

# **CODE OF PROFESSIONAL CONDUCT**

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## **OF THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS**

(Revised through May 19, 2010)

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**NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS  
3 PARK AVENUE  
NEW YORK, NEW YORK 10016-5991**

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**CODE OF PROFESSIONAL CONDUCT OF  
THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS**

**CODE OF PROFESSIONAL CONDUCT - INTRODUCTION & PREAMBLE**

**INTRODUCTION**

**Composition, Applicability, and Compliance**

The Code of Professional Conduct of the New York State Society of Certified Public Accountants (the "Society") consists of two sections - (1) the Principles, and (2) the Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members. The bylaws require adherence to those Rules.

The Code of Professional Conduct was adopted by the membership of the Society to provide guidance and rules to all members--those in public practice, in industry, in government, and in education--in the performance of their professional responsibilities.

Compliance with the Code of Professional Conduct, as with all standards, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.

*The Society's Code of Professional Conduct provides guidance for members in the performance of their professional responsibilities. Members should be aware that there may be other rules of conduct to which they are subject in connection with their professional responsibilities and such rules may differ from those of the Society. Organizations which may have such differing rules include the following:*

*The Board of Regents of the State of New York, which Board has the authority to revoke the license of a certified public accountant who violates its rules.*

*Governmental agencies which regulate the client's business or use the member's attestation to evaluate the client's compliance with applicable laws and related regulations and which may have established their own rules of conduct on the part of persons practicing before them.*

*Professional accounting organizations in which Society members may also hold membership (such as the American Institute of Certified Public Accountants or other state societies) or be registered to practice in other states, and such organizations or applicable state boards of accountancy may have established their own rules of professional conduct to which the member may also be subject.*

**Other Guidance**

Interpretations of Rules of Conduct consist of interpretations which have been adopted to provide guidelines as to the scope and application of the Rules. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary investigation. The effective date of the Interpretations appearing in this printing is March 25, 1992 as authorized by the Board of Directors. Publication of subsequent Interpretations in a Society publication which is sent

to all members constitutes notice to members. Hence, the publication date of the notice, unless a later date is specifically indicated, constitutes the effective date of the Interpretation. The Professional Ethics Committee will take into consideration the time that would have been reasonable for the member to comply with the Interpretations.

### **Preamble**

Membership in the New York State Society of Certified Public Accountants is voluntary. By accepting membership, a certified public accountant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

These Principles of the Code of Professional Conduct of the New York State Society of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

## Code of Professional Conduct -- Applicability and Definitions

### Applicability

The bylaws of the New York State Society of Certified Public Accountants require that members adhere to the Rules of the Code of Professional Conduct. Members must be prepared to justify departures from these Rules. For purposes of the Applicability Section of the Code, a “member” is a member of the New York State Society of Certified Public Accountants.

1. The Rules of Conduct that follow apply to all professional services performed except (a) where the wording of the rule indicates otherwise and (b) that a member who is practicing outside the United States will not be subject to discipline for departing from any of the rules stated herein as long as the member's conduct is in accord with the rules of the organized accounting profession in the country in which he or she is practicing. However, where a member's name is associated with financial statements under circumstances that would entitle the reader to assume that United States practices were followed, the member must comply with the requirements of Rules 202 and 203.
2. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in the practice of public accounting whom the member has the authority or capacity to control.
3. A member may be considered to have his or her independence impaired, with respect to a client, as the result of the actions or relationships of certain persons or entities, as described in Rule 101 and its interpretations and rulings, whom the member does not have the authority or capacity to control. Therefore, nothing in this section should lead one to conclude that the member's independence is not impaired solely because of his or her inability to control the actions or relationships of such persons or entities.

### Definitions

**Attest engagement.** An attest engagement is an engagement that requires independence as defined in AICPA Professional Standards.

**Attest engagement team.** The attest engagement team consists of individuals participating in the attest engagement, including those who perform concurring and second partner reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists as discussed in SAS No. 73, *Using the Work of a Specialist* [AU section 336], and individuals who perform only routine clerical functions, such as word processing and photocopying.

**Client.** A client is any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services or a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term “employer” does not include--

- a. Entities engaged in the practice of public accounting; or
- b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities--
  - i. Is directly elected by voters of the government or component unit thereof with respect to which professional services are performed; or
  - ii. Is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
  - iii. Is appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.

**Close relative.** A close relative is a parent, sibling, or nondependent child.

**Commissions and Referral Fees.** Commission means compensation, except a referral fee, for recommending or referring any product or service to be supplied by another person. Referral fee means compensation for recommending or referring any service of a CPA to any person.

**Council.** The Council of the American Institute of Certified Public Accountants

**Covered member.** A covered member is—

- a. An individual on the attest engagement team;
- b. An individual in a position to influence the attest engagement;
- c. A partner or manager who provides nonattest services to the attest client beginning once he or she provides ten hours of nonattest services to the client within any fiscal year and ending on the later of the date (i) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) he or she no longer expects to provide ten or more hours of nonattest services to the attest client on a recurring basis;
- d. A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
- e. The firm, including the firm's employee benefit plans; or
- f. An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described in (a) through (e) or by two or more such individuals or entities if they act together.

**Ethics Rulings.** Guidance issued by the AICPA ethics division in the form of questions and answers concerning the scope and application of the rules and interpretations of the Code of Professional Conduct.

**Financial Institution.** A financial institution is considered to be an entity that, as part of its normal business operations, makes loans to the general public.

**Financial statements.** A presentation of financial data, including accompanying notes, if any, intended to communicate an entity's economic resources and/or obligations at a point in time or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

Incidental financial data to support recommendations to a client or in documents for which the reporting is governed by Statements on Standards for Attestation Engagements and tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

**Firm.** A firm is a form of organization permitted by law or regulation that is engaged in the practice of public accounting. Except for purposes of applying Rule 101: *Independence*, the firm includes the individual partners thereof.

**Holding out.** In general, any action initiated by a member that informs others of his or her status as a CPA or NYSSCPA-accredited specialist constitutes holding out as a CPA. This would include, for example, any oral or written representation to another regarding CPA status, use of the CPA designation on business cards or letterhead, the display of a certificate evidencing a member's CPA designation, or listing as a CPA in local telephone directories.

**Immediate family.** Immediate family is a spouse, spousal equivalent, or dependent (whether or not related).

**Individual in a position to influence the attest engagement.** An individual in a position to influence the attest engagement is one who—

- a. Evaluates the performance or recommends the compensation of the attest engagement partner;
- b. Directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm's chief executive;
- c. Consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement; or
- d. Participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring, with respect to the specific attest engagement.

**Institute.** The American Institute of Certified Public Accountants.

**Interpretations of rules of conduct.** Pronouncements issued by the Board of Directors to provide guidelines concerning the scope and application of the rules of conduct.

**Joint closely held investment.** A joint closely held investment is an investment in an entity or property by the member and the client (or the client's officers or directors, or any owner who has the

ability to exercise significant influence over the client) that enables them to control (as defined by GAAP for consolidation purposes) the entity or property.

**Key position.** A key position is a position in which an individual:

- a. Has primary responsibility for significant accounting functions that support material components of the financial statements;
- b. Has primary responsibility for the preparation of the financial statements; or
- c. Has the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of attest engagements not involving a client's financial statements, a key position is one in which an individual is primarily responsible for, or able to influence, the subject matter of the attest engagement, as described above.

**Loan.** A loan is a financial transaction, the characteristics of which generally include, but are not limited to, an agreement that provides for repayment terms and a rate of interest. A loan includes, but is not limited to, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment.

**Manager.** A manager is a professional employee of the firm who has either of the following responsibilities:

- a. Continuing responsibility for the overall planning and supervision of engagements for specified clients.
- b. Authority to determine that an engagement is complete subject to final partner approval if required.

**Member.** A member or associate member of the New York State Society of Certified Public Accountants.

**Normal Lending Procedures, Terms, and Requirements.** "Normal lending procedures, terms, and requirements" relating to a covered member's loan from a financial institution are defined as lending procedures, terms, and requirements that are reasonably comparable with those relating to loans of a similar character committed to other borrowers during the period in which the loan to the covered member is committed. Accordingly, in making such comparison and in evaluating whether a loan was made under "normal lending procedures, terms, and requirements," the covered member should consider all the circumstances under which the loan was granted, including

1. The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member.
2. Repayment terms.
3. Interest rate, including "points."

4. Closing costs.
5. General availability of such loans to the public.

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.

**Office.** An office is a reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, where personnel who make up the subgroup generally serve the same group of clients or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual's physical location.

**Partner.** A partner is a proprietor, shareholder, equity or non-equity partner or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

**Period of the professional engagement.** The period of the professional engagement begins when a member either signs an initial engagement letter or other agreement to perform attest services or begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship (which could cover many periods) and ends with the formal or informal notification, either by the member or the client, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year's attest engagement.

**Practice of public accounting.** The practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as CPA(s), of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by the Board of Directors, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements.

However, a member or a member's firm, while holding out as CPA(s), is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.

**Professional services.** Professional services include all services performed by a member while holding out as a CPA.

**Significant influence.** The term *significant influence* is as defined in Accounting Principles Board Opinion No. 18 [AC section 182] and its interpretations.

**Society.** The New York State Society of Certified Public Accountants.

## **Principles of Professional Conduct**

### **Article I -- Responsibilities**

*In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.*

As professionals, certified public accountants perform an essential role in society. Consistent with that role, members of the New York State Society of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.

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## **Article II --The Public Interest**

*Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.*

A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services--all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct. All who accept membership in the New York State Society of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

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### **Article III -- Integrity**

*To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.*

Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

Integrity also requires a member to observe the principles of objectivity and independence and of due care.

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## **Article IV -- Objectivity and Independence**

*A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.*

Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services.

Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest.

Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services. Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.

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## **Article V -- Due Care**

*A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.*

The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles.

Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence--of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

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## **Article VI -- Scope and Nature of Services**

*A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.*

The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be developed to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

In order to accomplish this, members should

- Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
- Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.
- Assess, in their individual judgments, whether an activity is consistent with their role as professionals.

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## Rules and Interpretations: Independence

### ET Section 101

#### Independence

**Rule 101—Independence.** A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by the Board of Directors of the NYSSCPA.

#### Interpretations under Rule 101

##### —Independence

*In performing an attest engagement, a member should consult the rules of the New York State Board of Regents, his or her state CPA society, the Public Company Accounting Oversight Board and the U.S. Securities and Exchange Commission (SEC) if the member's report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member's report will be filed with the DOL, the Government Accountability Office (GAO) if law, regulation, agreement, policy or contract requires the member's report to be filed under GAO regulations, and any organization that issues or enforces standards of independence that would apply to the member's engagement. Such organizations may have independence requirements or rulings that differ from (e.g., may be more restrictive than) those of the NYSSCPA.*

#### **101-1—Interpretation of Rule 101. Independence shall be considered to be impaired if:**

##### A. During the **period of the professional engagement** \* a **covered member**

1. Had or was committed to acquire any direct or material indirect financial interest in the **client**.
2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and
  - (i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or
  - (ii) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
  - (iii) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.
3. Had a **joint closely held investment** that was material to the covered member.
4. Except as specifically permitted in interpretation 101-5, had any **loan** to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

- B. During the period of the professional engagement, a **partner** or professional employee of the **firm**, his or her **immediate family**, or any group of such persons acting together owned more than 5 percent of a client's outstanding equity securities or other ownership interests.
- C. During the period covered by the **financial statements** or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n)
  - 1. Director, officer, or employee, or in any capacity equivalent to that of a member of management;
  - 2. Promoter, underwriter, or voting trustee; or
  - 3. Trustee for any pension or profit-sharing trust of the client.

### **Transition Period for Certain Business and Employment Relationships**

A business or employment relationship with a client that impairs independence under interpretation 101-1.C, and that existed as of December 2001, will not be deemed to impair independence provided such relationship was permitted under rule 101, and its interpretations and rulings as of December 2001, and the individual severed that relationship on or before May 31, 2002.

### **Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client**

An individual who was formerly (i) employed by a client or (ii) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client would impair his or her firm's independence if the individual--

- 1. Participated on the **attest engagement team** or was an **individual in a position to influence the attest engagement** for the client when the attest engagement covers any period that includes his or her former employment or association with that client; or
- 2. Was otherwise a covered member with respect to the client unless the individual first dissociates from the client by—
  - (a) Terminating any relationships with the client described in interpretation 101-1.C;
  - (b) Disposing of any direct or material indirect financial interest in the client;
  - (c) Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under interpretation 101-5;
  - (d) Ceasing to participate<sup>fn1</sup> in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and

- (e) Liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty<sup>fn2</sup> significant to the benefits is imposed upon liquidation or transfer.

### **Application of the Independence Rules to a Covered Member's Immediate Family**

Except as stated in the following paragraph, a covered member's immediate family is subject to rule 101, and its interpretations and rulings.

The exceptions are that independence would not be considered to be impaired solely as a result of the following:

1. An individual in a covered member's immediate family was employed by the client in a position other than a **key position**.
2. In connection with his or her employment, an individual in the immediate family of one of the following covered members participated in a retirement, savings, compensation, or similar plan that is a client, is sponsored by a client, or that invests in a client (provided such plan is normally offered to all employees in similar positions):
  - a. A partner or **manager** who provides ten or more hours of non-attest services to the client; or
  - b. Any partner in the **office** in which the lead attest engagement partner primarily practices in connection with the attest engagement.

For purposes of determining materiality under rule 101 the financial interests of the covered member and his or her immediate family should be aggregated.

### **Application of the Independence Rules to Close Relatives**

Independence would be considered to be impaired if—

1. An individual participating on the attest engagement team has a **close relative** who had
  - a. A key position with the client, or
  - b. A financial interest in the client that
    - (i) Was material to the close relative and of which the individual has knowledge; or
    - (ii) Enabled the close relative to exercise **significant influence** over the client.

2. An individual in a position to influence the attest engagement or any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement has a close relative who had
  - a. A key position with the client; or
  - b. A financial interest in the client that
    - (i) Was material to the close relative and of which the individual or partner has knowledge; and
    - (ii) Enabled the close relative to exercise significant influence over the client.

### **Grandfathered Employment Relationships**

Employment relationships of a covered member's immediate family and close relatives with an existing attest client that impair independence under this interpretation and that existed as of December 2001, will not be deemed to impair independence provided such relationships were permitted under preexisting requirements of rule 101, and its interpretations and rulings.

### **Other Considerations**

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. Members should consider whether personal and business relationships between the member and the client or an individual associated with the client would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member's and the firm's independence.

**101-2—Employment or association with attest clients.** A firm's independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all the following conditions are met:

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may also be adjusted for inflation and interest may be paid on amounts due.
2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.
3. The former partner or professional employee does not participate or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:
  - The individual provides consultation to the firm.

- The firm provides the individual with an office and related amenities (for example, secretarial and telephone services).
  - The individual's name is included in the firm's office directory.
  - The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.
4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.
  5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.
  6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

Responsible members within the firm should implement procedures for compliance with the preceding conditions when firm professionals are employed or associated with attest clients.

With respect to conditions 4, 5, and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the positions he or she held at the firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure.<sup>fn3</sup>

### **Considering Employment or Association with the Client**

When a member of the attest engagement team or an individual in a position to influence the attest engagement intends to seek or discuss potential employment or association with an attest client, or is in receipt of a specific offer of employment from an attest client, independence will be impaired with respect to the client unless the person promptly reports such consideration or offer to an appropriate person in the firm, and removes himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought. When a covered member becomes aware that a member of the attest engagement team or an individual in a position to influence the attest engagement is considering employment or association with a client, the covered member should notify an appropriate person in the firm.

The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under rule 102. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and the individual involved.

### **101-3—Performance of nonattest services.**

Before a member or his or her firm ("member") performs nonattest services (for example, tax or consulting services) for an attest client,<sup>fn 4</sup> the member should determine that the requirements described in this interpretation have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired.

### **Engagements Subject to Independence Rules of Certain Regulatory Bodies**

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the Government Accountability Office [GAO], the Department of Labor [DOL], and the New York State Board of Regents) where a member performs nonattest services for an attest client and is required to be independent of the client under the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

### **General Requirements for Performing Nonattest Services**

1. The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.
2. The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
  - a. Make all management decisions and perform all management functions;
  - b. Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
  - c. Evaluate the adequacy and results of the services performed; and
  - d. Accept responsibility for the results of the services;

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.

3. Before performing nonattest services, the member should establish and document in writing <sup>fn 5</sup> his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:
  - a. Objectives of the engagement
  - b. Services to be performed
  - c. Client's acceptance of its responsibilities
  - d. Member's responsibilities
  - e. Any limitations of the engagement

The documentation requirement does not apply to:

- a. Nonattest services performed prior to January 1, 2005.
- b. Nonattest services performed prior to the client becoming an attest client. <sup>fn 6</sup>

General requirements 2 and 3 above do not apply to certain routine activities performed by the member such as providing advice and responding to the client's questions as part of the normal client-member relationship.

### **General Activities**

The following are some general activities that would impair a member's independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents, <sup>fn 7</sup> in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities
- Determining which recommendations of the member should be implemented
- Reporting to the board of directors on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent
- Establishing or maintaining internal controls, including performing ongoing monitoring activities <sup>fn 8</sup> for a client

## Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member's independence. These examples presume that the general requirements in the previous section "General Requirements for Performing Nonattest Services" have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

<b>Impact on Independence of Performance of Nonattest Services</b>		
<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Bookkeeping	<ul style="list-style-type: none"> <li>Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger.</li> <li>Prepare financial statements based on information in the trial balance.</li> <li>Post client-approved entries to a client's trial balance.</li> <li>Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.</li> <li>Authorize or approve transactions.</li> <li>Prepare source documents.</li> <li>Make changes to source documents without client approval.</li> </ul>
Non tax disbursement	<ul style="list-style-type: none"> <li>Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.</li> <li>Transmit client-approved payroll or other disbursement information to a financial institution provided the client has</li> </ul>	<ul style="list-style-type: none"> <li>Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.</li> <li>Accept responsibility to sign or cosign client</li> </ul>

	<p>authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.</p>	<p>checks, even if only in emergency situations.</p> <ul style="list-style-type: none"> <li>• Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client.</li> <li>• Approve vendor invoices for payment</li> </ul>
<p>Benefit plan administration fn 9</p>	<ul style="list-style-type: none"> <li>• Communicate summary plan data to plan trustee.</li> <li>• Advise client management regarding the application or impact of provisions of the plan document.</li> <li>• Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member's electronic medium, such as an interactive voice response system or Internet connection or other media.</li> <li>• Prepare account valuations for plan participants using data collected through the member's electronic or other media.</li> <li>• Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other medium.</li> </ul>	<ul style="list-style-type: none"> <li>• Make policy decisions on behalf of client management.</li> <li>• When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence.</li> <li>• Make disbursements on behalf of the plan.</li> <li>• Have custody of assets of a plan.</li> <li>• Serve a plan as a fiduciary as defined by ERISA.</li> </ul>
<p>Investment— advisory or management</p>	<ul style="list-style-type: none"> <li>• Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, etc.</li> <li>• Perform recordkeeping and reporting of client's portfolio</li> </ul>	<ul style="list-style-type: none"> <li>• Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments.</li> <li>• Execute a transaction to</li> </ul>

	<p>balances including providing a comparative analysis of the client's investments to third-party benchmarks.</p> <ul style="list-style-type: none"> <li>• Review the manner in which a client's portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client's investment policy statement; (2) meeting the client's investment objectives; and (3) conforming to the client's stated investment styles.</li> <li>• Transmit a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.</li> </ul>	<p>buy or sell a client's investment.</p> <ul style="list-style-type: none"> <li>• Have custody of client assets, such as taking temporary possession of securities purchased by a client.</li> </ul>
<p>Corporate finance—consulting or advisory</p>	<ul style="list-style-type: none"> <li>• Assist in developing corporate strategies.</li> <li>• Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria.</li> <li>• Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.</li> <li>• Assist in drafting an offering document or memorandum.</li> <li>• Participate in transaction negotiations in an advisory capacity.</li> <li>• Be named as a financial adviser in a client's private placement memoranda or offering documents.</li> </ul>	<ul style="list-style-type: none"> <li>• Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.</li> <li>• Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.</li> <li>• Maintain custody of client securities.</li> </ul>

Executive or employee search	<ul style="list-style-type: none"> <li>• Recommend a position description or candidate specifications.</li> <li>• Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).</li> <li>• Participate in employee hiring or compensation discussions in an advisory capacity.</li> </ul>	<ul style="list-style-type: none"> <li>• Commit the client to employee compensation or benefit arrangements.</li> <li>• Hire or terminate client employees.</li> </ul>
Business risk consulting	<ul style="list-style-type: none"> <li>• Provide assistance in assessing the client's business risks and control processes.</li> <li>• Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.</li> </ul>	<ul style="list-style-type: none"> <li>• Make or approve business risk decisions.</li> <li>• Present business risk considerations to the board or others on behalf of management.</li> </ul>
Information systems—design, installation or integration	<ul style="list-style-type: none"> <li>• Install or integrate a client's financial information system that was not designed or developed by the member (e.g., an off-the-shelf accounting package).</li> <li>• Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system.</li> <li>• Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records.</li> <li>• Provide training and instruction to client employees on an information and control system.</li> </ul>	<ul style="list-style-type: none"> <li>• Design or develop a client's financial information system.</li> <li>• Make other than insignificant modifications to source code underlying a client's existing financial information system.</li> <li>• Supervise client personnel in the daily operation of a client's information system.</li> <li>• Operate a client's local area network (LAN) system.</li> </ul>

## Tax Compliance Services

Tax compliance services addressed by this interpretation are preparation of a tax return,<sup>fn 10</sup> transmittal of a tax return and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, and authorized representation of clients in administrative proceedings before a taxing authority.

Preparing a tax return and transmitting the tax return and related tax payment to a taxing authority, in paper or electronic form, would not impair a member's independence provided the member does not have custody or control<sup>fn 11</sup> over the client's funds and the individual designated by the client to oversee the tax services:

- Reviews and approves the tax return and related tax payment; and,
- If required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

However, signing and filing a tax return on behalf of client management would impair independence, unless the member has the legal authority to do so and:

- a. The taxing authority has prescribed procedures in place for a client to permit a member to sign and file a tax return on behalf of the client (for example, Form 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in I.R.S. Form 8879; or
- b. An individual in client management who is authorized to sign and file the client's tax return provides the member with a signed statement that clearly identifies the return being filed and represents that:
  1. Such individual is authorized to sign and file the tax return;
  2. Such individual has reviewed the tax return, including accompanying schedules and statements, and it is true, correct and complete to the best of his or her knowledge and belief; and
  3. Such individual authorizes the member or another named individual in the member's firm to sign and file the tax return on behalf of the client.

Authorized representation of a client in administrative proceedings before a taxing authority would not impair a member's independence provided the member obtains client agreement prior to committing the client to a specific resolution with the taxing authority. However, representing a client in a court<sup>fn 12</sup> to resolve a tax dispute would impair a member's independence.

## Transition

Independence would not be impaired as a result of the more restrictive requirements of the tax compliance services provisions provided such services are pursuant to engagements commenced prior to September 1, 2009, and completed prior to June 1, 2010, and the member complied with all applicable independence interpretations and rulings in effect on September 1, 2009.

## Appraisal, Valuation, and Actuarial Services

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.

Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence.<sup>fn 13</sup> However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

## Forensic Accounting Services

For purposes of this interpretation, forensic accounting services<sup>fn 14</sup> are nonattest services that involve the application of special skills in accounting, auditing, finance, quantitative methods and certain areas of the law, and research, and investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings and consist of:

- Litigation services; and
- Investigative services.

Litigation services recognize the role of the member as an expert or consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of the following services:

- a. Expert witness services<sup>fn 15</sup> are those litigation services where a member is engaged to render an opinion before a trier of fact as to the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events.

Expert witness services create the appearance that a member is advocating or promoting a client's position.<sup>fn 16</sup> Accordingly, if a member conditionally or unconditionally agrees to provide expert witness testimony for a client,<sup>fn 17</sup> independence would be considered to be impaired.

However, independence would not be considered impaired if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more attest clients of the firm provided that at the outset of the engagement: 1) the member's attest clients constitute less than 20 percent of (i) the members of the group (ii) the voting interests of the group, and (iii) the claim; (2) no attest client within the group is designated as the "lead" plaintiff or defendant of the

group; and (3) no attest client has the sole decision-making power to select or approve the expert witness.

While testifying as a fact witness, <sup>fn 18</sup> a member may be questioned by the trier of fact or counsel as to his or her opinions pertaining to matters within the member's area of expertise. Answering such questions would not impair the member's independence.

- b. Litigation consulting services are those litigation services where a member provides advice about the facts, issues, and strategy of a matter. The consultant does not testify as an expert witness before a trier of fact.

The performance of litigation consulting services would not impair independence provided the member complies with the general requirements set forth under this interpretation. <sup>fn 19</sup> However, if the member subsequently agrees to serve as an expert witness, independence would be considered to be impaired.

- c. Other services are those litigation services where a member serves as a trier of fact, special master, court-appointed expert, or arbitrator (including serving on an arbitration panel), in a matter involving a client. These other services create the appearance that the member is not independent. Accordingly, if a member serves in such a role, independence would be considered to be impaired. However, independence would not be considered impaired if a member serves as a mediator or any similar role in a matter involving a client provided the member is not making any decisions on behalf of the parties, but rather is acting as a facilitator by assisting the parties in reaching their own agreement. <sup>fn 20</sup>

Investigative services include all forensic services not involving actual or threatened litigation such as performing analyses or investigations that may require the same skills as used in litigation services. Such services would not impair independence provided the member complies with the general requirements set forth under this interpretation.

### **Transition**

Independence would not be impaired as a result of the more restrictive requirements of the forensic accounting services provisions, provided such services are pursuant to engagements commenced prior to February 28, 2007, and the member complied with all applicable independence interpretations and rulings in existence on February 28, 2007.

### **Internal Audit Assistance Services**

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as "internal audit outsourcing." In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational <sup>fn 21</sup> internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

In addition to the general requirements of this interpretation, the member should ensure that client management:

- Designates an individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function;
- Determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services;
- Evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services; and
- Evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the member.

The member should also be satisfied that the client's board of directors, audit committee, or other governing body is informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide the client's governing body a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member is responsible for performing the internal audit procedures in accordance with the terms of the engagement and reporting thereon. The performance of such procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.

The following are examples of activities (in addition to those listed in the "General Activities" section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Determining which, if any, recommendations for improving the internal control system should be implemented

- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures

Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

### Transition

Independence would not be impaired as a result of the more restrictive requirements of interpretation 101-3, provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.

**101-4—Honorary directorships and trusteeships of not-for-profit organization.** Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be considered to impair independence under rule 101 provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or she must be identified as an honorary director or honorary trustee.

**101-5—Loans from financial institution clients and related terminology.** Interpretation 101-1.A.4 provides that, except as permitted in this interpretation, independence shall be considered to be impaired if a **covered member** \* has any **loan** to or from a **client**, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests. This interpretation describes the conditions a covered member (or his or her **immediate family**) must meet in order to apply an exception for a "Grandfathered Loan" or "Other Permitted Loan."

## Grandfathered Loans

Unsecured loans that are not material to the covered member's net worth, home mortgages<sup>fn22</sup>, and other secured loans<sup>fn22</sup> are grandfathered if:

- (1) they were obtained from a **financial institution** under that institution's **normal lending procedures, terms, and requirements**,
- (2) after becoming a covered member they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement<sup>fn23</sup>, and
- (3) they were:
  - a) obtained from the financial institution prior to its becoming a client requiring independence; or
  - b) obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or
  - c) obtained prior to February 5, 2001 and met the requirements of previous provisions of Interpretation 101-5 covering grandfathered loans; or
  - d) obtained between February 5, 2001 and May 31, 2002, and the covered member was in compliance with the applicable independence requirements of the SEC during that period; or
  - e) obtained after May 31, 2002 from a financial institution client requiring independence by a borrower prior to his or her becoming a covered member with respect to that client

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.

For purposes of applying the grandfathered loans provision when the covered member is a partner in a partnership:

- a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered member who is a partner in the partnership on the basis of their legal liability as a limited or general partner if:
  - the covered member's interest in the limited partnership, either individually or combined with the interest of one or more covered members, exceeds 50 percent of the total limited partnership interest; or
  - the covered member, either individually or together with one or more covered members, can control the general partnership.

- even if no amount of a partnership loan is ascribed to the covered member(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described below.

### **Other Permitted Loans**

This interpretation permits only the following new loans to be obtained from a financial institution client for which independence is required. These loans must be obtained under the institution's normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms.

1. Automobile loans and leases collateralized by the automobile.
2. Loans fully collateralized by the cash surrender value of an insurance policy.
3. Loans fully collateralized by cash deposits at the same financial institution (e.g., "passbook loans").
4. Credit cards and cash advances where the aggregate outstanding balance on the current statement is reduced to \$5,000 or less by the payment due date.

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.

**101-6—The effect of actual or threatened litigation on independence.** In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

#### *Litigation between client and member*

The relationship between the management of the client and a covered member must be characterized by complete candor and full disclosure regarding all aspects of the client's business operations. In addition, there must be an absence of bias on the part of the covered member so that he or she can exercise professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against a covered member, the covered member and the client's management may be placed in adversarial positions in which the management's willingness to make complete disclosures and the covered member's objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the covered member and the covered member's client or its management are in threatened or actual positions of material adverse interests by reason of threatened or actual litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.

2. The commencement of litigation by the covered member against the present management alleging management fraud or deceit would be considered to impair independence.
3. An expressed intention by the present management to commence litigation against the covered member alleging deficiencies in audit work for the client would be considered to impair independence if the auditor concludes that it is probable that such a claim will be filed.
4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered member's firm<sup>fn24</sup> or to the client company<sup>fn24</sup> would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

#### *Litigation by security holders*

A covered member may also become involved in litigation ("primary litigation") in which the covered member and the client or its management are defendants. Such litigation may arise, for example, when one or more stockholders bring a stockholders' derivative action or a so-called "class action" against the client or its management, its officers, directors, underwriters and covered members under the securities laws. Such primary litigation in itself would not alter fundamental relationships between the client or its management and the covered member and therefore would not be deemed to have an adverse impact on independence. These situations should be examined carefully, however, since the potential for adverse interests may exist if cross-claims are filed against the covered member alleging that the covered member is responsible for any deficiencies or if the covered member alleges fraud or deceit by the present management as a defense. In assessing the extent to which independence may be impaired under these conditions, the covered member should consider the following additional guidelines:

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered member in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered member's firm<sup>fn24</sup> or to the client.
2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.
3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

#### *Other third-party litigation*

Another type of third-party litigation against the covered member may be commenced by a lending institution, other creditor, security holder, or insurance company who alleges reliance on financial statements of the client with which the covered member is associated as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may

commence litigation (under subrogation rights) against the covered member in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered member and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered member alleges, in his defense, fraud, or deceit by the present management.

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered member ("the plaintiff client"), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered member's firm<sup>fn25</sup> or to the plaintiff client.

#### *Effects of impairment of independence*

If the covered member believes that the circumstances would lead a reasonable person having knowledge of the facts to conclude that the actual or intended litigation poses an unacceptable threat to independence, the covered member should either (a) disengage himself or herself, or (b) disclaim an opinion because of lack of independence. Such disengagement may take the form of resignation or cessation of any attest engagement then in progress pending resolution of the issue between the parties.

#### *Termination of impairment*

The conditions giving rise to a lack of independence are generally eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between the covered member and client. The covered member should carefully review the conditions of such resolution to determine that all impairments to the covered member's objectivity have been removed.

#### **[101-7]—[Deleted]**

#### **101-8—Effect on independence of financial interests in nonclients having investor or investee relationships with a covered member's client.**

##### **Introduction**

Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in AICPA rulings [AICPA Code ET section 191.138-.139, .158-.159, and .162-.163].

##### **Terminology**

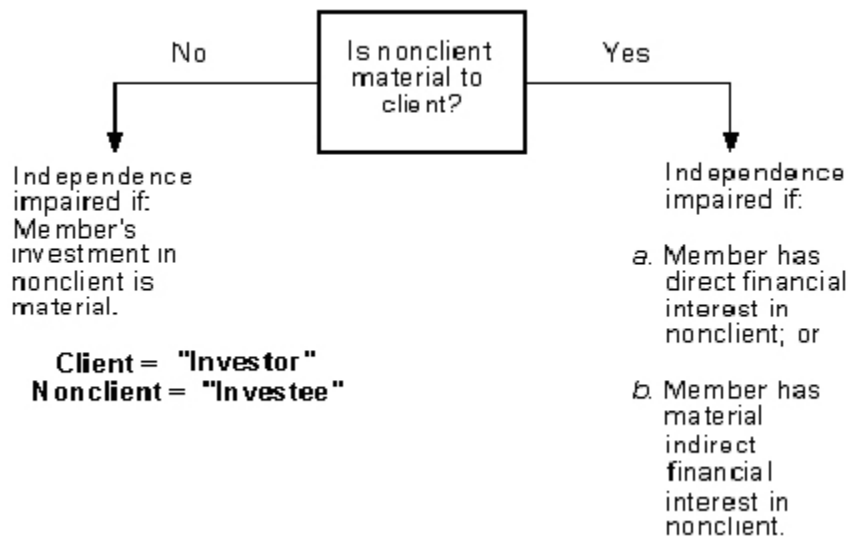
The following specifically identified terms are used in this interpretation as indicated:

1. Client. The term client means the person or entity with whose financial statements a covered member is associated.
2. Significant Influence. The term significant influence is as defined in Accounting Principles Board (APB) Opinion 18 [AC 182].

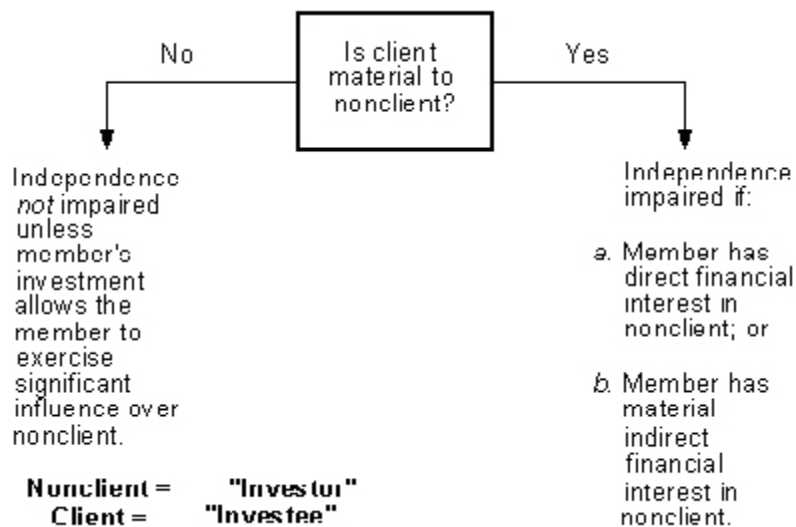
3. Investor. The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.
4. Investee. The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

### Interpretation

Where a nonclient investee is material to a client investor, any direct or material indirect financial interest of a covered member in the nonclient investee would be considered to impair independence with respect to the client investor. If the nonclient investee is immaterial to the client investor, a covered member's material investment in the nonclient investee would cause an impairment of independence.



Where a client investee is material to nonclient investor, any direct or material indirect financial interest of a covered member in the nonclient investor would be considered to impair independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a covered member's financial interest in the nonclient investor allows the covered member to exercise significant influence over the actions of the nonclient investor, independence would be considered to be impaired.



Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered member should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.

In general, in brother-sister common control situations, an immaterial financial interest of a covered member in the nonclient investee would not impair independence with respect to the client investee, provided the covered member could not exercise significant influence over the nonclient investor. However, if a covered member's financial interest in a nonclient investee is material, the covered member could be influenced by the nonclient investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered member in the nonclient investor would not impair the independence of the covered member with respect to the client investor, provided that the covered member could not exercise significant influence over the nonclient investor.

If a covered member does not and could not reasonably be expected to have knowledge of the financial interests or relationship described in this interpretation, independence would not be considered to be impaired under this interpretation.

Replaces previous interpretation 101-8, *Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Member's Client*

**[101-9]—[Deleted]**

**101-10—The effect on independence of relationships with entities included in the governmental financial statements.**<sup>fn26</sup> For purposes of this Interpretation, a financial reporting entity's basic financial statements, issued in conformity with generally accepted accounting principles in the United States of America, include the government-wide financial statements (consisting of the entity's governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be

disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures, jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

### **Auditor of Financial Reporting Entity**

A covered member issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity, as defined in paragraph 1 of this Interpretation. However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a member to be independent of that organization. However, the covered member and his or her immediate family should not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

### **Auditor of a Major Fund, Nonmajor Fund, Internal Service Fund, Fiduciary Fund, or Component Unit of the Financial Reporting Entity or Other Entity That Should Be Disclosed in the Notes to the Basic Financial Statements**

A covered member who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, should be independent with respect to those financial statements that the covered member is reporting upon. The covered member is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered member and his or her immediate family should not hold a key position within the primary government. For purposes of this Interpretation, a covered member and immediate family member would not be considered employed by the primary government if the exceptions provided for in the definition of client are met.

### **101-11—Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements**

Rule 101: *Independence*, and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are restricted to identified parties, only the following covered members, and their immediate families, are required to be independent with respect to the responsible party<sup>fn27</sup> in accordance with rule 101:

- Individuals participating on the attest engagement team
- Individuals who directly supervise or manage the attest engagement partner; and

- Individuals who consult with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.

In addition, independence would be considered to be impaired if the firm had a financial relationship covered by interpretation 101-1.A with the responsible party that was material to the firm.

In cases where the firm provides non-attest services to the responsible party that are proscribed under interpretation 101-3 and that do not directly relate to the subject matter of the attest engagement, independence would not be considered to be impaired.

In circumstances where the individual or entity that engages the firm is not the responsible party or associated with the responsible party, individuals on the attest engagement team need not be independent of the individual or entity, but should consider their responsibilities under interpretation 102-2 with regard to any relationships that may exist with the individual or entity that engages them to perform these services.

This interpretation does not apply to an engagement performed under the Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, or to an examination or review engagement performed under the Statements on Standards for Attestation Engagements.

**101-12—Independence and cooperative arrangements with clients.** Independence will be considered to be impaired if, during the period of a professional engagement, a member or his or her firm had any cooperative arrangement with the client that was material to the member's firm or to the client.

*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.

In addition, the member's firm should consider the requirements of rule 302 and rule 503.

**101-13—Extended audit services.** A member or his or her firm ("member") may be asked by a client, for which the member performs an attest engagement, to perform extended audit services. These services may include assistance in the performance of the client's internal audit activities and/or an extension of the member's audit service beyond the requirements of generally accepted auditing standards (hereinafter referred to as "extended audit services").

A member's performance of extended audit services would not be considered to impair independence with respect to a client for which the member also performs an attest engagement, provided that the member or his or her firm is not an employee of the client or does not act or appear to act in a capacity equivalent to a member of client management.

The responsibilities of the client, including its board of directors, audit committee, and management, and the responsibilities of the member, as described below, should be understood by both the member and the client. It is preferable that this understanding be documented in an engagement letter that indicates that the member may not perform management functions or make management decisions.

A member should be satisfied that the client understands its responsibility for establishing and maintaining internal control and directing the internal audit function, if any. As part of its responsibility to establish and maintain internal control, management monitors internal control to assess the quality of its performance over time. Monitoring can be accomplished through ongoing activities, separate evaluations or a combination of both.

Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time and that are built into the normal recurring activities of an entity and include regular management and supervisory activities, comparisons, reconciliations and other routine actions. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities.

The member should understand that, with respect to the internal audit function, the client is responsible for --

- Designating a competent individual or individuals, preferably within senior management, to be responsible for the internal audit function
- Determining the scope, risk and frequency of internal audit activities, including those to be performed by the member providing extended audit services
- Evaluating the findings and results arising from the internal audit activities, including those performed by the member providing extended audit services
- Evaluating the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the member

The member should be satisfied that the board of directors and/or audit committee is informed of roles and responsibilities of both client management and the member with respect to the engagement to provide extended audit services as a basis for the board of directors and/or audit committee to establish guidelines for both management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member should be responsible for performing the audit procedures in accordance with the terms of the engagement and reporting thereon. The day-to-day performance of the audit procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.

Performing procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, would not impair the independence even if the extent of such testing exceeds that required by generally accepted auditing standards.

The following are examples of activities that, if performed as part of an extended audit service, would be considered to impair independence

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
- Authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of the client
- Preparing source documents on transactions
- Having custody of assets
- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities and frequency of performance of audit procedures

- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all inclusive.

**101-14—The effect of alternative practice structures on the applicability of independence rules.** Because of changes in the manner in which **members** \* are structuring their practices, the NYSSCPA's Professional Ethics Committee (PEC) studied various alternatives to "traditional structures" to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many "nontraditional structures," a substantial (the nonattest) portion of a member's practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled by the member. All such structures must comply with applicable laws, regulations, and Rule 505, *Form of Organization and Name*. In complying with laws, regulations, and rule 505, many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by NYSSCPA Board-designated bodies. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the "traditional firm" engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and the chart below provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

The example APS in this interpretation is one where an existing CPA practice ("Oldfirm") is sold by its owners to another (possibly public) entity ("PublicCo"). PublicCo has subsidiaries or divisions such as a bank, insurance company or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (e.g., tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm ("Newfirm") to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

## APS Independence Rules for Covered Members

The term **covered member** in an APS includes both employed and leased individuals. The **firm** in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to rule 101 and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

**Partners** of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

## APS Independence Rules for Persons and Entities Other Than Covered Members

As stated above, the independence rules normally extend only to those persons and entities included in the definition of covered member. This normally would include only the "traditional firm" (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

1. *Direct Superiors.* Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can *directly control* the activities of such partner or manager. For this purpose, a person who can *directly control* is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (e.g. through another entity over which the Direct Superior can exercise significant influence ) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. *Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence<sup>fn28</sup> are subject to rule 101 and its interpretations and rulings in their entirety.*

2. *Indirect Superiors and Other PublicCo Entities.* Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the **immediate family** of the Indirect Superior. PEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm

attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEC believes that he or she would not be sufficiently financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to rule 101 and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

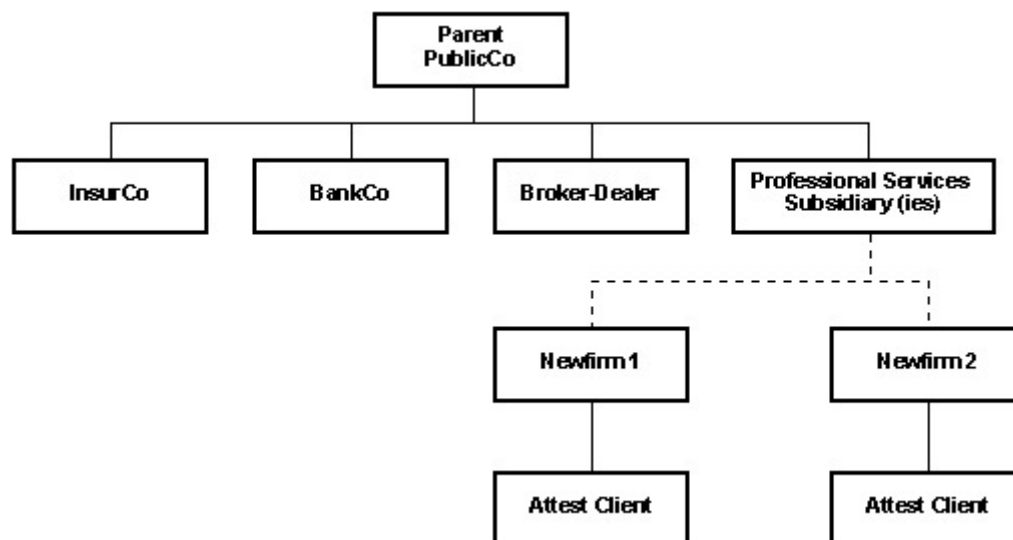
- A. Indirect Superiors and Other PublicCo Entities may not have a relationship contemplated by interpretation 101-1.A (e.g., investments, loans, etc.) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity's financial statements.
- B. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence<sup>fn28</sup> over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.
- C. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.
- D. Except as noted in C above, Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to rule 101 and its interpretations and rulings in their entirety.

## Other Matters

1. An example, using the chart below, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.
2. PEC has concluded that Newfirm (and its partners and employees) may not perform an **attest engagement** for PublicCo or any of its subsidiaries or divisions.

3. PEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence<sup>fn28</sup> over PublicCo.
4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation 102-2, *Conflicts of Interest*.

### Alternative Practice Structure (APS) Model




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[Revised by the NYSSCPA Executive Committee, effective February 13, 2009 meeting, Agenda Item EC09-A-11]

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### Footnotes ET Section 101

<sup>fn1</sup> See AICPA Ethics Ruling No. 107, “Participation in Health and Welfare Plan of Client” [AICPA Code ET section 191.214–.215], for instances in which participation was the result of permitted employment of the individual’s spouse or spousal equivalent.

<sup>fn2</sup> A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.

<sup>fn3</sup> An inadvertent and isolated failure to meet conditions 4, 5, and 6 would not impair independence provided that the required procedures are performed promptly upon discovery of the failure to do so, and all other provisions of the interpretation are met.

<sup>fn4</sup> A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* [Codified Section of AICPA Professional Standards: AR section 100.19]).

<sup>fn 5</sup> A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202, *Compliance With Standards*, provided that the member did establish the understanding with the client.

<sup>fn 6</sup> However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client.

<sup>fn 7</sup> Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders.

<sup>fn 8</sup> Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time, and is built into the normal recurring activities of an entity; these activities include regular management and supervisory activities. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities.

<sup>fn 9</sup> When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed.

<sup>fn 10</sup> For purposes of this interpretation, a tax return includes informational tax forms (for example, estimated tax vouchers, extension forms, and Forms 990, 5500, 1099, and W-2) filed with a taxing authority or other regulatory agencies.

<sup>fn 11</sup> Making electronic tax payments under a taxing authority's specified criteria or remitting a check payable to the taxing authority and signed by the client would not be considered having custody or control over a client's funds.

<sup>fn 12</sup> The term 'court' encompasses a tax, district, or federal court of claims, and the equivalent state, local or foreign forums.

<sup>fn 13</sup> Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings.

<sup>fn 14</sup> The definitions of the specific services identified in this interpretation are solely for purposes of this interpretation and are not intended to be used for any other purpose.

<sup>fn 15</sup> In determining whether the member's services are considered to be expert witness services or fact witness testimony, members should refer to the Federal Rules of Evidence, Article VII, Opinions and Expert Testimony (Rules 701, 702, and 703), and other applicable laws, regulations, and rules.

<sup>fn 16</sup> See advocacy threat as defined in the Conceptual Framework for AICPA Independence Standards (AICPA ET section 100.01). However, even though there is an appearance of advocacy, when providing expert witness services, a member must comply with Rule 102, Integrity and Objectivity, which requires that a member maintain objectivity and integrity and not subordinate his or her judgment to others.

<sup>fn 17</sup> Client in this case refers to the party to the litigation on whose behalf the member is providing testimony and not to the law firm that engaged the member on the client's behalf. If the law firm that engaged the

member on behalf of the client is also an attest client of the member, the member should consider the applicability of Interpretation 101-12, Independence and Cooperative Arrangements with Clients.

<sup>fn 18</sup> A fact witness is also referred to as a percipient witness or a sensory witness. Fact witness testimony is based on the member's direct knowledge of the facts or events in dispute. A fact witness may have obtained his or her direct knowledge of the facts or events in dispute from the performance of prior professional services for the client. As a fact witness, the member's role is to provide factual testimony to the trier of fact.

<sup>fn 19</sup> For purposes of complying with general requirement 2, the client may designate its attorney to oversee the litigation consulting services.

<sup>fn 20</sup> However, the member should consider the requirements of Interpretation 102-2, Conflicts of Interest.

<sup>fn 21</sup> For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making.

<sup>fn 22</sup> The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered member's net worth.

<sup>fn 23</sup> Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants.

<sup>fn 24</sup> Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment.

<sup>fn 25</sup> See <sup>fn 24</sup>

<sup>fn 26</sup> Except for a financial reporting entity's basic financial statements, which is defined within the text of this Interpretation, certain terminology used throughout the Interpretation is specifically defined by the Governmental Accounting Standards Board.

<sup>fn 27</sup> As defined in the SSAEs.

<sup>fn 28</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section 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.

## Rules and Interpretations: Integrity and Objectivity

### ET Section 102

#### Integrity and Objectivity

#### Rule 102--Integrity and Objectivity

In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

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

**102-1--Knowing misrepresentations in the preparation of financial statements or records.** A member shall be considered to have knowingly misrepresented facts in violation of rule 102 when he or she knowingly –

- a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records; or
- b. Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

#### **102-2: Conflicts of Interest**

A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider Rule 301--Confidential Client Information.

Certain professional engagements, such as audits, reviews, and other attest services, require independence. Independence impairments under Rule 101, its interpretations, and rulings cannot be eliminated by such disclosure and consent.

The following are examples, not all-inclusive, of situations that should cause a member to consider whether or not the client, employer, or other appropriate parties could view the relationship as impairing the member's objectivity:

- A member has been asked to perform litigation services for the plaintiff in connection with a lawsuit filed against a client of the member's firm.

- A member has provided tax or personal financial planning services for a married couple who are undergoing a divorce, and the member has been asked to provide the services for both parties during the divorce proceedings.
- In connection with a personal financial planning engagement a member plans to suggest that the client invest in a business in which he or she has a financial interest.
- A member provides tax or personal financial planning services for several members of a family who may have opposing interests.
- A member has a significant financial interest, is a member of management, or is in a position of influence in a company that is a major competitor of a client for which the member performs management consulting services.
- A member serves on a city's Board of Tax Appeals, which considers matters involving several of the member's tax clients.
- A member has been approached to provide services in connection with the purchase of real estate from a client of the member's firm.
- A member refers a personal financial planning or tax client to an insurance broker or other service provider who refers clients to the member under an exclusive arrangement to do so.
- A member recommends or refers a client to a service bureau in which the member or partner(s) in the member's firm hold material financial interest(s).

The above examples are not intended to be all inclusive.

### **102-3--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 knowingly 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.

### **102-4--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. (A member in the practice of public accounting should refer to the Statements on Auditing Standards. For example, SAS No. 22 Planning and Supervision [AU section 311], discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.)

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 102-3.

#### **102-5 Applicability of Rule 102 to Members Performing Educational Services**

Educational services (for example, teaching full- or part-time at a university, teaching a continuing professional education course, or engaging in research and scholarship) are professional services as defined in the Code of Professional Conduct and are therefore subject to Rule 102. Rule 102 provides that the member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

#### **102-6: Professional Services Involving Client Advocacy**

A member or a member's firm may be requested by a client--

1. To perform tax or consulting services engagements that involve acting as an advocate for the client.
2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.

Services provided or actions taken pursuant to such types of clients' requests are professional services governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201--General Standards, Rule 202--Compliance with Standards, and Rule 203--Accounting Principles, and interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with Rule 102, which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with Rule 101 of the Code of Professional Conduct.

Moreover, there is a possibility that some requested professional services involving client advocacy may appear to stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk of impairing the reputation of the member and his or her firm with respect to independence, integrity, and objectivity. In such circumstances, the member and the member's firm should consider whether it is appropriate to perform the service.

**102-7 Applicability of Rule 102 when receiving commissions or referral fees.**

A member may perform services, recommend a product, or make a referral and receive a commission under certain conditions as explained in Rule 503. When providing such services or making a referral, the member is obligated under Rule 102 to maintain objectivity and integrity, act in the client's interest, and not knowingly misrepresent facts or subordinate his or her judgment to others. In addition, the member is obligated under Rule 201 to comply with the general standards when performing any professional service for a client.

A member may not recommend a product or service, or make a referral, without determining that the product, service, or referral is appropriate for the client.

## Rules and Interpretations: General Standards, Accounting Principles

### ET Section 201

#### General Standards

**Rule 201--General standards.** A member shall comply with the following standards and with any interpretations thereof by appropriate bodies.

- A. *Professional Competence.* Undertake only those professional services that the member or the members firm can reasonably expect to be completed with professional competence.
- B. *Due Professional Care.* Exercise due professional care in the performance of professional services.
- C. *Planning and Supervision.* Adequately plan and supervise the performance of professional services.
- D. *Sufficient Relevant Data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

#### Interpretation under Rule 201--General Standards

**201-1--Competence.** A member who accepts a professional engagement implies that he or she has the necessary competence to complete the engagement according to professional standards, applying his or her knowledge and skill with reasonable care and diligence, but he or she does not assume a responsibility for infallibility of knowledge or judgment.

Competence in the practice of public accounting involves both the technical qualifications of the member and his or her staff and his or her ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques and the technical subject matter involved, and to the capability to exercise sound judgment in applying such knowledge in the performance of professional services.

The member may have the knowledge required to complete an engagement professionally before undertaking it. In many cases, however, additional research or consultation with others may be necessary during the course of the engagement. This does not ordinarily represent a lack of competence, but rather is a normal part of the performance of professional services.

However, if a CPA is unable to gain sufficient competence through these means, he or she should suggest, in fairness to his or her client and the public, the engagement of someone competent to perform the needed service, either independently or as an associate.

## **ET Section 202**

### **Compliance With Standards**

**Rule 202--Compliance with standards.** A member who performs auditing, review, compilation, management advisory, tax, or other professional services shall comply with standards promulgated by appropriate bodies.

## **ET Section 203**

### **Accounting Principles**

**Rule 203--Accounting principles.** A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by appropriate bodies designated to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

### **Interpretations under Rule 203--Accounting Principles**

#### **203-1--Departures from established accounting principles**

Rule 203 was adopted to require compliance with accounting principles promulgated by appropriate bodies designated to establish such principles. There is a strong presumption that adherence to officially established accounting principles would in nearly all instances result in financial statements that are not misleading.

However, in the establishment of accounting principles it is difficult to anticipate all of the circumstances to which such principles might be applied. This rule therefore recognizes that upon occasion there may be unusual circumstances where the literal application of pronouncements on accounting principles would have the effect of rendering financial statements misleading. In such cases, the proper accounting treatment is that which will render the financial statements not misleading.

The question of what constitutes unusual circumstances as referred to in Rule 203 is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle would be regarded generally by reasonable people as producing a misleading result.

Examples of events which may justify departures from a principle are new legislation or the evolution of a new form of business transaction. An unusual degree of materiality or the existence of conflicting industry practices are examples of circumstances which would not ordinarily be regarded as unusual in the context of Rule 203.

#### **203-2-Status of FASB, GASB and FASAB interpretations**

The NYSSCPA Board of Directors is authorized under rule 203 to designate bodies to establish accounting principles. The Board has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB Statements of Financial Accounting Standards, together with those Accounting Research Bulletins and APB Opinions which are not superseded by action of the FASB, constitute accounting principles as contemplated in rule 203. The Board has also designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body

to establish financial accounting principles for state and local governmental entities pursuant to rule 203. The Board has also designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities pursuant to rule 203.

In determining the existence of a departure from an accounting principle established by a Statement of Financial Accounting Standards, Accounting Research Bulletin or APB Opinion encompassed by rule 203 or the existence of a departure from an accounting principle established by a Statement of Governmental Accounting Standards or a Statement of Federal Accounting Standards encompassed by rule 203, the Professional Ethics Committee will construe such Statements, Bulletin or Opinion in the light of any interpretations thereof issued by the FASB or the GASB.

**[203-3]-[Deleted]**

**203-4-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) if such statements or data contain any departure from an accounting principle promulgated by a body designated by the Board of Directors 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.

## Rules and Interpretations: Responsibilities to Clients

### ET Section 301

#### Confidential Client Information

**Rule 301-Confidential client information.** A member in public practice shall not disclose any confidential client information without the specific consent of the client.

This rule shall not be construed (1) to relieve a member of his or her professional obligations under rules 202 and 203, (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the Professional Ethics Committee or trial board or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy or (5) to prohibit a member from participating in actual or threatened legal proceedings or alternative dispute resolution proceedings either initiated by or against the member, provided the member discloses only the information necessary to file, pursue, or defend against the lawsuit, and takes reasonable precautions to ensure that the information disclosed does not become a matter of public record.

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

#### Interpretations Under Rule 301-Confidential Client Information

**[301-1]-[Deleted]**

**[301-2]-[Deleted]**

#### **301-3-Confidential information and the purchase, sale, or merger of a practice.**

Rule 301 prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client. The rule provides that it shall not be construed to prohibit the review of a member's professional practice under AICPA or Society authorization.

For purposes of Rule 301, a review of a member's professional practice is hereby authorized to include a review in conjunction with a prospective purchase, sale, or merger of all or part of a member's practice. The member must take appropriate precautions (for example, through a written confidentiality agreement) so that the prospective purchaser does not disclose any information obtained in the course of the review, since such information is deemed to be confidential client information.

Members reviewing a practice in connection with a prospective purchase or merger shall not use to their advantage nor disclose any member's confidential client information that comes to their attention.

## ET Section 302

### Contingent Fees

**Rule 302--Contingent fees.** A member in public practice shall not:

- (1) Perform for a contingent fee any professional services for or receive such a fee from a client for whom the member or the member's firm performs:
  - (a) an audit or review of a financial statement; or
  - (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement, and the member's compilation report does not disclose a lack of independence; or
  - (c) an examination of prospective financial information; or
- (2) Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

The prohibition in (1) above applies during the period in which the member or the member's firm is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in any such listed services.

Except as stated in the next sentence, a contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. Solely for purposes of this rule, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

A member's fees may vary depending, for example, on the complexity of services rendered.

### Interpretation Under Rule 302--Contingent Fees

**302-1--Contingent fees in tax matters.** This interpretation defines certain terms in Rule 302 and provides examples of the application of the rule.

#### Definition of Terms

- (a) Preparation of an original or amended tax return or claim for tax refund includes giving advice on events which have occurred at the time the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a return or claim for refund.
- (b) A fee is considered determined based on the findings of governmental agencies if the member can demonstrate a reasonable expectation at the time of a fee arrangement, of substantive consideration by an agency with respect to the

member's client. Such an expectation is deemed not reasonable in the case of preparation of original tax returns.

## Examples

The following are examples, not all-inclusive, of circumstances where a contingent fee would be permitted.

1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return.
2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case (involving a different taxpayer) or with respect to which the taxing authority is developing a position.
3. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation (\$1 million at March 1991) or state taxing authority.
4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests.
5. Requesting, by means of "protest" or similar document, consideration by the state or local taxing authority of a reduction in the "assessed value" of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value.
6. Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute.

The following is an example of a circumstance where a contingent fee would not be permitted:

1. Preparing an amended federal or state income tax return for a client claiming a refund of taxes because a deduction was inadvertently omitted from the return originally filed. There is no question as to the propriety of the deduction; rather the claim is filed to correct an omission.

## Rules and Interpretations: Other Responsibilities and Practices

### ET Section 501

#### Acts Discreditable

**Acts Discreditable**—A member shall not commit an act discreditable to the profession.

#### Interpretations Under Rule 501—*Acts Discreditable*

##### 501-1—Response to requests by clients and former clients for records.

#### Terminology

The following terms are defined below solely for use with this interpretation:

- *Client provided records* are accounting or other records, including but not limited to photocopies, emails, faxes, computer disc or other electronic formats belonging to the client that were provided to the member by or on behalf of the client.
- *Client records prepared by the member* are accounting or other records (for example, tax returns, general ledgers, subsidiary journals, and supporting schedules such as detailed employee payroll records and depreciation schedules) that the member was engaged to prepare for the client.
- *Supporting records* are information not reflected in the client's books and records that are otherwise not available to the client with the result that the client's financial information is incomplete. For example, supporting records include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries) that are produced by the member during an engagement (for example, an audit).
- *Member's working papers* include, but are not limited to, audit programs, analytical review schedules, and statistical sampling results, analyses, and schedules prepared by the client at the request of the member.

#### Interpretation

When a client or former client (client) makes a request for client-provided records, client records prepared by the member, or supporting records that are in the custody or control of the member or the member's firm (member) that have not previously been provided to the client, the member should respond to the client's request as follows:<sup>fn 1</sup>

- *Client provided records* in the member's custody or control should be returned to the client.
- *Client records prepared by the member* should be provided to the client, except that client records prepared by the member may be withheld if the preparation of such records is not complete or there are fees due the member for the engagement to prepare those records.

- *Supporting records* relating to a completed and issued work product should be provided to the client, except that such supporting records may be withheld if there are fees due to the member for the specific work product.

Once the member has complied with these requirements, he or she is under no ethical obligation to comply with any subsequent requests to again provide such records or copies of such records. However, if subsequent to complying with a request, a client experiences a loss of records due to a natural disaster or an act of war, the member should comply with an additional request to provide such records.

Member's working papers are the member's property and need not be provided to the client under provisions of this interpretation; however, such requirements may be imposed by state and federal statutes and regulations, and contractual agreements, i.e. Rules of the New York State Board of Regents Section 29.10(a)(8-iv) and Treasury Department Circular 230 Section 10.28.

In connection with any request for client-provided records, client records prepared by the member, or supporting records, the member may:

- Charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records and require that such fee be paid prior to the time such records are provided to the client;
- Provide the requested records in any format usable by the client <sup>fn 2</sup> ; and
- Make and retain copies of any records returned or provided to the client.

Where a member is required to return or provide records to the client, the member should comply with the client's request as soon as practicable but, absent extenuating circumstances, no later than 45 days after the request is made. The fact that the statutes of the state in which the member practices grants the member a lien on certain records in his or her custody or control does not relieve the member of his or her obligation to comply with this interpretation. In addition, certain states have laws and regulations that impose obligations on the member greater than the provisions of this interpretation and should be complied with.

[Revised by the NYSSCPA Executive Committee, effective February 13, 2009 meeting, Agenda Item EC09-A-11]

### **501-2—Discrimination and harassment in employment practices.**

Whenever a member is finally determined by a court of competent jurisdiction to have violated any of the antidiscrimination laws of the United States or any state or municipality thereof, including those related to sexual and other forms of harassment, or has waived or lost his/her right of appeal after a hearing by an administrative agency, the member will be presumed to have committed an act discreditable to the profession in violation of rule 501.

[Revised by the NYSSCPA Executive Committee, effective February 13, 2009 meeting, Agenda Item EC09-A-11]

**501-3--Failure to follow standards and/or procedures or other requirements in governmental audits.** Engagements for audits of government grants, government units, or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules, and regulations, in addition to generally accepted auditing standards. If a member has accepted such an engagement and undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules and regulations, in addition to generally accepted auditing standards, he or she is obligated to follow such requirements. Failure to do so is an act discreditable to the profession in violation of Rule 501, unless the member discloses in his or her report the fact that such requirements were not followed and the+ reasons therefor.

**501-4--Negligence in the preparation of financial statements or records.** A member shall be considered to have committed an act discreditable to the profession in violation of rule 501 when, by virtue of his or her negligence, such member -

- a. Makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity; or
- b. Fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry; or
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

**501-5--Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies.** - Many governmental bodies, commissions or other regulatory agencies have established requirements such as audit standards, guides, rules, and regulations that members are required to follow in the preparation of financial statements or related information, or in performing attest or similar services for entities subject to their jurisdiction. For example, the Securities and Exchange Commission, Federal Communications Commission, state insurance commissions, and other regulatory agencies have established such requirements.

If a member prepares financial statements or related information (for example, management's discussion and analysis) for purposes of reporting to such bodies, commissions, or regulatory agencies, the member should follow the requirements of such organizations in addition to generally accepted accounting principles. If a member agrees to perform an attest or similar service for the purpose of reporting to such bodies, commissions, or regulatory agencies, the member should follow such requirements, in addition to generally accepted auditing standards (where applicable). A material departure from such requirements is an act discreditable to the profession, unless the member discloses in the financial statements or his or her report, as applicable, that such requirements were not followed and the reasons therefore.

**501-6--Solicitation or disclosure of CPA examination questions and answers.** A member who solicits or knowingly discloses the May 1996 or later Uniform CPA Examination questions(s) and/or answer(s) without the written authorization of the AICPA shall be considered to have committed an act discreditable to the professional in violation of Rule 501.

**501-7--Failure to File Tax Return or Pay Tax Liability.** A member who fails to comply with applicable federal, state, or local laws or regulations regarding the timely filing of his or her personal tax returns or tax returns of the member's firm, or the timely remittance of all payroll and other taxes collected on behalf of others, may be considered to have committed an act discreditable to the profession in violation of Rule 501.

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#### **Footnotes ET Section 501**

<sup>fn1</sup> The member is under no obligation to retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed. [i.e. Rules of the New York State Board of Regents--Section 29.10(a)(11-iv)]

<sup>fn2</sup> The member is not required to convert records that are not in electronic format to electronic format. However if the client requests records in a specific format and the member was engaged to prepare the records in that format, the client's request should be honored.

## ET Section 502

### Advertising and Other Forms of Solicitation

**Rule 502--Advertising and other forms of solicitation.** A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, overreaching, or harassing conduct is prohibited.

### Interpretations under Rule 502--Advertising and Other Forms of Solicitation

**502-1--False, misleading, or deceptive acts in advertising or solicitation.** Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that:

1. Create false or unjustified expectations of favorable results.
2. Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
3. Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood.
4. Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

**502-2--Engagements obtained through efforts of third parties.** Members are often asked to render professional services to clients or customers of third parties. Such third parties may have obtained such clients or customers as the result of their advertising and solicitation efforts.

Members are permitted to enter into such engagements. The member has the responsibility to ascertain that all promotional efforts are within the bounds of the Rules of Conduct. Such action is required because the members will receive the benefits of such efforts by third parties, and members must not do through others what they are prohibited from doing themselves by the Rules of Conduct.

## ET Section 503

### Commissions and Referral Fees

#### Rule 503-Commissions and Referral Fees

##### A. *Prohibited commissions*

A member in public practice shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to be supplied by a client, or receive a commission, when the member or the member's firm also performs for that client

- (a) an audit or review of a financial statement; or
- (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
- (c) an examination of prospective financial information. This prohibition applies during the period in which the member is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in such listed service.

##### B. *Disclosure of permitted commissions*

A member in public practice who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall fully disclose in writing and in plain language that fact to any person or entity to whom the member recommends or refers a product or service to which the commission relates.

##### C. *Referral fees*

Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

**Members should refer to Interpretation 102-7 Applicability of Rule 102 when receiving a commission or referral fee.**

#### **Interpretation 102-7**

*Applicability of Rule 102 when receiving commissions or referral fees.* A member may perform services, recommend a product, or make a referral and receive a commission under certain conditions as explained in Rule 503. When providing such services or making a referral, the member is obligated under Rule 102 to maintain objectivity and integrity, act in the client's interest, and not knowingly misrepresent facts or subordinate his or her judgment to others. In addition, the member is obligated under Rule 201 to comply with the general standards when performing any professional service for a client.

A member may not recommend a product or service, or make a referral, without determining that the product, service, or referral is appropriate for the client.

## ET Section 505

### Form of Practice and Name

**Rule 505—Form of practice and name.** A member may practice public accounting only in the form of organization permitted by law or regulation.

A member shall not practice public accounting under a firm name that is misleading. Names of one or more past owners may be included in the firm name of a successor organization.

A firm may not designate itself as “Members of the new York State Society of Certified Public Accountants” unless all of its CPA owners are members of the Society.

### Interpretations under Rule 505—Form of Practice and Name

#### 505-1 [Deleted]

**505-2—Application of rules of conduct to members who own a separate business.** A member in the practice of public accounting may own an interest in a separate business that performs for clients any of the professional services of accounting, tax, personal financial planning, litigation support services, and those services for which standards are promulgated by bodies designated by the Board of Directors. If the member, individually or collectively with his or her firm or with members of his or her firm, controls the separate business (as defined by generally accepted accounting principles [GAAP] in the United States of America), the entity and all its owners (including the member) and employees must comply with all of the provisions of the Code of Professional Conduct. For example, in applying Rule 503—Commissions and Referral Fees, if one or more members individually or collectively can control the separate business, such business would be subject to Rule 503 and its interpretations. With respect to an attest client, Rule 101 and all its interpretations and rulings would apply to the separate business, its owners and employees.

If the member, individually or collectively with his or her firm or with members of his or her firm, does not control the separate business, the provisions of the Code would apply to the member for his or her actions but not apply to the entity, its other owners and employees. For example, the entity could enter into a contingent fee arrangement with an attest client of the member or accept commissions for the referral of products or services to such attest client.

## **ET Section 506**

### **Communications**

**Rule 506—Communications.** A member shall respond to communications from the Professional Ethics Committee with respect to complaints against such member within 30 days of the mailing of such communications by registered or certified mail.

### **Interpretation under 506--Communications**

**506-1--Duty To Cooperate.** A member's duty to cooperate with the Professional Ethics Committee is without exception. A member must cooperate with the Professional Ethics Committee in any disciplinary investigation of the member or a partner or employee of the firm by making a substantive response to interrogatories or a request for documents from the committee or by complying with the educational and remedial or corrective action determined to be necessary by the professional ethics committee, within thirty days after the posting of notice of such interrogatories, or request for documents, or directive to take CPE or corrective action by registered or certified mail, postage prepaid, to the member at his or her last known address shown on the books of the Society. It is incumbent upon members to see that the Society's membership records have their current address. The trial board may expel a member for not cooperating with the Professional Ethics Committee and publish that fact with the member's name in the Society's newsletter.