
EXPOSURE DRAFT

PROPOSED REVISED INTERPRETATION AICPA PROFESSIONAL ETHICS DIVISION SUBORDINATION OF JUDGMENT BY A MEMBER

November 16, 2012

Comments are requested by January 16, 2013

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

Comments should be addressed to Lisa A. Snyder, director of the Professional Ethics Division, at lsnyder@aicpa.org.

*Copyright © 2012 by
American Institute of Certified Public Accountants, Inc.
New York, NY 10036-8775*

Permission is granted to make copies of this work provided that such copies are for personal, intraorganizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2012 by the American Institute of Certified Public Accountants, Inc. Used with permission."

November 16, 2012

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

After the exposure period is concluded, and PEEC has evaluated the comments, PEEC may decide to publish the proposed pronouncement. Once published, the pronouncement becomes effective on the last day of the month in which it is published in the *Journal of Accountancy*, except if otherwise stated in the pronouncement.

Your comments are an important part of the standard-setting process; please take this opportunity to comment. Responses must be received at the AICPA by January 16, 2012. All written replies to this exposure draft will become part of the public record of the AICPA.

All comments received will be considered by PEEC at its next open meeting.

Please send comments to Lisa A. Snyder, director of the Professional Ethics Division, via e-mail at lsnyder@aicpa.org.

Sincerely,

Wes Williams, *Chair*
AICPA Professional Ethics Executive Committee

Lisa A. Snyder, *Director*
AICPA Professional Ethics Division

Professional Ethics Executive Committee (2012–2013)

Wes Williams, *Chair*

Corey Arvizu
Martin J. Benison
Samuel L. Burke
Cassandra A. Camp
Tom Campbell
John F. Dailey, Jr.
Robert E. Denham
Raymond Johnson
Bruce J. Jorth
Brian S. Lynch

John Malahoski
Linda J. McAninch
Jarold Mittleider
Nancy Mutscher
Mary Louise Nunes
Ray Roberts
Michael Schmitz
Edward Schultz
Lawrence I. Shapiro

Task Force

John F. Dailey, Jr., *Chair*
Bruce J. Jorth
Mary Louise Nunes
Tom Volturo

Ethics Division Project Staff

Lisa A. Snyder, CPA, *Director*
James West, CPA, *Technical Manager*

CONTENTS

Proposed Revised Interpretation No. 102-4 Under Rule 102.....	6
Explanation	6
Effective Date	7
Text of Proposed Revision.....	8

Proposed Revised Interpretation No. 102-4 Under Rule 102

Explanation

The Professional Ethics Executive Committee (PEEC) is exposing for comment a proposed revision to Interpretation No. 102-4, “Subordination of Judgment by a Member” under Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, ET sec. 102 par. .05), of the AICPA Code of Professional Conduct.

In January 2012, PEEC formed a task force to broaden the guidance in Interpretation No. 102-4 so that it was more relevant to members in public practice and to determine whether the steps set forth in the interpretation remained appropriate. Specifically, the current Interpretation No. 102-4 provides an example specifically tailored for members in business without a comparable example for members in public practice. The example focuses on a situation when a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions and requires that the member take specific steps to ensure that the situation does not constitute a subordination of judgment. PEEC’s proposed revision broadens the interpretation to cover differences of opinion with a supervisor related to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services, or applicable laws or regulations. In addition, PEEC has clarified that the guidance applies when performing professional services for a client, an employer, or on a volunteer basis.

PEEC believes that such differences of opinion could result in self-interest, familiarity, and undue influence threats to the member’s compliance with the Integrity and Objectivity rule. Therefore, when a difference of opinion exists between a member and his or her supervisor, the revised interpretation requires that the member should assess any identified threats and form a conclusion, after appropriate research or consultation, about whether the result of the position taken by the supervisor fails to comply with professional standards, when applicable; creates a material misrepresentation of facts; or may violate applicable laws or regulations. If the member concludes that the position taken by the supervisor is not in compliance with professional standards but does not result in a material misrepresentation of fact or a violation of applicable laws or regulations, threats to the member’s compliance with the Integrity and Objectivity rule would not be considered significant. However, PEEC believes that the member should discuss his or her conclusions with the person taking the position.

PEEC believes that in circumstances whereby the member concludes that the position taken by the supervisor results in a material misrepresentation of facts or a violation of applicable laws or regulations, threats to the member’s compliance with the Integrity and Objectivity rule would be considered significant. Consistent with extant Interpretation No. 102-4, in such circumstances, the member should discuss his or her concerns with the supervisor, and if the difference of opinion is not resolved with the supervisor, the member should discuss his or her concerns with the appropriate higher level(s) of management within the organization.

PEEC believes that in circumstances whereby the member concludes that appropriate action has not been taken by the supervisor or appropriate higher level(s) of management within the organization, the member should consider applying safeguards to eliminate or reduce the threats

to an acceptable level. The revised interpretation provides specific examples of safeguards for the member to consider. If the member concludes that no safeguards can eliminate or reduce the threats to an acceptable level or if the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the organization.

PEEC believes that a member should not be precluded from resigning from the organization at any time. However, PEEC believes that resignation should not relieve the member of any responsibilities that may exist, such as a responsibility to disclose to regulatory authorities if such a requirement exists.

Finally, the interpretation provides that similar safeguards should be applied to other situations involving a difference of opinion with a supervisor so that the member does not subordinate his or her judgment.

Effective Date

PEEC does not believe that a delayed effective date for transition purposes is necessary. Accordingly, PEEC proposes that, if adopted, the interpretation be effective when published in the *Journal of Accountancy*.

Request for Specific Comments

Although PEEC welcomes comments on all aspects of this proposal, it specifically requests feedback on the following:

1. Do you believe the proposal should be effective immediately? If not, please explain why you believe additional time to comply is necessary and how much time you believe would be adequate.

Text of Proposed Revision

(Additions appear in **boldface italic**, and deletions are ~~stricken~~.)

.05 102-4—Subordination of Judgment by a Member

~~Rule 102~~ ***The Integrity and Objectivity rule*** [ET section 102.01] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services ***for a client, an employer, or on a volunteer basis.***

~~Under this rule, if~~ a member and his or her supervisor ***or other person to whom subordination of judgment might occur (supervisor)*** have a ~~disagreement or dispute~~ ***difference of opinion*** relating to the preparation of financial statements or the recording of transactions, ***application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services, or applicable laws or regulations, self-interest, familiarity, and undue influence threats to the member's compliance with the Integrity and Objectivity rule may exist.*** ~~the member should take the following steps to ensure that the situation does not constitute a subordination of judgment:~~⁺ ***Accordingly, the member should apply appropriate safeguards so that the member does not subordinate his or her judgment when the member concludes that threats are significant.***

In assessing the significance of any identified threats the member should form a conclusion, after appropriate research or consultation, about whether the result of the position

- a. fails to comply with professional standards, when applicable;***
- b. creates a material misrepresentation of fact; or***
- c. may violate applicable laws or regulations.***

If the member concludes that the position taken is not in compliance with professional standards but does not result in a material misrepresentation of fact or a violation of applicable laws or regulations, threats would not be considered significant. However, the member should discuss his or her conclusions with the person taking the position.

If the member concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, threats would be considered significant. In such circumstances, the member should discuss his or her concerns with the supervisor. If the difference of opinion is still not resolved, the member should discuss his or her concerns with 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).

If after discussing such concerns with the supervisor and appropriate higher level(s) of management within the organization, the member concludes that appropriate action was not taken, the member should consider, in no specific order, the following safeguards to ensure

⁺ ~~1A member in the practice of public accounting should refer to the Statements on Auditing Standards. For example, see SAS No. 22, *Planning and Supervision* [AU section 311], which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.~~

that threats to the member's compliance with the Integrity and Objectivity rule are eliminated or reduced to an acceptable level:

- *Determining whether any additional requirements exist under his or her employer's internal policies and procedures for reporting differences of opinion.*
- *Determining whether any responsibilities exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. When dealing with the employer's external accountant, the member should at all times be cognizant of his or her obligation under Interpretation No. 102-3 [ET section 102.04].*
- *Consulting with his or her legal counsel regarding his or her responsibilities.*
- *Documenting his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.*

If the member concludes that no safeguards can eliminate or reduce the threats to an acceptable level or if the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the organization.

Nothing in this interpretation would preclude a member from resigning from the organization at any time. However, resignation may not relieve the member of his or her responsibilities in the situation, including any responsibility to disclose to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

A member should apply similar safeguards, as appropriate, to other situations involving a difference of opinion so that the member does not subordinate his or her judgment.

- ~~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 [ET section 102.04].~~