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## Comment letters on exposure draft Omnibus Proposal of Professional Ethics Division Interpretations and Rulings

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

PROPOSED INTERPRETATION UNDER RULE 101: Independence and Cooperative Arrangements With Clients  PROPOSED ETHICS RULING UNDER RULE 101: Indemnification Clause in Engagement Letters  PROPOSED ETHICS RULING UNDER RULE 101: Agreement With Attest Client to Use ADR Techniques  PROPOSED ETHICS RULING UNDER RULE 101: Commencement of ADR Proceeding  PROPOSED ETHICS RULING UNDER RULE 101: Auditor's Performance of Certain Internal Audit Services  PROPOSED ETHICS RULING UNDER RULE 101: Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company  PROPOSED REVISION OF INTERPRETATION 101-9 UNDER RULE 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence  PROPOSED REVISION OF ETHICS RULING NO. 60 UNDER RULE 101: Employee Benefit Plans—Member's Relationships With Participating Employer(s)  PROPOSED REVISION OF ETHICS RULING NO. 67 UNDER RULE 101: Servicing of Loan  PROPOSED DELETION OF RULING NO. 13 UNDER RULE 101: Member as Bank Stockholder  PROPOSED INTERPRETATION UNDER RULE 102: Obligations of a Member to His or Her Employer's External Accountant  PROPOSED INTERPRETATION UNDER RULE 102: Subordination of Judgment by a Member  PROPOSED INTERPRETATION UNDER RULE 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP  PROPOSED ETHICS RULING UNDER RULE 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier  PROPOSED REVISION OF ETHICS RULING NO. 158 UNDER RULE 505: Operation of Separate Data Processing Business by a Public Practitioner  PROPOSED DELETION OF ETHICS RULING NO. 180 UNDER RULE 505: Side Businesses Which Offer Services of a Type Performed by CPAs

**MAY 19, 1993**

**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 August 19, 1993, and addressed to  
Herbert A. Finkston, Director, Professional Ethics Division,  
AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881**

# APPENDIX

## A

# PROPOSED INTERPRETATION UNDER RULE 101

[*Explanation*]

The Professional Ethics Executive Committee takes the position that a member's firm may enter into a cooperative arrangement with a client without impairing independence with respect to that client as long as the arrangement is not material to the firm or the client. The proposed interpretation that is recommended for adoption provides this position along with examples of cooperative arrangements.

[*Text of Proposed Interpretation Under Rule 101*]

## **Independence and Cooperative Arrangements With Clients**

Independence will be considered to be impaired if, during the period of a professional engagement or at the time of expressing an opinion, a member's firm had any cooperative arrangement with the client that was material to the member's firm or to the client.

### **Definition of Terms**

**Firm** — For purposes of this interpretation only, a firm is a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting.

**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.

# PROPOSED ETHICS RULING UNDER RULE 101

[*Explanation*]

The Professional Ethics Executive Committee takes the position that independence would not be considered to be impaired if a member included a clause in his or her engagement letters that provides that the member would be held harmless from any liability resulting from misrepresentations of the client's management. The committee proposes that the following ruling be adopted and become part of the AICPA Code of Professional Conduct.

[Text of Proposed Ruling Under Rule 101]

### **Indemnification Clause in Engagement Letters**

*Question* — A member 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 the inclusion of such an indemnification clause in engagement letters impair the member's independence with respect to the client?

*Answer* — No.

## **PROPOSED ETHICS RULING UNDER RULE 101**

[Explanation]

The Professional Ethics Executive Committee has concluded that independence would not be considered to be impaired if a member and client agree to use alternative dispute resolution (ADR) techniques to resolve any future disputes that may arise. The committee proposes that the following ruling be adopted and become part of the AICPA Code of Professional Conduct.

[Text of Proposed Ruling Under Rule 101]

### **Agreement With Attest Client to Use ADR Techniques**

*Question* — Would a predispute agreement between a member and a client to use alternative dispute resolution (ADR) techniques to resolve disputes relating to attest services cause the member's independence to be impaired?

*Answer* — No. Such an agreement would not cause an impairment of independence since the member and the client are not in threatened or actual positions of material adverse interests by reason of threatened or actual litigation.

## **PROPOSED ETHICS RULING UNDER RULE 101**

[Explanation]

The Professional Ethics Executive Committee concluded that an alternative dispute resolution (ADR) proceeding would not have the same effect on independence as litigation involving a member and client unless binding arbitration is used. The committee proposes that the following ruling be adopted into the AICPA Code of Professional Conduct.

[Text of Proposed Ruling Under Rule 101]

### **Commencement of ADR Proceeding**

*Question* — Would the commencement of an alternative dispute resolution (ADR) proceeding impair independence?

*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 and the client in threatened or actual positions of material adverse interests. Nevertheless, if binding arbitration is used, the member and the client would be in positions of material adverse interests because arbitration proceedings are considered to be sufficiently similar to litigation for ethics interpretation 101-6 [ET section 101.08] to be applied.

## PROPOSED ETHICS RULING UNDER RULE 101

[*Explanation*]

Frequently, a member or the member's firm is asked by a client to perform certain internal audit activities. The Professional Ethics Executive Committee has agreed that the performance of such services would not impair independence and recommends that the following ruling be adopted into the AICPA Code of Professional Conduct.

[*Text of Proposed Ruling Under Rule 101*]

### **Auditor's Performance of Certain Internal Audit Services**

*Question* — An audit client of the member's firm is in need of assistance with the performance of its internal audit activities. The activities could include, among other things, the following: testing of reconciliations of general ledger accounts; surprise counts of cash; confirmations of accounts receivable; analyses of significant fluctuations in income and expense accounts; and reviews of operational activities. Would independence be considered to be impaired if the firm was engaged to perform such services or a staff member of the firm assisted the client's employees in the performance of such services?

*Answer* — The performance of internal audit services, such as those described in the preceding paragraph, would not impair the firm's independence regardless of whether the firm was engaged to perform such services or the firm provided staff to assist the client's internal auditors.

## PROPOSED ETHICS RULING UNDER RULE 101

[*Explanation*]

Interpretation 101-1.A.4 under rule 101, *Independence* [ET section 101.02], provides that if a member has a loan to or from an attest client or any officer, director, or principal stockholder of that client, independence is considered to be impaired (with certain exceptions). Therefore, a member's loan from a parent company, a principal stockholder, would impair the member's independence with respect to any client that is a subsidiary of that parent.

The AICPA Code of Professional Conduct is currently silent on whether a loan from a nonclient subsidiary company would impair independence with respect to the client parent. The Professional Ethics Executive Committee recommends that the following ruling be adopted to provide guidance on this issue.

[*Text of Proposed Ruling Under Rule 101*]

### **Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company**

*Question* — A member has obtained a loan from a company that is not a client. The parent of the nonclient has asked the member to perform an audit of its financial statements. Does the member's loan from the subsidiary impair the member's independence with respect to the parent?

*Answer* — Yes.

## PROPOSED REVISION OF INTERPRETATION 101-9 UNDER RULE 101

[*Explanation*]

The "Spouses and Dependent Persons" section of this interpretation is being proposed for revision. The remainder of the interpretation would not be changed.

Under the current interpretation, if a partner's spouse is in a position of "significant influence" with a client, the entire firm's independence would be considered to be impaired with respect to that client. The proposed revision would consider the firm to be independent if the partner meets the following four criteria:

1. The partner does not participate in the engagement.
2. The partner is not located in an office participating in a significant portion of the engagement.
3. The partner does not have the ability to exercise influence over the engagement.
4. The partner does not have any involvement with the engagement.

Similarly, a change is proposed with respect to an individual in a managerial position within the firm whose spouse is in a position of "significant influence" with the client. Under the current interpretation, the firm's independence would be impaired with respect to the client unless the manager does not participate in the engagement and is located in an office that is not participating in a significant portion of the engagement. The committee's proposed revision would consider the firm to be independent as long as the individual with the managerial position does not participate in the engagement.

The Professional Ethics Executive Committee recommends that the following revision of interpretation 101-9 [ET section 101.11] related to the employment of spouses and dependent persons be adopted as part of the AICPA Code of Professional Conduct.

*[Text of Current Interpretation 101-9 Proposed for Revision]*

### **The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence**

This interpretation defines certain terms used in interpretation 101-1 [ET section 101.02] and, in doing so, also explains how independence may be impaired through certain family relationships.

#### ***Member or Member's Firm***

A member (as used in rule 101) and a member or a member's firm (as used in interpretation 101-1 [ET section 101.02]) include—

1. The member's firm and its proprietors, partners, or shareholders. A member's firm is defined as a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.
2. All individuals<sup>3</sup> participating in the engagement, except those who perform only routine clerical functions, such as typing and photocopying.
3. All individuals<sup>3</sup> with a managerial position located in an office participating in a significant portion of the engagement.
4. Any entity (for example, a partnership, corporation, trust, joint venture, or pool) whose operating, financial, or accounting policies can be controlled (see definition of control for consolidation purposes in Financial Accounting Standards Board [FASB] Statement No. 94 [AC section C51]) by one or more of the persons described in (1) through (3) or by two or more such persons if they choose to act together.

A member or a member's firm does not include an individual<sup>3</sup> solely because he or she was formerly associated with the client in any capacity described in interpretation 101-1-B [ET section 101.02], if such an individual<sup>3</sup> has disassociated himself or herself from the client and does not participate in the engagement for the client covering any period of his or her association with the client.

A member or a member's firm includes individuals who provide services to clients and are associated with the client in any capacity described in interpretation 101-1-B [ET section 101.02], if the individuals are located in an office participating in a significant portion of the engagement.

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<sup>3</sup> Refers to all employees of the member and all contractors retained by the member, except specialists as discussed in SAS No. 11 [AU section 336], irrespective of their functional classification (for example, audit, tax, or management consulting services).

### ***Managerial Position***

The organization of firms varies; therefore, whether an individual has a managerial position depends on the responsibilities and how he or she 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 individual has a managerial position:

1. Continuing responsibility for the overall planning and supervision of engagements for specified clients
2. Authority to determine 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 and marketing the firm's services)
4. Existence of profit sharing as a significant feature of total compensation
5. Responsibility for overall management of the firm, development or establishment of firm policies on technical matters, and implementation of or compliance with the following nine elements of quality control:
  - a. Independence
  - b. Assigning personnel to engagements
  - c. Consultation
  - d. Supervision
  - e. Hiring
  - f. Professional development of personnel
  - g. Advancement of personnel
  - h. Acceptance and continuance of clients
  - i. Inspection of compliance with policies and procedures

### ***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, voting trustee, general partner, or director (other than an honorary director as defined in the AICPA Code of Professional Conduct).
2. Is connected with the entity in a policy-making position related to the entity's primary operating, financial, or accounting policies, such as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer.
3. Meets the criteria established in Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* [AC 182], and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity.

The foregoing examples are not necessarily all-inclusive.

### ***Office Participating in a Significant Portion of the Engagement***

An office would be considered to be participating in a significant portion of an engagement if the office had primary client responsibility for a multioffice engagement. In addition, professional judgment must be exercised in deciding whether any other office participates in a significant portion of a multioffice engagement. For example, an office would be considered to be participating in a significant portion of the engagement if the office's engagement hours or fees are material to total engagement hours or fees or if the office's responsibility for reporting, whether internally or externally, on a portion of the engagement relates to a material amount of assets or income (loss) before income taxes of the client.

The foregoing examples are not necessarily inclusive of all situations in which an office may be considered to be participating in a significant portion of the engagement.

### ***Spouses and Dependent Persons***

The term *member* includes spouses (whether or not dependent) and dependent persons (whether or not related) for all purposes of complying with rule 101 subject to one exception.



The exception is that the independence of the member and the member's firm will not normally be impaired solely because of employment of a spouse or dependent persons by a client if the employment is in a position that does not allow "significant influence" over the client's operating, financial, or accounting policies. However, if such employment is in a position in which the person's activities are audit-sensitive (even if the position is not one of significant influence), the member should not participate in the engagement.

In general, 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 (though not of significant influence): cashier, internal auditor, accounting supervisor, purchasing agent, and inventory warehouse supervisor.

### ***Nondependent Close Relative***

The term *member or member's firm* excludes nondependent close relatives of the persons described in (1) through (3) of that definition. Nevertheless, in the 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, grandchildren, stepchildren, brothers, sisters, grandparents, parents, parents-in-law and their respective spouses. Close relatives do not include the brothers and sisters of the member's spouse.

The independence of a member's firm would be considered to be impaired with respect to an enterprise if—

1. During the period of the professional engagement or at the time of expressing an opinion, an individual participating in the engagement has a close relative with a financial interest in the enterprise that was material to the close relative and of which the individual participating in the engagement has knowledge.
2. During the period covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion—
  - a. An individual participating in the engagement has a close relative who could exercise significant influence over the operating, financial, or accounting policies of the enterprise or who is otherwise employed in a position in which the person's activities are audit-sensitive, or
  - b. A proprietor, partner, or shareholder who is located in an office participating in a significant portion of the engagement, has a close relative who could exercise significant influence over the operating, financial, or accounting policies of the enterprise.

### ***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. For example, a member's relationship with a cohabitant may be equivalent to that of a spouse. In addition, 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, in conjunction with the specified association with the client, would lead a reasonable person aware of all the facts who took into consideration normal strength of character and normal behavior under such circumstances, to conclude that the situation poses an unacceptable threat to the member's objectivity and appearance of independence.

*[Text of Proposed Revision of Interpretation 101-9]*

## **The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence**

This interpretation defines certain terms used in interpretation 101-1 [ET section 101.02] and, in doing so, also explains how independence may be impaired through certain family relationships.

### ***Member or Member's Firm***

A member (as used in rule 101) and a member or a member's firm (as used in interpretation 101-1 [ET section 101.02]) include—

1. The member's firm and its proprietors, partners, or shareholders. A member's firm is defined as a form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.
2. All individuals<sup>3</sup> participating in the engagement, except those who perform only routine clerical functions, such as typing and photocopying.
3. All individuals<sup>3</sup> with a managerial position located in an office participating in a significant portion of the engagement.
4. Any entity (for example, a partnership, corporation, trust, joint venture, or pool) whose operating, financial, or accounting policies can be controlled (see definition of control for consolidation purposes in Financial Accounting Standards Board [FASB] Statement No. 94 [AC section C51]) by one or more of the persons described in (1) through (3) or by two or more such persons if they choose to act together.

A member or a member's firm does not include an individual<sup>3</sup> solely because he or she was formerly associated with the client in any capacity described in interpretation 101-1-B [ET section 101.02], if such an individual<sup>3</sup> has disassociated himself or herself from the client and does not participate in the engagement for the client covering any period of his or her association with the client.

A member or a member's firm includes individuals who provide services to clients and are associated with the client in any capacity described in interpretation 101-1-B [ET section 101.02], if the individuals are located in an office participating in a significant portion of the engagement.

### ***Managerial Position***

The organization of firms varies; therefore, whether an individual has a managerial position depends on his or her responsibilities and how he or she 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 individual has a managerial position:

1. Continuing responsibility for the overall planning and supervision of engagements for specified clients
2. Authority to determine 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 and marketing the firm's services)
4. Existence of profit sharing as a significant feature of total compensation
5. Responsibility for overall management of the firm, development, or establishment of firm policies on technical matters, and implementation of or compliance with the following nine elements of quality control:
  - a. Independence
  - b. Assigning personnel to engagements
  - c. Consultation
  - d. Supervision
  - e. Hiring
  - f. Professional development of personnel
  - g. Advancement of personnel
  - h. Acceptance and continuance of clients
  - i. Inspection of compliance with policies and procedures

### ***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, voting trustee, general partner, or director (other than an honorary director as defined in the AICPA Code of Professional Conduct).

<sup>3</sup> Refers to all employees of the member and all contractors retained by the member, except specialists as discussed in SAS No. 11 [AU section 336], irrespective of their functional classification (for example, audit, tax, or management consulting services).

2. Is connected with the entity in a policy-making position related to the entity's primary operating, financial, or accounting policies, such as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer.
3. Meets the criteria established in Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* [AC 182], and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity.

The foregoing examples are not necessarily all-inclusive.

### **Office Participating in a Significant Portion of the Engagement**

An office would be considered to be participating in a significant portion of an engagement if the office had primary client responsibility for a multioffice engagement. In addition, professional judgment must be exercised in deciding whether any other office participates in a significant portion of a multioffice engagement. For example, an office would be considered to be participating in a significant portion of the engagement if the office's engagement hours or fees are material to total engagement hours or fees or if the office's responsibility for reporting, whether internally or externally, on a portion of the engagement relates to a material amount of assets or income (loss) before income taxes of the client.

The foregoing examples are not necessarily inclusive of all situations in which an office may be considered to be participating in a significant portion of the engagement.

### **Spouses and Dependent Persons**

Except as stated in the following paragraph, the term *member* includes spouses (whether or not dependent) and dependent persons (whether or not related) for all purposes of complying with rule 101.

The exception is that the independence of the member and the member's firm will not normally be impaired solely as a result of the employment of a spouse or dependent person by a client subject to the following conditions:

1. Independence would be considered to be impaired if a spouse or dependent person of one of the following has a position with the client that allows significant influence over the client's operating, financial, or accounting policies:
  - a. An individual participating in the engagement
  - b. A proprietor, partner, or shareholder who—
    - i. is located in an office participating in a significant portion of the engagement; or
    - ii. has the ability to exercise influence over the engagement; or
    - iii. has any involvement with the engagement (for example, consultation on accounting or auditing issues)
2. Independence will be considered to be impaired if a spouse or dependent person of an individual participating in the engagement has a position with the client involving activities that are *audit-sensitive* (even though the position is not one that allows *significant influence*).

In general, 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: cashier; internal auditor; accounting supervisor; purchasing agent; or inventory warehouse supervisor.

### **Nondependent Close Relative**

The term *member* or *member's firm* excludes nondependent close relatives of the persons described in (1) through (3) of that definition. Nevertheless, in the 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, grandchildren, stepchildren, brothers, sisters, grandparents, parents, parents-in-law, and their respective spouses. Close relatives do not include the brothers and sisters of the member's spouse.

The independence of a member's firm would be considered to be impaired with respect to an enterprise if—

1. During the period of the professional engagement or at the time of expressing an opinion, an individual participating in the engagement has a close relative with a financial interest in the enterprise that was material to the close relative and of which the individual participating in the engagement has knowledge.
2. During the period covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion—
  - a. An individual participating in the engagement has a close relative who could exercise significant influence over the operating, financial, or accounting policies of the enterprise or who is otherwise employed in a position in which the person's activities are audit-sensitive, or
  - b. A proprietor, partner, or shareholder, any one of whom is located in an office participating in a significant portion of the engagement, has a close relative who could exercise significant influence over the operating, financial, or accounting policies of the enterprise.

### ***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. For example, a member's relationship with a cohabitant may be equivalent to that of a spouse. In addition, 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, in conjunction with the specified association with the client, would lead a reasonable person aware of all the facts, who took into consideration normal strength of character and normal behavior under such circumstances, to conclude that the situation poses an unacceptable threat to the member's objectivity and appearance of independence.

## **PROPOSED REVISION OF ETHICS RULING NO. 60 UNDER RULE 101**

### *[Explanation]*

The Professional Ethics Executive Committee has considered numerous inquiries concerning whether certain financial relationships of a member with sponsor(s) of an employee benefit plan would impair independence with respect to the plan. The committee has concluded that the current ruling does not give appropriate recognition to the distinction between the plan and its sponsor(s), and, therefore, proposes that the following revision be adopted.

### *[Text of Current Ruling No. 60 Proposed for Revision]*

#### **Employee Benefit Plans—Member's Relationships With Participating Employer(s)**

*Question* — A member has been asked to audit the financial statements of an employee benefit plan. A plan may have one or more participating employers. Must the member maintain his or her independence with respect to each participating employer in order to be considered independent of the plan?

*Answer* — Except as described below, in order to be considered independent with respect to an employee benefit plan the member must remain independent with respect to the employer who is the sole sponsor of the plan, or, in the case of a multi-employer plan, with respect to any employer on whom the plan has material financial impact.

The exceptions referred to above are:

1. A financial interest, direct or indirect, in any employer will not impair the member's independence with respect to the plan if:

- a. The financial interest is not large enough to permit the member to exercise significant influence over operating and financial policies of any employer, and
  - b. The financial interest is not material in relation to the net worth of the member.
2. A member loan to or from any employer or any of its officers, directors, or principal stockholders will not impair the member's independence with respect to the plan if the loan is not material in relation to the net worth of the member.

[Reference changed December 31, 1983, by issuance of interpretation 101-9 [ET section 101.11.] Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective December 31, 1991, by the Professional Ethics Executive Committee.]

*[Text of Proposed Revision of Ruling No. 60]*

**Employee Benefit Plans—  
Member's Relationships with Participating Employer(s)**

*Question* — A member has been asked to audit the financial statements of an employee benefit plan that may have one or more participating employer(s). Must the member maintain independence with respect to the participating employer(s) in order to be considered independent of the plan?

*Answer* — Independence would not be considered to be impaired with respect to the plan unless the member has a financial interest in the participating employer(s) or other relationships with the participating employer(s) that would give the member significant influence over such employer(s).

## PROPOSED REVISION OF ETHICS RULING NO. 67 UNDER RULE 101

*[Explanation]*

The proposed revision to this ruling clarifies the committee's position that the *mere* servicing of a member's loan by a client financial institution would not impair independence with respect to the client. It is recommended for adoption.

*[Text of Current Ruling No. 67 Proposed for Revision]*

**Servicing of Loan**

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

*Answer* — The mere servicing of a member's loan by a client financial institution would not impair the member's independence with respect to that client as long as there was no risk of material loss to the client with respect to the loan being serviced.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee.]

*[Text of Proposed Revision of Ethics Ruling No. 67]*

**Servicing of Loan**

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

*Answer* — No.

## PROPOSED DELETION OF RULING NO. 13 UNDER RULE 101

*[Explanation]*

The Professional Ethics Executive Committee recommends that the current ruling be deleted from the AICPA Code of Professional Conduct as it disagrees with the stated conclusion. The committee has concluded that the member's ownership of a financial interest, even if material, in a bank has no relationship with the bank's customers and would not impair independence.

*[Text of Ruling No. 13 Under Rule 101 Proposed for Deletion]*

### **Member as Bank Stockholder**

*Question* — A member in public practice holds a stock interest in a bank. Would the independence of the member's firm be considered to be impaired with respect to a client that has borrowings with the bank?

*Answer* — The member's stock ownership in the bank creates an indirect financial interest with respect to the bank's customers. To the extent that such an indirect financial interest is not material, independence of the member's firm would not be considered to be impaired.

## PROPOSED INTERPRETATION UNDER RULE 102

*[Explanation]*

Rule 102, *Integrity and Objectivity*, as adopted by membership in January 1988, applies to all members who perform any professional services. As defined in the AICPA Code of Professional Conduct (ET section 92.10), "professional services include all services performed by a member while holding out as a CPA."

The following proposed Interpretation clarifies the obligations of a member under rule 102 with respect to the employer's external accountants.

The committee proposes that the following interpretation be adopted into the AICPA Code of Professional Conduct.

*[Text of Proposed Interpretation Under Rule 102]*

### **Obligations of a Member to His or Her Employer's External Accountant**

Under rule 102, 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 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 from management and disclosing material matters about which the member is aware.

## PROPOSED INTERPRETATION UNDER RULE 102

*[Explanation]*

All members who perform professional services are subject to rule 102, which prohibits knowing misrepresentations of fact and subordination of judgment. Members who perform professional services and members in public practice are subject to this rule.

The proposed Interpretation clarifies the obligations of a member when he or she has a disagreement or dispute with his or her supervisor relating to the preparation of financial statements or the recording of transactions.

The Professional Ethics Executive Committee proposes that the following interpretation be adopted into the AICPA Code of Professional Conduct.

*[Text of Proposed Interpretation Under Rule 102]*

**Subordination of Judgment by a Member**

Rule 102 prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment:<sup>1</sup>

1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature or omission of disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. If, after appropriate research or consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.
2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed.
3. If, after discussing his or her concerns with the appropriate person(s) in the organization, the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member also should consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In this connection, the member may wish to consult with his or her legal counsel.
4. The member should at all times be cognizant of his or her obligations under interpretation 102-\_\_, ET section 191.\_\_.

## **PROPOSED INTERPRETATION UNDER RULE 203**

*[Explanation]*

Rule 203, *Accounting Principles*, applies to all members, including those in industry, government, and education as well as to those in public practice.

The following proposed Interpretation, which is recommended for adoption, emphasizes a member's responsibility under rule 203 for any affirmative statement that financial statements or other financial data are presented in conformity with generally accepted accounting principles (GAAP).

*[Text of Proposed Interpretation Under Rule 203]*

**Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP**

Rule 203 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 generally accepted accounting principles (GAAP)

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<sup>1</sup> A member in the practice of public accounting should refer to the Statements on Auditing Standards. For example, see SAS No. 22, "Planning and Supervision," (AICPA, *Professional Standards*, vol. 1, AU sec. 311), which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.

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 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 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.

## PROPOSED ETHICS RULING UNDER RULE 301

*[Explanation]*

Rule 301 provides that "a member in public practice shall not disclose any confidential client information without the specific consent of the client." The Professional Ethics Executive Committee has concluded that this rule is not intended to prevent a member from providing information to his or her professional liability insurance carrier in connection with the defense against a potential or an actual claim against the member. The committee recommends adoption of the following ruling.

*[Text of Proposed Ethics Ruling Under Rule 301]*

### **Disclosure of Confidential Client Information to Professional Liability Insurance Carrier**

*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 obtaining the client's permission, would the member be in violation of rule 301?

*Answer* — No. Rule 301 is not intended to prohibit a member from releasing confidential client information to the member's professional liability insurance carrier solely to assist the defense against an actual or potential claim against the member.

## PROPOSED REVISION OF ETHICS RULING NO. 158 UNDER RULE 505

*[Explanation]*

In light of the adoption of new rule 505, *Form of Organization and Name*, in January 1992, the Professional Ethics Executive Committee has reviewed the rulings previously adopted under the preceding rule.

The committee recommends that current ruling No. 158 be revised to provide guidance frequently requested by members of the Professional Ethics Division.

*[Text of Current Ethics Ruling No. 158 Proposed for Revision]*

### **Data Processing: Employee-Shareholder in Public Practice**

*Question* — A member having a public accounting practice is also president and a shareholder of a corporation whose main business is financing but which also engages in adjunct data processing services for the public. Is he acting in accord with interpretation 505-1?

*Answer* — Because the member is engaged in a public accounting practice his relationship to the corporation should be solely that of an investor, and his financial interest in the corporation should not be



material to the corporation's net worth. His association with the data processing corporation should be limited to that of a consultant, as opposed to that of an officer and shareholder.

*[Text of Proposed Revision of Ethics Ruling No. 158 Under Rule 505]*

### **Operation of Separate Data Processing Business by a Public Practitioner**

*Question* — A member in the practice of public accounting also participates in the operation of a separate business that provides data processing services to the public. These services include the preparation of financial statements. Must the member comply with all the rules of conduct in connection with the separate business?

*Answer* — Yes. As provided in interpretation 505-2, the member is considered to be in the practice of public accounting in connection with the data processing center. The member, therefore, must comply with all the rules of conduct in connection with this business. For example, if compilation or attest engagements are performed, the member must comply with the applicable standards and independence requirements.

## **PROPOSED DELETION OF ETHICS RULING NO. 180 UNDER RULE 505**

*[Explanation]*

The Professional Ethics Executive Committee proposes to delete this ruling as it is no longer accurate in light of the revision of rule 505, *Form of Organization and Name*, which took effect on January 14, 1992, after membership vote.

*[Text of Current Ruling No. 180 Under Rule 505 Proposed for Deletion]*

### **Side Businesses Which Offer Services of a Type Performed by CPAs**

*Question* — A member in public practice desires to form a commercial estate planning corporation in a separate office from that of his accounting practice. The member maintains that he will not hold himself out to the public as being a CPA in the commercial corporation and is therefore not bound by the Institute's Rules of Conduct. Is the member correct in his conclusion?

*Answer* — No, estate planning is a service of a type performed by public accountants. Because the member is presently holding himself out to the public as being a CPA in his public accounting practice, he must conduct the estate planning business in accordance with the Institute's Rules of Conduct. Rule 505 provides that members may practice public accounting only in the form of a proprietorship, a partnership or a professional corporation whose characteristics conform to resolutions of Council. Therefore, the member may not operate the separate business in the form of a commercial corporation. Because the member is considered to be in the practice of public accounting regarding the operation of his estate planning business, he must observe all of the Rules of Conduct in that business.

①

# EXPOSURE DRAFT

JUN 07 1993

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation:

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments: AGREE

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Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments: AGREE

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Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments: AGREE

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### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

CUT ALONG LINE

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

Comments: AGREE

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Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

Comments: AGREE

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Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

Comments: AGREE

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Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain  
Independence Terminology and the Effect of Family Relationships on Independence

Comments: AGREE

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**Name and Affiliation:**

Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

**Comments:** ANY INTEREST IN ONE OF THE EMPLOYERS OR ANY LOAN RELATIONSHIP  
COULD LEAD AN OUTSIDE PARTY TO PERCEIVE THAT THERE IS A LACK OF  
INDEPENDENCE. IF OUTSTANDING AUDIT FEES CAUSE A LACK OF INDEPENDENCE  
WHY WOULD NOT A LOAN OR FINANCIAL INTEREST OF ANY AMOUNT.

Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

**Comments:** AGREE

Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

**Comments:** A FINANCIAL INTEREST OF ANY AMOUNT GIVES THE  
APPEARANCE OF A LACK OF INDEPENDENCE. THIS PROPOSAL ALLOWS TO  
MUCH GRAY AREA. WHEN IT COMES TO INDEPENDENCE ANY POSITION  
THAT LEAVES A POTENTIAL DOUBT SHOULD BE AVOIDED.

Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

**Comments:** AGREE

CUT ALONG LINE

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

Comments: PARAGRAPHS 2+3 ARE NOT WORKABLE IN THE WORKPLACE.  
P 2. IT IS UNLIKELY THAT A PERSON IN A POSITION OTHER THAN  
CONTROLLER OR CFO WOULD HAVE SUFFICIENT KNOWLEDGE OF ALL  
ASPECTS OF THE ENTITY'S ACTIVITIES TO MAKE THIS TYPE OF DETERMINATION  
P 3 UNREALISTIC

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of  
Financial Statements in Conformity With GAAP

Comments: AGREE

Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to  
Professional Liability Insurance Carrier

Comments: AGREE

Proposed Revision of Ethics Ruling No. 158 Under Rule 505:  
Operation of Separate Data Processing Business by a Public Practitioner

Comments: DISAGREE - AS LONG AS THE MEMBER IS NOT REPRESENTING  
HIMSELF AS A CPA IN THESE OTHER ACTIVITIES MULTI-BUSINESS  
SHOULD NOT BE BARRIED. THIS APPEARS TO BE A RESTRAINT OF  
TRADE.

**Name and Affiliation:**

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:** AGREE  
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\_\_\_\_\_ (1)

**Return this response form to the address below:**  
**Herbert A. Finkston, Director, Professional Ethics Division**  
**AICPA**  
**Harborside Financial Center**  
**201 Plaza Three**  
**Jersey City, NJ 07311-3881**

CUT ALONG LINE

R.C. BALDWIN, CPA

2

June 3, 1993

Received Ethics Division

JUN 08 1993

Mr. Herbert A. Finkston  
Director, Professional Ethics Division  
American Institute of CPA's  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Mr. Finkston:

Re: Omnibus Proposal dated 5/19/93

I am writing to provide my views on the "Omnibus Proposal of Professional Ethics Division Interpretations and Rulings".

To put my comments in perspective, I have a small practice with no partners and one staff accountant. Our particular emphasis is computer consulting, particularly installation of computer accounting systems. We have one sizeable audit client in a regulated industry, and provide tax services principally to our business clients. We recently completed a Quality Review with an unqualified report and no matters for comment.

Proposed Interpretation Under Rule 101  
Independence and Cooperative Arrangements With Clients

I believe the proposed interpretation is self serving and is a major step in eroding the fine reputation CPA's have developed for independent, objective services. You cannot be a little bit pregnant when it comes to independence. A \$1 million cooperative arrangement between Microsoft and a Big Six firm might not be material, but consider how that would play in the press if independence is questioned.

Further, the "separate arrangements" escape clause is, in my view, little more than a sham to justify a cooperative arrangement.

Proposed Ethics Ruling Under Rule 101  
Indemnification Clause in Engagement Letters

I agree with this interpretation. This Ruling will emphasize to clients the need for management integrity in providing information to auditors.

Proposed Ethics Ruling under Rule 101  
Agreement With Attest Client to Use ADR Techniques

I have no problem on independence with an agreement to use ADR techniques should a problem arise.

Proposed Ethics Ruling under Rule 101  
Commencement of ADR Proceeding

While I see no problem with an agreement to use ADR techniques should a problem arise, I believe that commencement of an ADR Proceeding has a decided impact on independence. Further from a practical standpoint, once a client raises such issues, a member would be well advised to decline any further services for that client.

Proposed Ethics Ruling under Rule 101  
Auditor's Performance of Certain Internal Audit Services

Since it is well settled that a member can provide bookkeeping and assembly services without impairing independence, performing internal audit functions should pose no problems.

Some internal audit activities emphasize operational auditing that could come close (or step over) the line of making management decisions. It might be useful to provide an admonition, as is done for bookkeeping and assembly services, that such a line exists.

Proposed Ethics Ruling under Rule 101  
Members Loan from a Nonclient Subsidiary of an Attest Client Parent Company

I agree with the proposed ruling.

Proposed Revision of Interpretation 101-9 Under Rule 101  
The Meaning of Certain Independence Terminology  
and the Effect of Family Relationships on Independence

I disagree with the proposed revision. If a spouse were the CEO of a client served by another office of the firm, I cannot believe that the general public would believe that the firm would be independent.

The positions defined as "significant influence" are so pervasive within the client that no amount of separation of the member in another office, etc. would be successful in demonstrating independence.

Proposed Revision of Ethics Ruling No. 60 Under Rule 101  
Employee Benefit Plans - Member's Relationships With Participating Employer(s)

The proposed revision provides a simple, concise standard for independence. It is probably more restrictive than the present ruling, although at first glance it seems to loosen the independence constraints.

2



Proposed Revision of Ethics Ruling No. 67 Under Rule 101  
Servicing of Loan

I agree with the proposed revision.

Mere servicing of a loan is a ministerial function and is well understood by the public.

Proposed Deletion of Ethics Ruling No. 13 Under Rule 101  
Member as Bank Stockholder

I do not agree with the proposed deletion. A major shareholder of a bank, particularly in these credit crunch times, has a major influence on a borrower of the bank.

A stock position not material to the bank or the member should pose no problem.

Proposed Interpretation Under Rule 102  
Obligations of a Member to His or Her Employer's External Accountant

I am troubled by this and the next two proposed interpretations.

The explanation of this proposed interpretation clarifies that Rule 102 applies to "services performed by a member while holding out as a CPA".

Clearly, employment services with a non-CPA enterprise is not "holding out as a CPA".

This proposed interpretation deals with actions of a CPA who is an employee of a client, that could manipulate the external accountant's understanding of financial information and could result in misleading financial information being issued by the external accountant.

On the very narrow grounds that a member should not take actions that would cause a violation by a member holding out as a CPA I would approve this proposed interpretation.

Proposed Interpretation Under Rule 102  
Subordination of Judgment by a Member

I believe that this interpretation plows new ground not supported by Rule 102.

A key phrase in Rule 102 is "performance of any professional service", which is defined as "services performed as a member while holding out as a CPA". The member in the described situation is functioning as an employee of a company preparing its internal financial statements and I do not view this as the type of "professional service" ordinarily associated with a CPA's functions.

2

R.C. BALDWIN, CPA

Mr. Herbert A. Finkston

-4-

June 3, 1993

There is nothing in this proposed interpretation that indicates that the disagreement relates to financial information that would be available outside the enterprise and could possibly mislead third parties. There are many instances in which non-GAAP and untraditional financial information provides useful managerial information. Marginal cost analyses and direct costing are but two examples.

The judgement of what is appropriate in these internal analyses is appropriately made by the supervisor, and this proposed interpretation would require the member to jeopardize his employment inappropriately.

Proposed Interpretation Under Rule 203  
Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

Building on my comments in the two preceding proposed interpretations, this proposed interpretation should exempt situations in which the financial information is not used, or is not likely to be used, outside the enterprise.

Proposed Ethics Ruling under Rule 301  
Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

I agree with this proposed ruling.

Proposed Revision of Ethics Ruling No. 158 Under Rule 505  
Operation of Separate Data Processing Business by a Public Practitioner

I support the proposed revision because it deletes extraneous considerations such as investor, consultant, etc.

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505  
Side Businesses That Offer Services of a Type Performed by CPA's

I agree with the proposed deletion.

\* \* \* \* \*

I hope these comments are helpful.

Yours truly,



Ronald C. Baldwin, CPA

②

3

Received Ethics Division

Fred J. Newton  
3202 Amberley Lane  
Fairfax, Virginia 22031

JUN 08 1993

June 4, 1993

Mr. Herbert A. Finkston  
Director, Professional Ethics Division  
AICPA, Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Mr. Finkston:

Regarding the exposure draft, Omnibus Proposal of Professional Ethics Division Interpretations and Rulings," I concur with the proposals except as noted below:

**Independence and Cooperative Arrangements With Clients**

Since any such arrangements present a perception of business partnership, there would be an impairment of independence. The proposal should be rejected.

**Effect of Family Relationships on Independence**

Since the attestation opinion is signed in the name of the partnership, there is perception of involvement impairing independence when a partner's spouse has a position of significant influence with the client. The proposal should be rejected.

**Servicing of Loan**

The proposed phrase "mere servicing" is not sufficient. Either clarify the nature of the servicing (i.e. explain the absence of authority to set or alter any terms of the loan or to defer collection) or reject the proposal.

**Obligations to Employer's External Accountant**

A member having no role in an attestation engagement, either as the external accountant or as the duly authorized representative of the client firm, has no obligations to the external accountant. The proposal should be rejected. Also, I will point out that the phrase "must be candid" would just stimulate varying interpretations.

Sincerely,



Fred J. Newton, CPA

Member of the AICPA

# EXPOSURE DRAFT

4

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

Received Ethics Division

May 19, 1993

Comment date: August 19, 1993

JUN 08 1993

Name and Affiliation: *Elliot Koos, Partner  
Anderson, Bowen & Company, CPA's Eau Claire, Wisconsin*  
Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments: \_\_\_\_\_  
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### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

CUT ALONG LINE

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

Comments: \_\_\_\_\_  
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Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain  
Independence Terminology and the Effect of Family Relationships on Independence

Comments: *Because managerial personnel are frequently deemed to be "Partners in Training", it is our position that the same rules should apply to managers as partners. In addition, the def. rules definition # 5 of a managerial position suggests that managers are frequently involved with the administration of the firm in the same manner as are partners, and they are.*

( PLEASE SEE COMMENTS ON  
OTHER SIDE )

Name and Affiliation:

W. JEFFREY SAWYERS CPA/CMA  
CORPORATE CONTROLLER - CONICAL INDUSTRIES, INC.  
Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

Comments:

Received Ethics Division

JUN 09 1993

5

Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

Comments:

Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

Comments:

Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

Comments:

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

6/3/93

Comments: THE REQUIREMENT (IN STEP 3) THAT "THE MEMBER CONSIDER ANY RESPONSIBILITY THAT MAY EXIST TO COMMUNICATE TO THIRD PARTIES" IS IN MY OPINION "EXCESSIVE" AND PLACES TOO GREAT A BURDEN ON THE MEMBER. I AGREE WITH AND BELIEVE THE APPROPRIATE ACTIONS ARE AS OUTLINED IN STEPS (1) AND (2) AND THE 1ST HALF OF STEP (3) THAT A MEMBER CONSIDER HIS/HER CONTINUING RELATIONSHIP WITH THE EMPLOYER. THE FURTHER REQUIREMENT TO COMMUNICATE WITH 3RD PARTIES PLACES TOO GREAT A BURDEN ON THE MEMBER ~~(BY THE WAY)~~ AND AS ~~THE~~ SUGGEST WILL MOST LIKELY RESULT IN LITIGATION.

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

(THE INTERPRETATION)

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

Comments: \_\_\_\_\_  
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Proposed Revision of Ethics Ruling No. 158 Under Rule 505: Operation of Separate Data Processing Business by a Public Practitioner

Comments: \_\_\_\_\_  
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# EXPOSURE DRAFT

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

(6)

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation: *Prof. Anthony T. Barbera, St. John's University, CBA-Accounting Dept.,  
Grand Central + Utopia Parkways, Jamaica NY 11439*

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Received Ethics Division

Comments: \_\_\_\_\_

JUN 11 1993

Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments: \_\_\_\_\_

Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments: \_\_\_\_\_

Instructions for Response Form

(OVER)

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.



Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

6

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

Comments: *If the internal audit services which the auditor performs are part of the internal audit procedures which the external auditor relies upon when he relies on the client's internal controls while performing his audit, then independence would be impaired.*

*The "answer" should be altered so as to include the above situation; especially applicable when the firm provides staff to assist the client.*

Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

Comments: \_\_\_\_\_  
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Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence

Comments: \_\_\_\_\_  
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**Name and Affiliation:**

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

Received Ethics Division

Comments: \_\_\_\_\_

JUN 15 1993

(7)

**Return this response form to the address below:  
Herbert A. Finkston, Director, Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881**

MAURICE E. GLICK, CPA  
3421 S.W. 50th Terrace  
Ft. Lauderdale, FL 33314

Dear Mr. Finkston

I have reviewed this exposure draft & have only one comment - "If you have to read a book to determine an ethical answer - you are short on ethics. Common sense - morality - Tell you when you are about to do wrong; if it looks unethical or gives an appearance of impropriety - then don't undertake it. Walk away with a clear conscience. You'll make a million dollars next year."

Sincerely  
Maurice E. Glick

CERTIFIED - NYS - 1940  
MEMBER - FLORIDA - 1962  
MEMBER - AICPA - 1944

# EXPOSURE DRAFT <sup>8</sup>

JUN 23 1993

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation: DAVID G. Walker, Amco Partners (not in public practice)

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments: Good

Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments: Good

Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments: Good

### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

Comments:

Binding arbitration vs. Non binding arbitration is often an attempt to stay out of court no matter what unforeseen circumstances arise. It can also be designed to clear up small insignificant matters and disputes that would not create material adverse interests between the two parties. There should be an ~~adverse~~ material adverse interest threshold instead of the type of resolution chosen (even litigation).

Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

Comments:

Good

Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

Comments:

Good

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence

Comments:

Good

8

~~DAW~~

**Name and Affiliation:** David G. Walker, Amco Partners (not in public practice)  
Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

**Comments:** \_\_\_\_\_

Good

Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

**Comments:** \_\_\_\_\_

Good

Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

**Comments:** \_\_\_\_\_

Good

Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

**Comments:** \_\_\_\_\_

Good

⑧

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

Comments:

Be careful with this one. There are practical implications of employees going over the heads of their Bosses. <sup>There</sup> are plenty of marriages with BAD Judgement or impractical Book ~~knowledge~~ Knowledge. Your putting a Brand new CPA in the position of having to potentially ruin his career with his employer based on potentially incomplete information or BAD Judgment.

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

Comments: It has always bothered me that an internal CPA employed by a company can't hand a banker the internal financials of the employer which don't have disclosures and say they are GAAP financials except the disclosures have been omitted. Most small companies only prepare the ~~disclosure~~ notes to financials once a year. When the BANK asks for GAAP financials every month or quarter they are not asking for the disclosures, just the numbers prepared according to the provisions of GAAP that apply to the numbers. There is nothing misleading about what is going on in the real world!

Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

Comments:

Fine

Proposed Revision of Ethics Ruling No. 158 Under Rule 505: Operation of Separate Data Processing Business by a Public Practitioner

Comments:

Good

8

**Name and Affiliation:** *David Walker, Amest Partners (not in public practice)*  
Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:** \_\_\_\_\_  
\_\_\_\_\_ *Good* \_\_\_\_\_  
\_\_\_\_\_ 8 \_\_\_\_\_  
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\_\_\_\_\_  
\_\_\_\_\_  
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**Return this response form to the address below:**  
**Herbert A. Finkston, Director, Professional Ethics Division**  
**AICPA**  
**Harborside Financial Center**  
**201 Plaza Three**  
**Jersey City, NJ 07311-3881**

NOT A VALID LINE

Certified Public Accountants

**Peat Marwick Main & Co.**  
767 Fifth Avenue  
New York, NY 10153

June 30, 1993

Herbert A. Finkston, Director  
Professional Ethics Division  
American Institute of Certified Public Accountants  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

Re: Omnibus Proposal of Professional Ethics Division Interpretations and Rulings

Dear Mr. Finkston:

KPMG Peat Marwick agrees with the proposed ethics rulings and interpretations except for the matters discussed below:

**Commencement of ADR Proceedings** (page 6 of Exposure Draft)

The answer states that binding arbitration proceedings involving the member and the client would impair the independence of the member. We suggest that the answer be modified to make it clear that the use of binding arbitration would not always impair independence. We believe that criteria similar to those used in ethics interpretation 101-6 [ET Section 101.8] should be considered in determining whether independence is impaired.

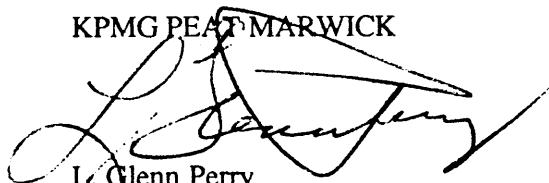
**Member's Loan from a Nonclient Subsidiary of an Attest Client Parent Company** (page 7 of Exposure Draft)

Ethics interpretation 101-5 [ET Section 101.7] specifically permits certain loans to or from financial institution clients. We believe the answer should state that such permitted loans from the subsidiary of the parent would not impair the member's independence with respect to the client.

If you would like to discuss any of these comments with me, please do not hesitate to call.

Very truly yours,

KPMG PEAT MARWICK



L. Glenn Perry  
Partner

PK:dl



Name and Affiliation: James M Davoli , Elf Aguiraine (Paris, France)

Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

Comments: \_\_\_\_\_  
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Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

Comments: \_\_\_\_\_  
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Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

Comments: \_\_\_\_\_  
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Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

Comments: I agree completely with the proposed interpretation  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
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\_\_\_\_\_

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

Comments: I agree entirely with the proposal.

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

Comments: I agree with the proposal.

Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

Comments:

Proposed Revision of Ethics Ruling No. 158 Under Rule 505:  
Operation of Separate Data Processing Business by a Public Practitioner

Comments:

(10)

**Name and Affiliation:** James M Davoli, ELF Aquitaine (Paris, France)

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:** I agree. We can not have behavioural double standards

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(10)

**Return this response form to the address below:  
Herbert A. Finkston, Director, Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881**

July 2, 1993

Herbert A. Finkston, Director, Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Received Ethics Division  
JUL 09 1993

Dear Mr. Finkston:

I am writing this letter to respond to the exposure draft dated May 19, 1993 on the "Omnibus Proposal of Professional Ethics Division Interpretations and Rulings." My only comments are in regards to the proposed revisions of Interpretation 101-9 under Rule 101: The meaning of certain independence terminology and the effect of family relationships on independence.

I believe the proposed changes to Interpretation 101-9 are inconsistent with the need to be independent in both fact and appearance. The public generally will not differentiate between two offices of the same firm. i.e. They will not see a difference between Joe Smith CPAs - Detroit and Joe Smith CPAs - Chicago; They will only recognize that it is one firm - Joe Smith CPAs. Allowing any office of a partner's Firm to audit a company where the Partner's spouse is in a position of "significant influence" will appear to create an independence issue whether or not one actually exists. In the current atmosphere of increased scrutiny of our profession, the last thing we should do is increase any appearance of a lack of independence.

Sincerely,



William Schneider, CPA

# EXPOSURE DRAFT

JUL 09 1993

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

12

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation:

*M. William Hays - University of Arkansas*

Proposed Interpretation Under Rule 101: Independence and Cooperative Arrangements With Clients

Comments:

*This interpretation would be devastating to the appearance, if not the fact, of independence. The materiality test is a failure. It might restrict some small firms, but it would have no effect on large firms. With all of the legal and other problems facing the profession, I cannot believe you are proposing this. Indeed has overcome professional independence.*

Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments:

*This is another self-serving rule, but probably not as detrimental to the public as the one above. I assume it would not affect third-party rights.*

Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments:

*OK*

### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

Comments:

OK

Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

Comments:

Independence would be impaired if management or employee decisions (e.g., sample sizes, sample evaluations, etc.) are made by the auditor.

Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

Comments:

Agree.

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence

Comments:

The proposed revision of the rule does not appear to say what you indicate that it says. Where are the four criteria within the rule? OK, I see now.

I think this is setting the profession up for another embarrassment when there is an audit failure and a partner's wife is in a position of significant influence.

(12)

**Name and Affiliation:**

Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

**Comments:** \_\_\_\_\_  
\_\_\_\_\_  
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Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

**Comments:** *The exception relating to risk of loss should be retained.*

Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

**Comments:** *The ruling should be retained. This is an indirect financial interest.*

Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

**Comments:** *I agree with this one.*

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

Comments: *This is a needed interpretation*

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

Comments: *This is a needed interpretation*

Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

Comments: *I agree with this ruling.*

Proposed Revision of Ethics Ruling No. 158 Under Rule 505:  
Operation of Separate Data Processing Business by a Public Practitioner

Comments: *OK*



**Name and Affiliation:**

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:**

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**Return this response form to the address below:  
Herbert A. Finkston, Director, Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881**



DANIEL G. KYLE, PH.D., CPA  
LEGISLATIVE AUDITOR

OFFICE OF  
**LEGISLATIVE AUDITOR**  
STATE OF LOUISIANA  
BATON ROUGE, LOUISIANA 70804-9397

June 30, 1993

13

1600 NORTH THIRD STREET  
P.O. BOX 94397  
TEL (504) 339-3800  
FAX (504) 339-3870

Received Ethics Division

JUL 13 1993

Mr. Herbert A. Finkston, Director  
Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

Dear Mr. Finkston:

I have reviewed the institute's exposure draft *Omnibus Proposal of Professional Ethics Division Interpretations and Rulings*.

I am very sensitive to issues of independence, objectivity, and ethics. Technical standards and competence mean very little if we lose the respect of those who use our reports. I consider the perception of independence to be crucial to the CPA community, regardless of independence in fact. With that explanation, I provide the following comments to the exposure draft.

*Cooperative Arrangement* I strongly agree with the interpretation. Furthermore, I would urge the institute to give, within the interpretation, guidance for determining materiality with respect to the member's firm and to the client organization.

*Hold Harmless Clauses* I agree with this interpretation.

*ADR Techniques* I agree with this interpretation.

*ADR Proceedings* I agree with this interpretation.

*Internal Audit Services* I agree with the interpretation, provided the services are not provided on a continual or regular basis. When those services are provided on a continual and routine basis, the external auditor becomes, to a large extent, an (audit-sensitive) employee of the client.

*Nonclient Subsidiary Loan* I strongly agree with this interpretation.

Mr. Herbert A. Finkston  
June 30, 1993  
Page 2

*Spouses and Dependent Persons* I object to revising the interpretation. The revision defines the member to be independent provided his or her spouse (with the ability to exert "significant" influence) does not participate in the engagement. Users of the report will perceive that the spouse's ability to significantly influence (operations, finances, and accounting) to have been exercised whether or not the spouse participates in the engagement. It is a matter of perception versus fact. In addition, the issue is not whether the spouse is independent (and thus whether or not she participates in the engagement), but whether the member is independent.

*Employee Benefit Plans* I disagree with the interpretation. I would urge the interpretation to state simply, as is done in the introduction, "Yes, the member must maintain independence with respect to all participating employers in order to be considered independent of the plan." The response, as written, leaves out many elements of independence, concentrating only on the member's influence over the employer.

*Loan Servicing* I strongly object to the interpretation. The client's oversight of the member's loan gives report users the perception that the client can influence the member and his actions.

*Banking Interest* I agree with the deletion of this interpretation.

*Member Obligation to External Accountant* I generally agree with the thrust of the interpretation. However, I am concerned with the wording "disclosing material matters about which the member is aware." This language is extremely vague. I suggest the interpretation define "material matters" in relation to financial data, financial presentations, financial statements, material errors and irregularities, and illegal acts having a direct impact on the financial statements.

*Subordination of Judgement* I agree with this interpretation. However, I would urge the institute to include a discussion of the member's obligation with respect to material irregularities and illegal acts having a direct and material impact on the financial statements.

*Representation Relating to Financial Statements* Again, I would urge the institute to include a discussion of the member's obligation with respect to material irregularities and illegal acts having a direct and material impact on the financial statements.

*Insurance Disclosures* I agree with this interpretation.

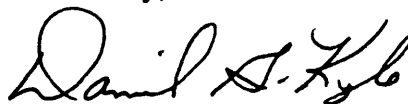
*Data Processing, Employer-Shareholder* I agree with this interpretation.

Mr. Herbert A. Finkston  
June 30, 1993  
Page 3

*Similar Service Business* I agree with this interpretation.

I appreciate the opportunity to comment on the exposure draft. I hope the foregoing comments and suggestions are beneficial to the committee's deliberations.

Sincerely,



Daniel G. Kyle, CPA  
Legislative Auditor

DGK/GCA/db

ETHICS

(14)

Received Ethics Division

# EXPOSURE DRAFT

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION 3 1993 INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation: Carolyn Seeman - Mazars & Co (Los Angeles office)

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments: \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments: This ruling should be adopted by the Committee.  
In the current business environment, members should be  
encouraged to consider using ADR techniques. By adopting  
this ruling the accounting profession would also set an  
important example for other professions.  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

Comments: This ruling should also be adopted. It is a realistic approach.

Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

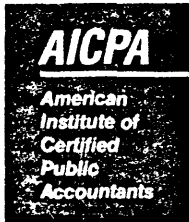
Comments: \_\_\_\_\_

Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

Comments: \_\_\_\_\_

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain  
Independence Terminology and the Effect of Family Relationships on Independence

Comments: \_\_\_\_\_



1211 Avenue of the Americas  
New York, NY 10036-8775

(212) 596-6200  
Fax (212) 596-6213

July 14, 1993

Received Ethics Division

JUL 15 1993

Mr. Herbert A. Finkston  
Director, Professional Ethics Div.  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Herb:

This letter represents the comments of the Members in Industry Executive Committee (the Committee) on relevant Interpretations included in the Omnibus Proposal of Professional Ethics Division Interpretations and Rulings dated May 19, 1993.

As you are aware, the Committee played an important role in drafting the two proposed interpretations under Rule 102 and had also spent a considerable amount of time discussing Rule 203 and its application to members in industry. We commend the efforts of the Professional Ethics Executive Committee (PEEC) in proposing these three new interpretations which, taken together, go a long way towards amplifying and clarifying the application of the AICPA Code of Professional Conduct to members in industry. We look forward to working with the PEEC in communicating these changes to the membership.

**Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant.**

The Committee concurs with the Interpretations as written, in its entirety.

**Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity with GAAP.**

The Committee concurs with the Interpretation as written, in its entirety.

In our discussion of this Interpretation, it was stressed that this is an extremely important clarification of current Rule 203, especially as it relates to members in industry.

Future communication about the obligations of industry members under Rule 203 is essential.

**Proposed Interpretation Under Rule 102: Subordination of Judgment By a Member.**

The Committee supports the thrust of the proposed interpretation, but believes it contains several flaws that should and can be corrected through amendments and additions to the draft wording. We have included a draft marked for changes as an attachment to this comment letter.

(A) The draft does not include sufficient information as to the nature of disagreements among preparers. Our proposed change would give consideration to the involvement of both accountants and non-accountant in the financial reporting process. A common understanding as to accounting principle applications is sometimes difficult to achieve between accounting professionals. The involvement of management personnel who are not sufficiently familiar with accounting can further complicate the process. A middle sentence added to paragraph 1 assists by informing the member that disagreements must be of a serious, unresolved nature before action is called for under Rule 102.

(B) Paragraph 2 and the draft does not give sufficient emphasis to the significant benefits to the profession and to the end users from encouraging close ties of communication between the preparer and external auditor. The external auditor may be appropriately involved in an early resolution to financial reporting disagreements. The mere mention of the external auditor as an example of a third party, near the end of paragraph 3 does not give sufficient weight to the auditor's potential role. For this reason, we have proposed an additional sentence at the end of the second paragraph.

(C) Paragraph 3 is presented in a sequence that fails to give the member the best guidance in dealing with the subject problem. The logical sequence of events for a member to follow is: (1) consult with appropriate persons; (2) if appropriate and desired by the member, perform a "whistle blowing" function before considering resignation; and (3) if all else fails, resign from the organization. In other words, consulting should be stressed before confrontation. We believe the proposed revised wording provides better guidance to the member, while retaining most of the draft language intact.



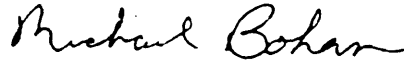
The Committee would be pleased to discuss this matter further with AICPA staff or PEEC members prior to your meeting to deliberate these proposals.

Sincerely,



David L. Summers  
Chairman, Members in  
Industry Executive

Committee



Michael P. Bohan  
Chairman, Professional  
Issues Subcommittee

Att.

cc: Professional Issues Subcommittee

## **Interpretation under Rule 102 - Integrity and Objectivity**

### **Subordination of judgment by a member**

Rule 102 prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or a dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment.<sup>1</sup>

1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature of the omission of the disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. It is not uncommon for a member to have a difference of opinion with an associate or supervisor (especially if the supervisor is a non-accountant) over the application of accounting principles. If, after appropriate research and consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.

2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization, (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed. The member should consider ~~the appropriateness of suggesting consultation between management and the external accountant.~~
  
  3. (WAS SECOND SENTENCE) The member should also consider any responsibility that may exist to communicate to third parties, such as the employer's external accountant or regulatory authorities. ~~or the employer's (former employer's) external accountant.~~ (WAS THIRD SENTENCE) In this connection the member may wish to consult with legal counsel. (WAS FIRST SENTENCE) If, after discussing his or her concerns with the appropriate person(s) within and/or external to the organization, the member concludes that appropriate action was not taken, the member should consider his or her continuing relationship with the employer.
  
  4. The member should at all times be cognizant of his or her obligations under interpretation 102-\_\_\_, ET section 191\_\_\_.
1. A member in the practice of public accounting should refer to the Statements of Auditing Standards. For example, see SAS No. 22, "Planning and Supervision," (AICPA, Professional Standards, vol. 1, AU sec. 311), which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.

OFFICERS

ARTHUR I. GORDON, CPA  
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ALLEN L. FETTERMAN, CPA  
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16

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OF  
CERTIFIED PUBLIC ACCOUNTANTS  
200 PARK AVENUE  
NEW YORK, NY 10166-0096  
212 973-8300  
TELECOPIER 212 972-5710

**nysscpa**

Received Ethics Division

July 15, 1993

JUL 20 1993

Herbert A. Finkston, Director  
Professional Ethics Division  
American Institute of CPAs  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Herb:

The Professional Ethics Committee of the New York State Society of CPAs considered the Exposure Draft, "Omnibus Proposal of Professional Ethics Division Interpretations and Rulings" dated May 19, 1993.

The Committee agrees with the proposals in the exposure draft but wishes to draw your attention to proposed ethics ruling under Rule 101 "Commencement of ADR Proceeding," the last sentence on page 6. The Committee felt that consideration should be given to changing the word "would" to "could." The sentence would then read, "Nevertheless, if binding arbitration is used, the member and the client could be in positions of material adverse interests because arbitration proceedings are considered to be sufficiently similar to litigation for ethics interpretation 101-6 [ET section 101.08] to be applied."

Thank you for the opportunity to comment.

Sincerely,

Ann E. Spaulding, Director  
Regulation

cc: Paul T. Sherman, CPA  
Chairman, Professional Ethics  
Committee

17

Received Ethics Division

JUL 21 1993



GEO. S. OLIVE & CO.  
CERTIFIED PUBLIC ACCOUNTANTS

700 CAPITAL CENTER SOUTH  
201 NORTH ILLINOIS STREET  
INDIANAPOLIS, INDIANA 46204-1904  
(317) 238-4000  
FAX: (317) 238-4200

July 16, 1993

Mr. Herbert A. Finkston, Director  
Professional Ethics Division  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

**Subject: May 19, 1993 Exposure Draft -- Omnibus Proposal of Professional Ethics  
Division Interpretations and Rulings**

Dear Mr. Finkston:

We have the following comments.

**Commencement of ADR Proceeding**

This should be clarified to allow the member to conduct the audit if the matter is resolved prior to the start of fieldwork, similar to the 101-6 provisions.

**Revision of Interpretation 101-9 Under Rule 101**

This should be expanded by deleting the second criteria -- "The partner is not located in an office participating in a significant portion of the engagement." This should be replaced by a provision that the partner is to be isolated from such engagement, which would be stronger than the fourth criteria.

**Revision of Ethics Ruling No. 158 Under Rule 505**

This ruling is troublesome. If the member and the side business do not hold themselves out as CPAs in the side business, and so state in their contract with their customers, then professional rules should not apply, except to the extent they would apply to others in industry.

Please contact Jerry Snow at (317) 238-4222 if you have any questions on our letter.

Sincerely,

Wm. Jerry Snow, CPA  
Partner  
(317) 238-4222

cac/AICPA.078



Received Ethics Division

JUL 27 1993

OFFICERS: July 20, 1993

Randall J. Nehring  
President  
Member:  
AICPA Council

Rose Kitzan  
President-Elect

Joan Houston  
1st Vice-President

Harold Wilde  
2nd Vice-President

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Secretary

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Lloyd Case  
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Michael Gallagher  
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Joe Talley  
Donald Forsberg  
Rick Lee

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Elected Member:  
AICPA Council

James S. Abbott  
Executive Director

Herbert A. Finkston, Director  
Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Mr. Finkston:

The Ethics Committee of the North Dakota Society of Certified Public Accountants is pleased to submit the enclosed comments on the Exposure Draft entitled "Omnibus Proposal of Professional Ethics Division Interpretations and Rulings" dated May 19, 1993.

We appreciate the opportunity to respond to this document. It should be noted that the enclosed comments are not intended to represent a single response for all NDSCPA members individually. The views of some members may not be fully in concert with all comments presented by this committee.

If you have any questions you may call me at (701) 224-2243.

Sincerely,

Ron Tolstad, Jr., M.Acc., CPA  
Ethics Committee Secretary

Enclosure

cc: Randy Nehring  
Rose Kitzan  
Joe Talley  
Jim Abbott  
Roene Hulsing

# EXPOSURE DRAFT

18

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

**Name and Affiliation:** Ron Tolstad, Secretary  
North Dakota Society of CPAs - Ethics Committee  
Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

**Comments:** The committee is very concerned about the conclusions of this proposed interpretation. If this proposal is accepted, it is this committee's opinion the profession's credibility will be damaged. This proposal would allow independence problems in fact, and, as important, independence problems in appearance.  
The committee is concerned that the "partner" relationship of the cooperative arrangement participants would indicate an independence problem to a reasonable person. Additional problems are foreseen on what to base materiality judgments. The current investment or income from the cooperative arrangement could be one base for materiality, but maybe the participants expectations of future income would be a more legitimate base but would be impractical to quantify with any certainty.  
The committee strongly encourages the rejection of this proposal.

Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

**Comments:** The committee agreed with this proposal.

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Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

**Comments:** The committee agreed with this proposal.

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### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

**Comments:** The committee agreed with this proposal.

Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

**Comments:** The committee agreed with this proposal.

Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

**Comments:** The committee thought this would be a good ruling!

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain  
Independence Terminology and the Effect of Family Relationships on Independence

**Comments:** The committee thought this would be an important revision  
and agreed strongly with its conclusion. This is very important realizing  
the number of two income households.



**Name and Affiliation:** NDSCPA

Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

**Comments:** The committee agreed with this proposal.

Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

**Comments:** The committee agreed with this proposal.

Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

**Comments:** The committee does not agree with this proposal. It is the opinion of this committee materiality would be difficult to measure, what base would be used?

It is the opinion of this committee there would be an appearance of an independence problem if not in fact.

Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

**Comments:** The committee agreed with this proposal.

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

**Comments:** The committee agreed with this proposal.

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of  
Financial Statements in Conformity With GAAP

**Comments:** The committee agreed with this proposal.

Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to  
Professional Liability Insurance Carrier

**Comments:** The committee agreed with this proposal.

Proposed Revision of Ethics Ruling No. 158 Under Rule 505:  
Operation of Separate Data Processing Business by a Public Practitioner

**Comments:** The committee agreed with this proposal.

**Name and Affiliation:** NDSCPA

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:** The committee agreed with this proposal.

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18

**Return this response form to the address below:  
Herbert A. Finkston, Director, Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881**



**BP AMERICA**

Michael P. Bohan  
Regional Center Controller

19

BP America Inc.  
200 Public Square 38-3801-N  
Cleveland, OH 44114-2375

Phone: 216-586-3984  
Fax: 216-586-5420

Received Ethics Division

JUL 27 1993

July 22, 1993

Mr. Herbert A. Finkston  
Director, Professional Ethics Division  
American Institute of Certified Public Accountants  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Herb:

I'm in basic support of the two proposed interpretations under Rule 102 and the proposed interpretation under Rule 203 with respect to members in industry as they appear in the May 19, 1993 Exposure Draft (exposure draft) of the "Omnibus Proposal of Professional Ethics Division Interpretations and Rulings." I am concerned, however, that the goal of the interpretation of Rule 203 will not be achieved. The substance of the interpretation of Rule 203 is a reminder to those AICPA members not in public practice that they are covered by the Code of Professional Conduct under Rule 203 in those situations in which they make an assertion that a given financial presentation with which they are associated is presented in accordance with general accepted accounting principles (GAAP). I believe there is a disconnect in the proposal in terms of what constitutes GAAP for members not in public practice and what constitutes GAAP for members in public practice.

The proposed interpretation refers only to the requirements of Rule 203, which literally means mandatory GAAP is comprised solely of authoritative pronouncements of the Financial Accounting Standards Board (and those of its predecessors) and those of the Governmental Accounting Standards Board -- because those are the only bodies under Rule 203 who have been so authorized by the AICPA Council. The so-called "House of GAAP," which establishes the remaining hierarchy of GAAP is contained in the Statement of Auditing Standards No. 69, "The Meaning of *Present Fairly in Conformity With Generally Accepted Accounting Principles* in the Independent Auditor's Report." This is an **auditing** standard and is not encompassed by Rule 203 and thus not encompassed by the proposed interpretation. The contents Statements of Auditing Standards are only encompassed under Rule 202 of the Code of Professional Conduct and may be overlooked by the member not in public practice if the proposal is not expanded.

Mr. Herbert A. Finkston  
7/22/93

2.

The Professional Ethics Executive Committee should consider expanding the interpretation to encompass Rule 202; otherwise, certified public accountants not in public practice may incorrectly believe they are subject to a less comprehensive view of what constitutes GAAP than is applied to those AICPA members in public practice. It is my view that the same rules should apply to all.

While I believe the motivation for the Professional Ethics Executive Committee in proposing this interpretation of our Rule 203 is entirely proper – I believe it leaves an unintended loophole. I'd be very happy to discuss this with you or with any representatives of the Professional Ethics Executive Committee.

Very truly yours,



MPB:cnb  
M1149

**TPI**  
**2500 INTERNATIONALE PARKWAY**  
**WOODRIDGE, IL 60517**  
**(708) 972-3000**  
**FAX: (708) 972-3029**

Received 7/26/93

JUL 29 1993

July 26, 1993

Herbert A. Finkston, Director  
AICPA Professional Ethics Division  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Herb:

Enclosed is my response to the May 19, 1993 Professional Ethics Exposure Draft. I have a special interest in the interpretations involving Rules 102 and 203 affecting industry members. Although I was involved in drafting the response from the AICPA Industry Professional Issues Subcommittee (copy enclosed) , I want to emphasize and expand on certain points.

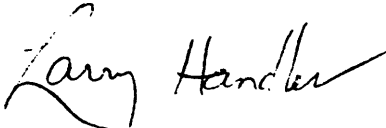
The proposed interpretation on subordination of judgment needs to be revised to give proper guidance to members. Consultation must be stressed and encouraged before discussing confrontation. Industry members are in a very different position from public members for several key reasons:

1. Many industry people, including myself, report directly to a CEO or COO, almost always a non-accountant. Great care must be taken when discussing accounting issues because an industry member typically must educate as well as inform his or her "superior" . Differences of opinion with these non-accountants are not uncommon and should be compared to similar disagreements between partners, managers or other professional staff within a firm. As such differences are common within firms, industry members must not be given the impression that their differences of opinion with the CEO are automatically subordination of judgment issues.
2. A major difference exists between the consequences of not resolving conflicts for members in public practice versus members in industry. A public member may risk the loss of a client which represents some varying amount of the firm's practice. An industry member may be forced to resign a position that represents 100% of his or her income. Some extra latitude and/or consideration should be given an industry member when considering a subordination of judgment issue. In the final analysis, of course, I do agree that industry members must be judged firmly if there is clear evidence that he or she violated Rule 102.

Industry members should be strongly encouraged to consult with appropriate individuals within the organization and ,in many cases, outside the organization before reaching a conclusion to resign. There are a growing number of cases in which "whistle blowers" are becoming heroes and collecting judgments, instead of being fired and collecting unemployment checks. Hopefully, our industry members will have the wisdom and courage to do what is right.

Finally, without repeating the comments submitted by the Professional Issues Subcommittee, I strongly urge adoption of the revised order of wording for the Subordination of Judgment interpretation.

Respectfully yours,



Lawrence D. Handler  
Vice President- Finance  
and Chief Financial Officer

Copy: Thomas Lemmon, AICPA

# EXPOSURE DRAFT

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation: LAWRENCE HANDLER, CFO, TPI/DOLLAR BILLS

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments: I AGREE THAT JOINT PARTICIPATION DOES NOT  
ORDINARILY CONSTITUTE COOPERATIVE ARRANGEMENTS.  
HOWEVER, WHERE COOPERATIVE ARRANGEMENTS DO EXIST, I  
AM CONCERNED THAT A FIRM MAY, IN THE AGGREGATE,  
HAVE A MATERIAL SEGMENT OF ITS BUSINESS ~~WHICH~~  
INVOLVED WITH COOPERATIVE ARRANGEMENTS WITH CLIENTS.  
THE FIRM'S PRACTICE MAY, THEREFORE, APPEAR TO HAVE  
INDEPENDENCE PROBLEMS.

Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments: STRONGLY AGREE WITH THIS PROPOSAL.

Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments: AGREE.

### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.



Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

Comments: AGREE.

Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

Comments: THE PROCEDURES MENTIONED ARE A NORMAL PART OF THE AUDIT PROCESS AND HAVE BEEN DONE BY INDEPENDENT AUDITORS FOR MANY YEARS. I DO NOT SEE HOW THEY COULD IMPAIR INDEPENDENCE.

AGREE WITH RULING.

Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

Comments: AGREE, THIS IS A DEFINATE PROBLEM.

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence

Comments: AGREE WITH RULING, BUT BELIEVE POTENTIAL PROBLEM STILL EXISTS DEPENDING ON HOW STRICTLY #4 ("DOES NOT HAVE ANY INVOLVEMENT WITH THE ENGAGEMENT") IS INTERPRETED. FOR EXAMPLE, I HAVE CONCERNS IF PARTNER ASSISTED IN PROMOTION OF THE BUSINESS, OR IF PARTNER, THROUGH THE SPOUSE, COULD BE A RECIPIENT OF

Name and Affiliation: LAWRENCE HANDLER, CFO, TPI/DOLLAR BILLS

Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

Comments:

AGREE

Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

Comments:

AGREE.

Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

Comments: I AM CONCERNED WITH THE POTENTIAL CONFLICT FOR A MEMBER IF THE MEMBER HAS A MATERIAL FINANCIAL INTEREST IN A BANK, AND THE BANK KEEPS EXPANDING CREDIT LINES TO A MEMBER'S CLIENT WHICH IS EXPERIENCING FINANCIAL DIFFICULTIES.

DISAGREE.

Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

Comments:

AGREE

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

Comments: THIS PROPOSAL REQUIRES REWORDING, ESPECIALLY PARAGRAPH NUMBER 3. MEMBERS NEED BETTER GUIDANCE THAN THIS DRAFT PROVIDES. PLEASE REFER TO DRAFT SUBMITTED BY PROFESSIONAL ISSUES INDUSTRY SUBCOMMITTEE, WHICH I STRONGLY SUPPORT. ADOPTION OF PROPOSAL WITHOUT WORDING CHANGES WOULD BE A DISSERVICE TO THE MEMBERS. I WOULD BE HAPPY TO DISCUSS THIS WITH ANYONE (708) 972-3000.

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

Comments: AGREE. WE FINALLY HAVE AN INTERPRETATION CONNECTING INDUSTRY MEMBERS AND RULE 203. THIS HAS BEEN NEEDED FOR A LONG TIME

Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

Comments: AGREE.

Proposed Revision of Ethics Ruling No. 158 Under Rule 505: Operation of Separate Data Processing Business by a Public Practitioner

Comments: AGREE

**Name and Affiliation:** LAURENCE HANDLER , CFO, TPI/DOLLAR BILLS

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:** \_\_\_\_\_

AGREE

20

**Return this response form to the address below:  
Herbert A. Finkston, Director, Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881**

Future communication about the obligations of industry members under Rule 203 is essential.

**Proposed Interpretation Under Rule 102: Subordination of Judgment By a Member.**

The Committee supports the thrust of the proposed interpretation, but believes it contains several flaws that should and can be corrected through amendments and additions to the draft wording. We have included a draft marked for changes as an attachment to this comment letter.

(A) The draft does not include sufficient information as to the nature of disagreements among preparers. Our proposed change would give consideration to the involvement of both accountants and non-accountant in the financial reporting process. A common understanding as to accounting principle applications is sometimes difficult to achieve between accounting professionals. The involvement of management personnel who are not sufficiently familiar with accounting can further complicate the process. A middle sentence added to paragraph 1 assists by informing the member that disagreements must be of a serious, unresolved nature before action is called for under Rule 102.

(B) Paragraph 2 and the draft does not give sufficient emphasis to the significant benefits to the profession and to the end users from encouraging close ties of communication between the preparer and external auditor. The external auditor may be appropriately involved in an early resolution to financial reporting disagreements. The mere mention of the external auditor as an example of a third party, near the end of paragraph 3 does not give sufficient weight to the auditor's potential role. For this reason, we have proposed an additional sentence at the end of the second paragraph.

(C) Paragraph 3 is presented in a sequence that fails to give the member the best guidance in dealing with the subject problem. The logical sequence of events for a member to follow is: (1) consult with appropriate persons; (2) if appropriate and desired by the member, perform a "whistle blowing" function before considering resignation; and (3) if all else fails, resign from the organization. In other words, consulting should be stressed before confrontation. We believe the proposed revised wording provides better guidance to the member, while retaining most of the draft language intact.

**Interpretation under Rule 102 - Integrity and Objectivity**

**Subordination of judgment by a member**

Rule 102 prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or a dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment.<sup>1</sup>

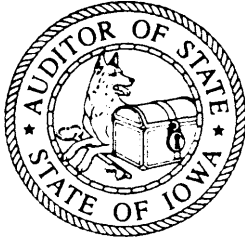
1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature of the omission of the disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. It is not uncommon for a member to have a difference of opinion with an associate or supervisor (especially if the supervisor is a non-accountant) over the application of accounting principles. If, after appropriate research and consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.

2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization, (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed. The member should consider ~~the appropriateness of suggesting~~ consultation between management and the external accountant.

3. (WAS SECOND SENTENCE) The member should also consider any responsibility that may exist to communicate to third parties, such as the employer's external accountant or regulatory authorities. ~~or the employer's (former employer's) external accountant.~~ (WAS THIRD SENTENCE) In this connection the member may wish to consult with legal counsel. (WAS FIRST SENTENCE) If, after discussing his or her concerns with the appropriate person(s) within and/or external to the organization, the member concludes that appropriate action was not taken, the member should consider his or her continuing relationship with the employer.

4. The member should at all times be cognizant of his or her obligations under interpretation 102-\_\_\_, ET section 191\_\_\_.

1. A member in the practice of public accounting should refer to the Statements of Auditing Standards. For example, see SAS No. 22, "Planning and Supervision," (AICPA, Professional Standards, vol. 1, AU sec. 311), which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.



OFFICE OF AUDITOR OF STATE  
STATE OF IOWA

Richard D. Johnson, CPA  
Auditor of State

State Capitol Building  
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

Kasey K. Kiplinger, CIA  
Deputy Auditor of State

Received Ethics Division

July 21, 1993

JUL 30 1993

Herbert A. Finkston, Director  
Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

RE: Exposure Draft - AICPA Omnibus Proposal of Professional Ethics Division  
Interpretations and Rulings

We have read this exposure draft and only have comments on the ruling pertaining to internal audit services.

At first blush this ruling seems to contradict the concept of independence. Further consideration has not changed our opinion. The ED only states that "...Committee has agreed that the performance of such services would not impair independence...". What is the basis for this agreement?

From a practical standpoint, how would this work? When performing as an internal auditor, do the AICPA Professional Standards apply? For instance, when confirming receivables, would the auditor be required to comply with AU330? When performing the audit, how would the auditor apply AU332 when evaluating the internal audit work?

The membership is entitled to more information on this proposal.

Should you wish further comments from this office please contact Don Meadows at this address or at (515) 281-5538.

Yours truly,

Richard D. Johnson

cf





STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050  
Fax (517) 334-8079

22

THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

Received Ethics Division

July 27, 1993

JUL 30 1993

Mr. Herbert A. Finkston, Director  
Professional Ethics Division  
American Institute of Certified Public Accountants  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Mr. Finkston:

We have reviewed the AICPA Exposure Draft, entitled Omnibus Proposal of Professional Ethics Division Interpretations and Rulings, dated May 19, 1993. From a governmental accounting and auditing perspective, we agree in principle with the sixteen individual proposals to be adopted by the AICPA Professional Ethics Executive Committee.

We appreciate the opportunity to comment on the Exposure Draft.

Sincerely,

Thomas H. McTavish, C.P.A.  
Auditor General

23

Stanley M. Bober, CPA  
Richard T. Bendel, CPA  
Richard C. Fedorovich, CPA  
Allan Markey, CPA  
Dale A. Ruther, CPA

# BOBER, MARKEY & COMPANY

Mark B. Bober, CPA  
Joan M. Grisplin, CPA  
Pamela K. Landis, CPA  
Robin C. Makar, CPA  
Bruce E. Manes, CPA  
Theresa M. Petit, CPA  
Cheryl L. Romis, CPA  
Lori A. Sheets, CPA  
Sharon M. Sledzik, CPA

*Certified Public Accountants  
A Professional Corporation*

July 27, 1993

Received Ethics Division

AUG 02 1993

Herbert A. Finkston  
Director Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Re: Exposure Draft, Omnibus Proposal  
of Professional Ethics Division  
Interpretations and Rulings

Dear Mr. Finkston:

In response to the above noted exposure draft, we are in support of the proposed revision of interpretation 101-9 under rule 101: "The meaning of certain independence terminology and the affect of family relationships in independence." More specifically, we agree that managers who have spouses in a position that allows "significant influence" over an audit client's operating, financial or accounting policies would not impair the firm's independence, provided the manager does not participate in the audit engagement.

Very truly yours,

BOBER, MARKEY & COMPANY

  
Allan Markey  
Partner

AM:dsm

c:Ms. Cathy Zaita

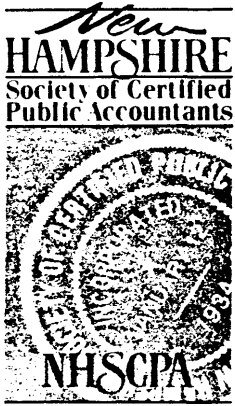
24

August 2, 1993

Accounting Ethics Division

AUG 05 1993

Mr. Herbert A. Finkston, Director  
Professional Ethics Division  
American Institute of Certified Public Accountants  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881



Dear Herb:

The Professional Ethics Committee of the New Hampshire Society of CPAs has reviewed the May 19, 1993 exposure draft of the omnibus proposal of professional ethics division interpretations and rulings and we are in agreement with the majority of the changes.

The comments that we do have are as follows:

1. Rule 101: Independence and Cooperative Arrangements With Clients.

The interpretation is too liberal in that it would allow any cooperative agreement between a member and a client as long as that cooperative agreement was not material. We believe that a cooperative agreement would be in conflict with Article IV which states in part "a member in public practice should be independent in fact and appearance..." Paragraph .01 further states that "independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services. We believe that any cooperative agreement, material or not, create an appearance problem.

2. Rule 102: Obligations of a Member to His or Her Employer's External Accountant.

We agree with this interpretation. We believe however, that there is an inconsistency with the first interpretation. This interpretation requires candid disclosure to the external accountant and that is the appropriate action. The next interpretation under paragraph 3 states "the member also should consider any responsibility that may exist to communicate to third parties, such as...external accountant." This language is too vague. The language under paragraph 3 should require disclosure to the external accountant which would make that interpretation consistent with this one.

Mr. Herbert A. Finkston, Director  
Page 2

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3. Rule 102: Subordination of  
Judgment by a Member.

We agree with all sections except  
3. This would create the possibility that a member could  
be disciplined for not quitting or reporting the problem  
to a regulatory authority. We believe that the member  
needs to take all steps necessary to advise people of  
his/her disagreement short of quitting.

If you need any additional information regarding the  
above, please feel free to call me.

Very truly yours,

  
Armand R. Genest, CPA  
Chairman

c: Dean Kenney, CPA, President

# May & Company

CERTIFIED PUBLIC ACCOUNTANTS  
110 MONUMENT PLACE • POST OFFICE BOX 821568  
VICKSBURG, MISSISSIPPI 39182-1568

TELEPHONE (601) 636-4762  
FAX (601) 636-9476

SHAREHOLDERS OF PROFESSIONAL  
CORPORATION:

Kenneth E. Hicks, C.P.A.  
Russell E. Hawkins, C.P.A.  
Steve K. Sessums, C.P.A.  
Donna M. Ingram, C.P.A.  
Peter A. Koury, C.P.A.  
Jack W. Palmer, C.P.A.  
Jimmy L. Childres, C.P.A.  
Tommy E. Butler, C.P.A.

DIRECTOR:

Harold D. Boleware, C.P.A.

Cindy B. Howington, C.P.A.  
Alyssa B. Oliver, C.P.A.  
Lisa T. Gwin, C.P.A.  
Barry K. LaGrone, C.P.A.  
Todd A. Boolos, C.P.A.  
J. Barry Higginbotham, C.P.A.  
Stephanie N. Hopkins, C.P.A.  
R. Buck Coats, C.P.A.  
J. Dan Stephens, C.P.A.  
Kenneth L. Guthrie, C.P.A.  
Janice L. Wehmann, C.P.A.  
Melanie S. Woodrick, C.P.A.  
J. Christopher Ready, C.P.A.  
Dickens Q. Fournet, C.P.A.

MEMBER OF

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S E C Practice Section  
Private Companies  
Practice Section  
Mississippi Society of CPA's  
Louisiana Society of CPA's

JACKSON OFFICE

SIXTH FLOOR  
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TELEPHONE (601) 354-2745  
FAX (601) 355-6521

25

Received Ethics Division

AUG 09 1993

August 4, 1993

Herbert A. Finkston  
Director, Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

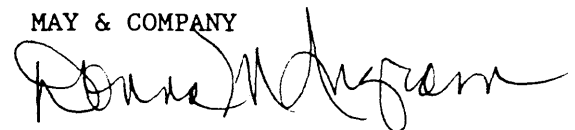
Dear Mr. Finkston:

The Accounting and Auditing Committee of the Mississippi Society of Certified Public Accountants, as one of their projects, is reviewing each exposure draft that is issued. The enclosed response was prepared by a Committee member. The views cited are that of the member, and may not reflect the views of all members of the Committee.

We appreciate the opportunity to be able to provide the enclosed comments.

Sincerely,

MAY & COMPANY



Donna M. Ingram, CPA  
Chairman, Accounting & Auditing  
Committee

DMI:rm

Enclosure

# EXPOSURE DRAFT

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

25

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation:

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments: Concur with this proposed interpretation

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Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments: Concur with this proposed ruling

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Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments: Concur with this proposed ruling

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### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

CUT ALONG LINE

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

**Comments:** Concur with this proposed ruling  
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Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

**Comments:** Concur with this proposed ruling  
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Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

**Comments:** Concur with this proposed ruling.  
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Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain  
Independence Terminology and the Effect of Family Relationships on Independence

**Comments:** Concur with this proposed interpretation.  
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(25)

**Name and Affiliation:**

Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

**Comments:** Concur with this proposed revision

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Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

**Comments:** Concur with this proposed revision

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Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

**Comments:** Concur with this proposed deletion

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Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

**Comments:** Concur with this proposed interpretation

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CUT ALONG LINE



Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

**Comments:** Do not concur with this proposed interpretation. The interpretation does not adequately address the issue of a subordinate being in the position of having to defer to higher management's making a final decision. This interpretation would place new CPAs in the position of having to make a decision without benefit of having full knowledge (as does higher management) regarding the situation which resulted in a disagreement.

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

**Comments:** Concur with this proposed interpretation

Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

**Comments:** Concur with this proposed ruling

Proposed Revision of Ethics Ruling No. 158 Under Rule 505: Operation of Separate Data Processing Business by a Public Practitioner

**Comments:** Concur with this proposed revision

**Name and Affiliation:**

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:** Concur with this proposed deletion  
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\_\_\_\_\_ (25)

**Return this response form to the address below:**  
**Herbert A. Finkston, Director, Professional Ethics Division**  
**AICPA**  
**Harborside Financial Center**  
**201 Plaza Three**  
**Jersey City, NJ 07311-3881**

CUT ALONG LINE

(26)

August 2, 1993

AUG 08 1993



Department of Accounting  
School of Business

August 2, 1993

Mr. Herbert A. Finkston  
Director, Professional Ethics Division  
American Institute of CPAs  
Harborside Financial Center  
201 Plaza Three  
Jersey City, N.J. 07311-3881

Dear Herb:

The purpose of this letter is to provide some comments on the AICPA's Proposed Ethics Ruling Under Rule 101: "Auditor's Performance of Certain Internal Audit Services."

According to Article IV of the Principles of the AICPA Code of Professional Conduct, "Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services." While the activities specifically mentioned in this Proposed Ethics Ruling currently are performed by external auditors, the door would be opened to other activities that are and should be the sole purview of the internal auditor. More importantly, by permitting the external auditor to provide internal audit services for a **client** the AICPA is subjecting itself and the profession to the criticism that a reasonable observer might conclude there exists the appearance of a lack of objectivity, a requirement of independence, even though objectivity in fact could exist. Given all of the recent negative publicity for the profession in light of the failure of so many savings and loan institutions and instances of fraudulent financial reporting that were not identified by the auditors, it seems to me that, at the very least, the Institute's timing is quite poor in proposing such a ruling. The

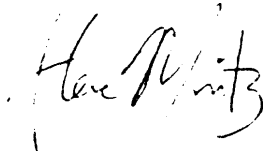
**Southwest Texas State University**

601 University Drive San Marcos, Texas 78666-4616  
512-245-2566

SWT is a member of the Texas State University System.

question must be raised whether the Institute and the profession would be acting in the public interest by approving the ruling or whether such action is motivated out of self-interest.

Sincerely,

A handwritten signature in cursive script that reads "Steven M. Mintz". The signature is written in dark ink and is positioned above the typed name.

Steven M. Mintz  
Chair, Department of Accounting

**RAE**

continued from page 1

According to Eisner, rapid expansion of MIS and litigation support services drove RAE's 16% revenue growth last year. The firm closed its books in January with net revenue of \$29 million, up from \$25 million in 1992.

"A lot of what we are doing today we weren't even doing five years ago," said Eisner, reflecting on the growth of the firm, which will celebrate its 30th anniversary this year. MCS, including MIS and litigation support, now represents nearly a third of the practice.

With the addition of K&K, the firm now has 47 partners/principals, 240 professionals and 65 support staff. Ten IPOs in the last year and new client additions brought the firm's total public client list to 40. In addition to financial institutions and textile/apparel clients, the firm specifically targets biotechnology and manufacturing concerns. ■

## Continental Outsources Internal Audit to PW

Continental Bank, a leader in the outsourcing of services, has turned to Price Waterhouse to help it meet new rules imposed by the FDIC. One of the act's provisions calls for the auditor to attest to management's report on internal controls, a requirement the bank decided would lead to unnecessary duplication of effort and higher costs.

So, the \$23 billion bank decided to outsource part of its internal audit function and requested audit proposals from its current auditors PW, as well as from Deloitte & Touche and KPMG

Peat Marwick.

Some 20 of the 72 current internal audit staff will remain with the bank to oversee the strategy and scope of the internal audit work, liaison with regulators and support the ongoing design of management controls. The remaining staff, who will continue to work on-site, will officially join PW, which will manage the day-to-day responsibility for internal auditing and conduct the independent audit of the bank.

Continental's auditors since 1985, PW earned \$2.4 million in fees from the bank in 1992. ■

## Louisiana Board Modifies Ban

The State Board of CPAs of Louisiana will no longer enforce its rule barring direct, uninvited telephone or in-person solicitation of new client engagements.

The board took the action within three days of a U.S. Supreme Court ruling that rescinded a similar prohibition in Florida because it violated the First Amendment right of free commercial speech. The Court cited Louisiana, Minnesota, Texas and Florida as the states that retain categorical bans on uninvited client solicitation by CPAs. To date, only Texas retains its statute in the wake of the recent High Court decision.

Pending the development of amendments of its rules on professional conduct, the board will no longer investigate complaints nor bring administrative disciplinary actions based solely on the rule. The board emphasized, however, that it will still enforce the remaining provisions of its rule prohibiting solicitation which is "misleading or deceptive or which uses coercion or harassing conduct." Truth-in-advertising rules will also continue to be enforced.

The Texas Board of Accountancy, which also discussed its statutes regarding solicitation, should soon announce its decision in the matter. ■

### PUBLIC ACCOUNTING REPORT

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Assistant Editor: Brian McGreevy  
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## IMA Announces Benchmarking Project

The AICPA and the Institute of Management Accountants (IMA) are battling for the hearts of corporate accountants.

Just weeks after the AICPA said it would create a database for benchmarking financial management practices in private industry, the IMA announced the establishment of a continuous improvement center, which will maintain a similar database drawing on the experience of its 90,000 members (see *PAR* April 15).

The center, which will open July 1, will continually update the benchmark database to establish best practices in financial management. IMA officials said their initial database already contains 50 companies.

Although both projects have at their core a database which will benchmark some 20 finance functions, they differ in a number of ways. The AICPA project will initially focus on identifying best practices among larger corporations with at least \$50 million in revenue. No fee will be charged at the outset.

The IMA project will also have open enrollment but will go beyond identifying best practices to assist participating members in assessing the results. The database will be updated on an ongoing basis and supported by focused research studies, training and forums for participating companies. Companies will pay a "modest" fee for access to the program. ■

AUG 06 1993

EXPOSURE DRAFT - OMNIBUS PROPOSAL  
OF PROFESSIONAL ETHICS DIVISION  
INTERPRETATION AND RULINGS

Name and Affiliation: John Rooney, IBM Corporation

Proposed Interpretation under Rule 101: Independence and Cooperative Arrangements With Clients

ED CONCLUSION: Auditors independence is not impaired as the result of the existence of a cooperative arrangement with a client provided that the parties interest in the arrangement is not material.

IBM RESPONSE: Although it may be financially immaterial, there could be potential for the client to exercise significant influence over the auditor in these circumstances, and therefore, it is suggested that the ED be revised accordingly.

Proposed Ethics Ruling Under Rule 101: Indemnification Clause in Engagement letters

ED CONCLUSION: Auditors independence is not impaired when indemnification clauses are reflected in an engagement letter, as the result of the incurrance of liabilities arising from management misrepresentations.

IBM RESPONSE: Agreed, no further comment.

Proposed Ethics Ruling Under Rule 101: Agreement With Attest Client to Use ADR Techniques

ED CONCLUSION: Auditors independence is not impaired despite the existence of a pre-dispute agreement since both parties are not actually in material adverse positions.

IBM RESPONSE: Agreed, however, it is suggest that examples of ADR techniques be provided.

Proposed Ethics Ruling Under Rule 101: Commencement of ADR Proceeding

ED CONCLUSION: Auditors independence would not be impaired despite the commencement of an ADR proceeding provided that such proceedings do not place the parties involved in material adverse positions.

IBM RESPONSE: Agreed, no further comment.

Name and Affiliation: John Rooney, IBM Corporation

Proposed Ethics Ruling Under Rule 101: Auditor's Performance of Certain Internal Audit Services

ED CONCLUSION: Auditors independence is not impaired despite the auditors assistance in performing certain internal audit services.

IBM RESPONSE: Agreed, no further comment.

Proposed Ethics Ruling Under Rule 101: Members Loan From a Nonclient Subsidiary of an Attest Client Parent Company

ED CONCLUSION: Auditors independence is impaired as the result of loans received from a nonclient subsidiary of an attest parent company.

IBM RESPONSE: Agreed, no further comment.

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence

ED CONCLUSION: Independence not impaired despite an audit partner's spouse having ability to exercise significant influence provided that the partner can not exercise significant influence or has any involvement in the audit engagement.

IBM RESPONSE: Agreed, no further comment.

Proposed Revision of Ethics Ruling No. 60 Under Rule 101: Employee Benefit Plans - Member's Relationships With Participating Employer(s)

ED CONCLUSION: Auditors independence is not impaired when an auditor audits an employee benefits plan and has a financial interest in the plan provided that such interest is not material and the auditor can not exercise significant influence.

IBM RESPONSE: Agreed, no further comment.

Proposed Revision of Ethics Ruling No. 67 Under Rule 101: Servicing a Loan

ED CONCLUSION: Auditors independence is not impaired despite a client servicing a loan to an auditor provided there is no material risk of loss to the client as the result of the servicing.

IBM RESPONSE: Agreed, no further comment.

Name and Affiliation: John Rooney, IBM Corporation

Proposed Deletion of Ruling No. 13 Under Rule 101: Member as Bank Stockholder

ED CONCLUSION: Auditors independence is not impaired when such auditor has stock in a bank that lends funds to a client even if stock interest is material. Current ruling cites that independence is impaired if the stock interest is material.

IBM RESPONSE: Agreed, no further comment, deletion of ruling appears appropriate.

Proposed Interpretation Under rule 102: Obligation of a Member to His or Her Employer's External Auditors

ED CONCLUSION: An auditor must maintain objectivity and integrity in dealings concerning his or her firm's external auditor.

IBM RESPONSE: Agreed, no further comment.

Proposed Interpretation Under rule 102: Subordination of Judgement by a Member

ED CONCLUSION: An auditor should bring concerns to a higher level of management when said auditors judgment on certain audit matters varies with his or her supervisor, and such judgement could materially impact the financial statements in question.

IBM RESPONSE: Agreed, no further comment.

Proposed Interpretation Under rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

ED CONCLUSION: Auditors should not state affirmatively that an entities financial statements are in conformity with GAAP if that is not the case.

IBM RESPONSE: Agreed, no further comment.

Proposed Ethics Ruling Under rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

ED CONCLUSION: An auditor is permitted to provide confidential client information to its insurance carrier even without receiving the clients consent if such information is being used to defend against a malpractice claim.

IBM RESPONSE: Agreed, no further comment.



Name and Affiliation: John Rooney, IBM Corporation

Proposed Revision of Ethics Ruling No. 158 Under Rule 505: Operation of Separate Data Processing Business By a Public Practitioner

ED CONCLUSION: A member who is an officer of a finance company that also performs data processing responsibilities is not permitted. The members involvement in the finance company is limited to that of an investor with an immaterial interest, and his or her participation in the data processing operation is limited to that of a consultant.

IBM RESPONSE: No comment.

Proposed Deletion of ethics Ruling No. 180 Under Rule 505: Side Businesses Which Offer Services Performed by CPAs

ED Conclusion: The current text should be deleted in light of previous revisions to rule 505 related to this subject. The current text cites that a practitioner is still bound to comply with the Rules of Conduct even when performing side services outside of his or her normal accounting practice such as estate planning.

IBM RESPONSE: No comment.



Received Ethics Division (28)  
AUG 11 1993

August 5, 1993

Mr. Herbert A. Finkston, Director  
Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311

Dear Mr. Finkston:

The following comments represent the Illinois CPA Society Ethics Committee's (ICPAS) responses to the Exposure Draft, "Omnibus Proposal of Professional Ethics Division Interpretations and Rulings, May 19, 1993".

**Proposed Interpretation Under Rule 101, Independence and Cooperative Arrangements With Clients**  
ICPAS is concerned as to the conflict between the proposed rule and the S.E.C. position on such services. In addition, the ICPAS is concerned that this rule could be applied in such a manner that large firms with very large revenues, etc. would have an advantage over small firms in the application of what is material.

**Proposed Ethics Ruling Under Rule 101, Indemnification Clause in Engagement Letters**  
ICPAS agrees.

**Proposed Ethics Ruling Under Rule 101, Agreement With Attest Client to Use ADR Techniques**  
ICPAS agrees.

**Proposed Ethics Ruling Under Rule 101, Commencement of ADR Proceeding**  
ICPAS agrees.

**Proposed Ethics Ruling Under Rule 101, Auditor's Performance of Certain Internal Audit Services**  
ICPAS agrees.

**Proposed Ethics Ruling Under Rule 101, Member's Loan From a Nonclient of an Attest Client parent Company**  
ICPAS agrees.

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SIDE PLAZA  
SUITE 1600  
CHICAGO, IL  
60606-6098  
TEL: 312-993-0393  
FAX: 312-993-9954

**Proposed Revision of Interpretation 101-9 Under Rule 101, The Meaning of Certain Independence Terminology and the Effects of Family Relationships on Independence**

ICPAS strongly objects to the proposed change. The following two are examples of problems we see with this proposed change.

Example 1- A firm has two offices - "Big City" (100 people, 5 partners) and "Suburban" (20 people, 1 partner). The wife of a "Big City" partner is Treasurer and Chief Financial Officer of a client audited by the Suburban office. How do you convince the Public that the firm and its Partner in the "Suburban" office are Independent?

Example 2- A "Suburban" office Manager's wife is the Chief Executive (President) and thus a director of an audit client of that office. The manager will not work on the engagement for that client. How do you convince the Public that the firm and its partners are independent, when by definition the Manager is part of management?

**Proposed Revision of Ethics Ruling NO. 60 Under Rule 101, Employee Benefits Plans-Member's Relationships With Participating Employer(s)**

ICPAS agrees, except a further clarification or a definition of what "significant influence", is needed. Does a 5%, 10%, 25%, 49%, or what represent a significant influence.

**Proposed Revision of Ethics Ruling NO. 67 Under Rule 101, Servicing of Loan**

ICPAS agrees.

**Proposed Deletion of Ruling NO. 13 Under Rule 101, Member as Bank Stockholder**

ICPAS disagrees with this deletion. The deletion of this rule would conflict with the rule on Directors. In as much as the shareholders have the right to elect Directors of a Bank, we view this as an impairment of independence.

An additional example: A member is a sole stockholder of a bank and is the only partner of a twenty person accounting firm. The bank loans \$500,000 to an audit client of the member's firm. How can one convince the Public that the member is independent of the client.

**Proposed Interpretation Under Rule 102, Obligations of a Member to His or Her Employer's External Accountant**

ICPAS agrees.

**Proposed Interpretation Under Rule 102, Subordination of Judgement by a Member**  
ICPAS agrees.

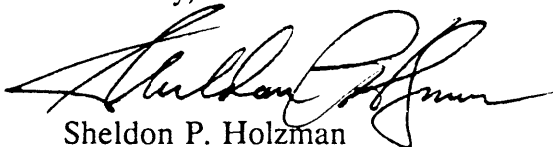
**Proposed Interpretation Under Rule 203, Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP**  
ICPAS agrees.

**Proposed Ethics Ruling Under Rule 301, Disclosure of Confidential Information to Professional Liability Insurance Carrier**  
ICPAS agrees.

**Proposed Revision of Ethics Ruling NO. 158 Under Rule 505, Operation of a Separate Data Processing Business by a Public Practitioner**  
ICPAS agrees, except there should be a distinguishment between being a "participant" (or possibly stating it as an "active participant") and a passive investor.

**Proposed Deletion of Ethics Ruling NO. 180 Under Rule 505, Side Business Which Offer Services of a Type Performed By CPAs**  
ICPAS agrees, except the last sentence should be a separate Q & A. A member must observe all the Rules of Conduct in what ever business the member performs. This question arises frequently and this appears to be the only reference we have been able to cite to members and the Public.

Sincerely,



Sheldon P. Holzman  
AICPA Liaison  
ICPAS Ethics Committee

**Eggleston, Smith,  
Hall, Cotman & Company**

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

Received Ethics Division

AUG 16 1993

29

August 10, 1993

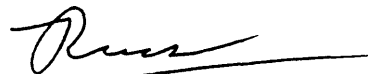
Mr. Herbert A. Finkston, Director  
Professional Ethics Division  
American Institute of Certified Public Accountants  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

Re: May 19, 1993 - Exposure Draft

Dear Herb:

Enclosed are the comments of the Virginia Society of Certified Public Accountants Professional Ethics Committee on the May 19, 1993, Exposure Draft.

Very truly yours,



Russell V. Meyers, CPA  
Chairman  
VSCPA Professional Ethics  
Committee

# EXPOSURE DRAFT

29

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

**Name and Affiliation:** Professional Ethics Committee  
Virginia Society of Certified Public Accountants  
Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

**Comments:** The Committee feels that the determination of materiality should be narrowed. The amount should be related to individual firm members. For example, while the cooperative agreement may not be material to the firm, it may be material to how an individual is compensated within his or her firm. We would like for the materiality level to be defined as immaterial to all members of the firm.

Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

**Comments:** We are in agreement with the proposed ruling.

Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

**Comments:** We do not object to the proposed ruling, however, we question the need for such agreements in the normal course of business.

### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

**Comments:** The Committee feels that the commencement of an ADR proceeding is similar to ethics interpretation 101-6 [ET Section 101-8] and that independence would be impaired.

The Committee also feels that the proposed ruling should cross-reference to the ruling on Past Due Fees. Any fees outstanding more than one year would impair independence, regardless of any ADR proceedings.

Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

**Comments:** The proposed ruling uses the term "among other things". We feel this term and the examples given may confuse practitioners. We recommend that they be deleted or greatly expanded.

The ruling should emphasize that all decision making regarding the interpretation of the results of any work should remain a management function. The wording in interpretation 101-3 regarding accounting services could be adapted to cover internal audit services.

Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

**Comments:** We agree with the proposed ruling.

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence

**Comments:** The Committee opposes the proposed changes. Continued relaxation of these rules undermines the Code of Professional Conduct.

The perception of independence is very important and these proposed changes are detrimental to the profession.

**Name and Affiliation:** Professional Ethics Committee  
Virginia Society of CPAs  
Proposed Revision of Ethics Ruling No. 60 Under Rule 101:  
Employee Benefit Plans—Member's Relationships With Participating Employer(s)

**Comments:** We agree with the proposed ruling.  
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Proposed Revision of Ethics Ruling No. 67 Under Rule 101:  
Servicing of Loan

**Comments:** We agree with the proposed ruling.  
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Proposed Deletion of Ruling No. 13 Under Rule 101:  
Member as Bank Stockholder

**Comments:** The Committee opposes the deletion of this ruling. We feel that a significant ownership interest makes a difference in the determination of materiality. We like the ruling as it is written.

If this ruling is deleted, there would be no specific guidance for ownership of bank stock. The determination of independence would then revert back to interpreting Rule 101-1(A)(1), which without a specific ruling may lead to a conclusion similar to the current ruling.

Proposed Interpretation Under Rule 102: Obligations of a Member to His or Her Employer's External Accountant

**Comments:** We agree with the proposed interpretation.  
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**Comments:** We agree with the proposed interpretation.

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Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of  
Financial Statements in Conformity With GAAP

**Comments:** Although the Committee agrees with the proposed interpretation, we  
feel that the word "communication" should clearly indicate that communication  
can be oral as well as written.

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Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to  
Professional Liability Insurance Carrier

**Comments:** We agree with the proposed ruling.

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Proposed Revision of Ethics Ruling No. 158 Under Rule 505:  
Operation of Separate Data Processing Business by a Public Practitioner

**Comments:** We agree with the proposed ruling.

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**Name and Affiliation:** Professional Ethics Committee  
Virginia Society of CPAs

29

Proposed Deletion of Ethics Ruling No. 180 Under Rule 505:  
Side Businesses Which Offer Services of a Type Performed by CPAs

**Comments:** We agree with the proposed ruling.

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**Return this response form to the address below:**  
**Herbert A. Finkston, Director, Professional Ethics Division**  
**AICPA**  
**Harborside Financial Center**  
**201 Plaza Three**  
**Jersey City, NJ 07311-3881**

CUT ALONG LINE

AUG 16 1993

30

# EXPOSURE DRAFT

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation:

*Cheryl A Hubbard CPA, w/ Transportation Dept  
Internal Audit*

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments:

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Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments:

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Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments:

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### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. Please see that name and affiliation appear on each page of the comments.

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

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**Comments:** \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

**Comments:** \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 101:  
Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company

**Comments:** \_\_\_\_\_  
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Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain  
Independence Terminology and the Effect of Family Relationships on Independence

**Comments:** \_\_\_\_\_  
Why does close relative include parents in law  
but not brother and sister-in-law?  
In many cases these relationships are all  
close and sibling relationships.



AUG 17 1993

31

August 9, 1993

Herbert A. Finkston, Director  
AICPA Professional Ethics Division  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

Dear Sir:

Columbia Gas Transmission Corporation is pleased to submit its comments concerning the Exposure Draft, Omnibus Proposal of Professional Ethics Division Interpretations and Rulings. The attached is in response to the Proposed Interpretation Under Rule 102 - Subordination of Judgement by a Member. It specifically pertains to the third step a member should take to ensure that a situation does not constitute a subordination of judgement. The proposed interpretation states, ". . . if the member concludes appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member should also consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employee's external accountant."

Columbia Gas Transmission Corporation appreciates the opportunity to contribute to the standard-setting process and hopes its comments will be useful to you in your deliberations.

Sincerely,

Nazzi C. Zola  
Vice President and Controller

NCZ/ks1

Attachment

Proposed Interpretation Under Rule 102: Subordination of Judgment by a Member

**Comments:** Statement on Auditing Standards No. 22 addresses circumstances involving a difference in opinion on accounting and auditing issues among auditors and assistants. The interpretation of SAS No. 22 states that procedures should exist that "enable an assistant to document his disagreement with the conclusion reached if, after appropriate consultation, he believes it necessary to disassociate himself from the resolution of the matter." We are proposing that this interpretation be adapted to Rule 102 and should replace the third step in the proposed interpretation.

Proposed Interpretation Under Rule 203: Responsibility of Employees for the Preparation of Financial Statements in Conformity With GAAP

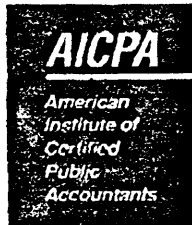
**Comments:** \_\_\_\_\_  
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Proposed Ethics Ruling Under Rule 301: Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

**Comments:** \_\_\_\_\_  
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Proposed Revision of Ethics Ruling No. 158 Under Rule 505: Operation of Separate Data Processing Business by a Public Practitioner

**Comments:** \_\_\_\_\_  
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**Division for CPA Firms**

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(212) 596-6200  
Fax (212) 596-6213



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August 19, 1993

Mr. Herbert A. Finkston, Director  
Professional Ethics Division  
American Institute of CPAs  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Re: Exposure Draft: "Omnibus Proposal of Professional Ethics  
Division Interpretations and Rulings," May 19, 1993

Dear Mr. Finkston:

One of the objectives that Council of the American Institute of CPAs established for the Private Companies Practice Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee ("TIC"). This communication is in accordance with that objective.

TIC has reviewed the above referenced exposure draft containing proposed revisions to various professional ethics interpretations and rulings. Our comments on the exposure draft follow.

#### Independence and Cooperative Arrangements With Clients

This interpretation states that independence will not be considered impaired if, during the period of a professional engagement or at the time of expressing an opinion, a member's firm has a cooperative arrangement with a client that is deemed to be immaterial to the member's firm or to the client. We do not believe materiality should be used to determine whether a particular arrangement impairs independence. The principles of professional conduct essentially obligate members to avoid any relationships that appear to impair independence. Even though a cooperative arrangement with a client may in fact be immaterial to a member's firm or to a client, from the public's perspective, such arrangements appear to impair a member's objectivity and, therefore, his or her independence. Moreover, this position conflicts with a comment contained in the recently issued position statement of the AICPA Board of Directors on the public accounting profession, which states, in part, that, "... auditors must scrupulously preserve their objectivity, in reality and

appearance." We believe allowing members to participate in cooperative arrangements with clients does little to increase the public's confidence in the accounting profession and raises serious questions about the effectiveness of the independent accountant's function. Accordingly, we strongly encourage a prohibition on all cooperative arrangements with clients.

Notwithstanding our disagreement with the conclusion reached in the proposed interpretation, we believe the illustrations of cooperative arrangements provided therein are valuable for members. Therefore, these examples should be retained in any revised interpretation of this rule.

#### **Indemnification Clause in Engagement Letters**

We believe a member may be released and held harmless from any liability and costs resulting from both known and unknown misrepresentations made by management. Consequently, the term "knowing" in the first sentence of this ruling should be omitted. The language should be revised to state, "...liability and costs resulting from misrepresentations by management."

#### **Agreement with Attest Client to Use ADR Techniques**

Since this ruling might be the only reference source for information concerning alternative dispute resolution ("ADR") techniques and related consideration that some members will use, it would be helpful if the ruling also warned them that in some instances advance agreements to use certain ADR techniques to resolve disputes concerning attest services could nullify their professional liability insurance with respect to services performed for that client. Accordingly, members should consult with their insurance carrier before entering into such an agreement.

#### **The Meaning of Certain Independence Terminology and Effect of Family Relationships on Independence**

We believe the proposed revision of Interpretation 101-9 would excessively liberalize the existing independence rule for members with spouses or dependents having positions of significant influence with clients. At a time when the public's confidence in the accounting profession is eroding, we do not believe such a broad interpretation of the rule would be prudent. It merely lends support to those already questioning the credibility of the independent accountant. We believe the accounting profession must protect its integrity and objectivity, in fact and appearance. In our view, the current interpretation provides sensible restrictions on our members and, therefore, is neither too lenient nor unduly harsh. Accordingly, we do not believe the proposed revision should be adopted.

#### **Member as Bank Stockholder**

This ruling is being deleted because the Professional Ethics Executive Committee does not agree with its stated conclusion. TIC concurs with the revised decision reached by the Executive Committee; however, this situation does occur often in practice



and specific guidance in this area would help members resolve such questions quickly and properly. Therefore, we believe the ruling should be retained and its answer revised to reflect the committee's amended conclusion.

#### Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

This proposed ruling would provide much needed guidance on this issue. Because a potential claim filed against a member will likely involve outside counsel, we suggest that application of this ruling be extended to information provided to a member's counsel. Alternatively, a separate ruling could be issued addressing the disclosure of confidential client information to attorneys.

#### Side Businesses Which Offer Services of a Type Performed by CPAs

As stated above under the "Member as Bank Stockholder" caption, although the conclusion reached in this ruling is no longer accurate, we believe members need specific guidance on this issue. Therefore, the ruling should be retained and modified to reflect revisions made to rule 505.

#### Other Comments

Some members may have difficulty understanding the responses provided to rulings concerning "Auditor's Performance of Certain Internal Audit Services" and "Employee Benefit Plans - Member's Relationships With Participating Employer(s)." Perhaps responses provided should first answer the specific question (e.g., Yes or No) and then elaborate on the rationale for the answer.

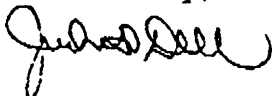
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We appreciate the opportunity to provide these comments and would be pleased to discuss them further with you or members of the Professional Ethics Executive Committee.

Sincerely,



Judith H. O'Dell, Chair  
PCPS Technical Issues Committee

JHO:al  
File 2222

cc: PCPS Technical Issues and PCP Executive Committees



STATE OF MINNESOTA  
OFFICE OF THE LEGISLATIVE AUDITOR  
CENTENNIAL BUILDING, ST. PAUL, MN 55155 • 612.296-4708  
JAMES R. NOBLES, LEGISLATIVE AUDITOR

AUG 18 1993

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August 13, 1993

Mr. Herbert A. Finkston  
AICPA Professional Ethics Division  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

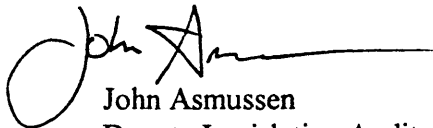
Dear Mr. Finkston:

Enclosed is the response of the Minnesota Office of the Legislative Auditor to the *Omnibus Proposal of Professional Ethics Division Interpretations and Rulings* Exposure Draft. The following staff participated in the development of this response:

John Asmussen, Deputy Legislative Auditor  
Warren Bartz, Audit Manager  
Tom Donahue, Audit Manager  
Claudia Gudvangen, Audit Manager  
Margaret Jenniges, Audit Manager  
Jeanine Leifeld, Audit Manager  
Renee Redmer, Audit Manager  
Jim Riebe, Quality Control Director

We appreciate the opportunity to respond to the Exposure Draft and hope you find our comments useful.

Sincerely,

  
John Asmussen  
Deputy Legislative Auditor

Minnesota Office of the Legislative Auditor  
Response to the *Omnibus Proposal of Professional Ethics Division*  
*Interpretations and Rulings* Exposure Draft

**Proposed Interpretation Under Rule 101**  
Independence and Cooperative Arrangements With Clients

We are very concerned with the position of the Professional Ethics Executive Committee that a member's firm may enter into a cooperative agreement with a client without impairing independence with respect to the client as long as the arrangement is not material to the firm or client. We understand that the committee's position is based on the immateriality of the arrangement. However, permitting public accountants to enter into joint ventures to develop or market products or services, or to combine services or products with their clients, is fundamentally in opposition to Article IV of the AICPA *Code of Professional Conduct* on Objectivity and Independence. This article states in part, "A member in public practice should be independent in fact and appearance when providing auditing and other attestation services." A member firm cannot maintain the appearance of independence if the *Code of Professional Conduct* permits cooperative agreements of this nature, regardless of the level of materiality of the agreement to either party.

**Proposed Interpretation Under Rule 101**  
Auditor's Performance of Certain Internal Audit Services

The Exposure Draft specifies that the performance of internal audit services such as testing reconciliations of general ledger accounts, surprise cash counts, confirmations of accounts receivable, analyses of significant fluctuations in income and expense accounts, and reviews of operational activities, among other things, would not impair the firm's independence. We acknowledge that many of these procedures are normally performed by the independent public accountant as part of a financial statement audit and would therefore not constitute an independence impairment. We are concerned, however, about independent public accountants performing internal audit services that are normally considered management responsibilities. Statement on Auditing Standards No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit*, paragraph .09, specifies that internal auditing is considered one of management's control methods for monitoring and following up on performance. Since internal audit is part of the entity's control environment, independence impairments could occur if public accountants perform certain internal audit services. We believe this proposed ethics ruling should caution practitioners about assuming internal audit services that are management's responsibilities which could impair independence, and should provide examples of such services as well.

August 16, 1993

Received Ethics Division

AUG 19 1993

Herbert A. Finkston, Director  
Professional Ethics Division  
American Institute of CPAs  
Harborside Financial Center  
201 Plaza II  
Jersey City, NJ 07311-3881

Dear Mr. Finkston:

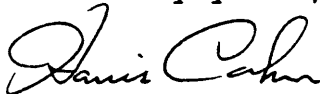
The Colorado Society of Certified Public Accountants Professional Ethics Board has reviewed the AICPA Exposure Draft, Omnibus Proposal of Professional Ethics Division Interpretations and Rulings.

The Ethics Board would like to offer the following comments on Proposed Interpretation Under Rule 101: Independence and Cooperative Arrangements With Clients:

The Board feels that cooperative arrangements, such as the examples listed in the proposed interpretation, would create circumstances in which the appearance of independence (Interpretation 101-9) if not the fact of independence, was impaired. In addition, the conditions under which joint participation with a client does not constitute a cooperative arrangement are not clear. Possibly situations which are "clearly insignificant" might be a better measure than "not material".

The Ethics Board does not have any comments to offer with respect to the other proposed interpretations and rules contained in the Exposure Draft.

Sincerely yours,



Harris Cohn, Chairman  
Professional Ethics Board

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# EXPOSURE DRAFT

## OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS

May 19, 1993

Comment date: August 19, 1993

Name and Affiliation:

*Anne M. LaMere, Internal Auditor Central Texas Co.*  
*Anne M. LaMere*

Proposed Interpretation Under Rule 101: Independence and  
Cooperative Arrangements With Clients

Comments:

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Proposed Ethics Ruling Under Rule 101:  
Indemnification Clause in Engagement Letters

Comments:

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Proposed Ethics Ruling Under Rule 101:  
Agreement With Attest Client to Use ADR Techniques

Comments:

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### Instructions for Response Form

This form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern

CUT ALONG LINE

Proposed Ethics Ruling Under Rule 101:  
Commencement of ADR Proceeding

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Comments:

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Proposed Ethics Ruling Under Rule 101:  
Auditor's Performance of Certain Internal Audit Services

Comments: *The pocketbook is setting the ethics for our profession. We would never consider allowing the Internal Auditor to express an opinion on the financial statements of the entities they work for--no matter how independent in appearance + fact; yet we propose to allow the external auditor to perform both activities. As the external auditor, an evaluation of the internal audit function should be performed and if not adequate, recommendations should be made to ensure adequate services, other than the external auditor provide the service. Times are ~~Proposed Ethics Ruling Under Rule 101~~ hard + we all need to find ~~Member's Loan From a Nonclient Subsidiary of an Attest Client Parent Company~~ ways to generate revenue, but compromising our ethical standards is not the way.*

*Thank you for the opportunity  
to comment,*

*Gene M. Sattler*

Proposed Revision of Interpretation 101-9 Under Rule 101: The Meaning of Certain Independence Terminology and the Effect of Family Relationships on Independence

Comments:

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Received Ethics Division

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AUG 20 1993

August 17, 1993

Mr. Herbert A. Finkston  
Professional Ethics Division  
AICPA  
Harborside Financial Center  
201 Plaza Three  
Jersey City, NJ 07311-3881

Dear Mr. Finkston:

We are pleased to comment on the Omnibus Proposal of Ethics Interpretations and Rulings dated May 19, 1993. In general we support these revisions.

On page 7, the proposed ruling regarding internal audit services appears to be valid. However, existing Interpretation 101-1 indicates independence is impaired if a firm was connected with the enterprise in any capacity equivalent to that of a member of management or "of an employee." The Committee should clarify in the ruling how a person performing internal audit services should approach and report on those services so as to not appear to be an "employee" of the client. How should a person performing such services hold himself out to the client, its board, and to the public in performing such services? Or does anything go, as long as you say you are doing "internal audit" work?

On page 8, there are 4 points listed regarding the criteria a partner must meet in certain circumstances. Two points appear very similar: point 1 "the partner does not participate in the engagement" and point 4 "the partner does not have any involvement with the engagement". Perhaps point 1 is not needed in view of the criterion in point 4.

On page 16, the proposed interpretation regarding subordination of judgment refers to Rule 102, and states that rule prohibits misrepresenting facts or subordinating judgment "while performing professional services." It is somewhat difficult to understand how the actions illustrated in this proposal constitute "performing professional services." Professional services are defined at ET 92.10 as services performed while holding out as a CPA, where holding out is an action informing others of status as a CPA. We are uncertain whether CPAs in industry would uniformly agree that preparing financial statements or recording transactions, while in the common role of an employee of an enterprise, constitutes performing professional services, but we fear many would not view these actions as professional services. Accordingly, to be effective in its apparent intent this interpretation will need to cover acts other than those acts that constitute "professional services." The Committee should reconsider the foundation for this interpretation and possibly for Rule 102 to decide whether it covers only professional services as defined or all financial statement-related activities. The final interpretation should be premised and worded accordingly.

Mr. Herbert A. Finkston  
August 17, 1993  
Page 2

On page 16, we are not sure what item 4 adds. If it is a reminder about other interpretations, we question why it is needed when other interpretations don't have numerous cross references to other important interpretations. Also, interpretations appear codified as ET 102, not ET 191 as indicated.

Please contact Jim Brown with any questions.

Very truly yours,

*Crowe, Chizek and Company*

Crowe, Chizek and Company





New Jersey Society of Certified Public Accountants

37

425 Eagle Rock Avenue  
Roseland, New Jersey 07068-1723  
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Fax (201) 226-7425

Received Ethics Division

AUG 20 1993

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August 17, 1993

Mr. Herbert Finkston  
Director, Professional Ethics Division  
American Institute of Certified Public Accountants  
Harborside Financial Center  
201 Plaza Three  
Jersey City, New Jersey 07311-3881

Re: Omnibus Proposal of Professional Ethics Division Interpretations and Rulings - Dated May 19, 1993

Dear Mr. Finkston:

The Professional Conduct Committee of the New Jersey Society of Certified Public Accountants has reviewed the exposure draft dated May 19, 1993 and has the following comments.

- 1. Independence and Cooperative Arrangements with Clients - Page 5.

We suggest that the restrictions on cooperative arrangements also run to the members as well as the firm. This could be accomplished by adding the words "a member or" before "a member's firm".

- 2. Indemnification Clause in Engagement Letters - Page 6.

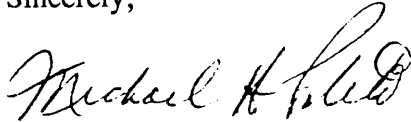
The Committee believes this should be tightened and clarify that the "liability and costs" relate only to those arising in connection with the professional services that are the subject of the engagement letter. A prudent client would quite reasonably be reluctant to sign a blanket "hold harmless" clause. This could be accomplished by adding words to the effect "in connection with the professional services covered by the engagement letter" after "harmless from any liability and costs".

3. The Meaning of Certain Independence Terminology - Page 12.

The Committee believes that the criteria of geographical proximity is not appropriate in evaluating independence and is prejudicial to one-office practices. Therefore, we recommend that item 1.b.i. on page 12 be deleted.

Should you have any questions or comments, please feel free to call me at (201) 631-6907.

Sincerely,



Michael A. Polito  
Chairman  
Professional Conduct Committee