ACTS DISCREDITABLE

[Text of Proposed Interpretation 501-8]

Certain governmental bodies, commissions, or other regulatory agencies (collectively, “regulators”) have established requirements (including, but not limited to, laws, regulations, and interpretations thereof) that prohibit entities subject to their regulation from entering into certain types of indemnification and limitation of liability agreements in connection with the member’s provision of audit or other attest services that are required by such regulators or that provide that the existence of such agreements causes the member to be disqualified from providing such services to these entities. For example, federal banking regulators, state insurance commissions, and the Securities and Exchange Commission have established such requirements.

If a member agrees to perform audit or other attest services that are subject to the requirements of these regulators, the member should not enter into an indemnification or limitation of liability agreement with the client that would place the client or member in violation of such requirements or that would cause the member to be disqualified from providing such services to the client. A member who enters into an agreement with a client that would place the client or member in violation of such requirements or that would cause the member to be disqualified from providing such services to the client would be considered to have committed an act discreditable to the profession.