Ethics and Professional Conduct for New York CPAs – Foundations Course

Course #42501

Course Material
# Ethics and Professional Conduct for New York CPAs – Foundations Course (Course #4250I)

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**Glossary**

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Chapter 1: Introduction to the Study of Ethics

Objectives: After completing this chapter, you will be able to:

- Explain the function of ethics.
- Discuss the theory of utilitarianism.
- Describe the history of ethics in Western civilization.
- Contrast the term “positive laws” with “natural laws.”
- Discuss whether the AICPA code of ethics is a positive law or natural law.
- Explain why people follow rules of laws.

Ethics has a number of functions or goals. The primary function is to develop formulas or logical constructs that can be used in choosing between various courses of action. The "moral" or "ethical" thing to do is considered the right thing to do. But it is not always easy to know what the moral course of action is. Ethical constructs and theories, such as Utilitarianism, which will be discussed later, are designed to be used as tools of thought in selecting an appropriate, ethical course of action. It does not matter if your goal is to be the best CPA or the best spouse or friend; the principles that guide one's actions will theoretically be the same.

Webster's Dictionary defines "ethics" as "the discipline dealing with what is good and bad and with moral duty and obligation" and as "a set of moral principles or values." The word "moral" is defined as "of or relating to principles of right and wrong in behavior." Ethics has also been defined as the "science of conduct." First and foremost, ethics is a philosophy. The study of ethics has a long and rich history in Western civilization, beginning with the early Greek philosophers such as Plato and Aristotle, emerging along with early Christian thought in the medieval period and continuing into modern European scholarship. Throughout the centuries, the great philosophers have attempted to develop normative constructs to use in defining behavior. Many schools of thought have developed that have been used not only to define conduct, but to establish norms. These theories have been used variously to justify different courses of conduct as ethical and to promote different modes of behavior.

OBSERVATION: Nowhere in the dictionary will you find the definition of ethics as doing that which one is legally obligated to do. Ethical responsibilities exceed legal obligations.

The modern professional rules of conduct that govern CPAs – like those governing attorneys and other professionals – have developed out of those schools of thought with an eye toward establishing a set of norms that benefit and promote the profession while protecting consumers. A general understanding of some of the background of this field of study is helpful to more fully understand the goal of the rules of professional conduct governing CPAs. This type of understanding is also useful in analyzing situations that may arise that do not fall squarely within the parameters of one of the specific professional rules. The ethical CPA should be able to determine the appropriate course of action regardless of the circumstances in which she finds herself. We will begin our discussion with a brief overview of a few of the major philosophical ethical constructs and then examine how those constructs can be used as models in guiding the behavior of CPAs.

Most societies attempt to compel ethical behavior by requiring adherence to a series of laws (in this way, the rules of professional conduct governing CPAs can be viewed as
laws designed to ensure that CPAs act ethically). English philosopher John Austin wrote that "a law, in the most general and comprehensive acceptation in which the term, in its literal meaning, is employed, may be said to be a rule laid down for the guidance of an intelligent being by an intelligent being having power over him." This definition is taken from Austin's "The Providence of Jurisprudence Determined," first published in 1832. Austin defines several types of laws. First, according to Austin, are laws laid down by God to govern the behavior of man. These are referred to as "natural laws."

Next are laws established by men, which are termed "positive laws," or laws that exist by position. Every law, according to Austin, is a "command":

Summary: Philosopher John Austin believed there are 2 types of laws:
1) Natural Laws – Laws laid down by God to govern the behavior of man;
2) Positive Laws – Laws that are established by men.

Viewed according to this philosophical model, the AICPA's Code of Professional Conduct is most properly characterized as a set of commands. As they are commands laid down by man to govern the conduct of man, philosopher John Austin would classify the AICPA's Code of Professional Conduct as a "positive law." And as the result of a failure to follow or abide by a rule of professional conduct can lead to the imposition of a punishment or a sanction, that rule of professional conduct can again, according to Austin's philosophical model, properly be referred to as a positive law. Even though the purpose of the rule is to achieve a certain good, the rule is defined by the sanction that is threatened when there is non-compliance:

I am determined or inclined to comply with the wish of another, by the fear of disadvantage or evil. I am also determined or inclined to comply with the wish of another, by the hope of advantage or good. But it is only by the chance of incurring evil, that I am bound or obliged to compliance. It is only by conditional evil, that duties are sanctioned or enforced. It is the power and purpose of inflicting eventual evil, and not the power and purpose of imparting eventual good, which gives to the expression of a wish the name of a command.

Thus, the AICPA Code requirement that CPAs "maintain objectivity and be free of conflicts of interest in discharging professional responsibilities" (Article IV) takes the form of a "command" over CPAs through the risk that a CPA who fails to act with objectivity in discharging his or her obligations could be sanctioned by the AICPA. It is through knowledge that a sanction is possible that the CPA follows the "commands" of the rules of professional conduct.

It is through the fact that the members of the group, in this case CPAs, follow the same set of commands, that a "society" is established: "In order that a given society may form a society political, the generality or bulk of its members must habitually obey a superior determinate as well as common." Thus, accountants, while they do not form a "society" within the traditional meaning of the term, defined as a political entity, do form a society in the broader definition as a group of individuals who voluntarily submit themselves to the same set of rules under the threat that non-compliance with any particular positive law can lead to the imposition of a sanction.
CHAPTER 1 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. The study of ethics as a philosophy began:
   a) in the 20th century
   b) with ancient Greek philosophers
   c) with the development of Christianity
   d) with medieval philosophers

2. The AICPA’s Code of Professional Conduct are most properly classified, according to Austin, as:
   a) natural laws
   b) philosophical models
   c) positive laws
   d) commands
CHAPTER 1 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. The study of ethics as a philosophy began over 2000 years ago.

   **B: Correct.** The study of ethics as a philosophy began with ancient Greek philosophers such as Plato and Aristotle.

   C: Incorrect. The study of ethics began with Plato which predates Christianity.

   D: Incorrect. The study of ethics was well founded by medieval times.

   (See page 1-1 of the course material.)


   B: Incorrect. The AICPA Code of Professional Conduct is a set of commands, not a philosophical model.

   **C: Correct.** Austin considers every set of commands as a positive law.

   D: Incorrect. Although the AICPA Code of Professional Conduct is a set of commands, under Austin's philosophical model a set of commands is a positive law. Most people studying philosophy would consider both c and d to be correct answers.

   (See page 1-2 of the course material.)
Chapter 2: The Value of Professional Codes of Ethics

Objectives: After completing this chapter, you will be able to:

- Discuss how professional codes of ethics protect consumers and promote the CPA profession.
- Explain how being ethical will lead to greater professional success.
- Describe the difference between blindly following the ethical rules and truly applying the ethical concepts to one’s thought process.

As we discussed in Chapter 1, professional ethical codes have been developed to both protect consumers and promote particular professions. While not expressly set forth in codes such as the AICPA, these practical, often very specific ethical rules are based at least in part on abstract philosophical theories.

It is easy to say that professional ethical codes have been developed to protect consumers and to promote the business whose ethics are being regulated. Stated in the abstract, however, this is of limited value. To truly understand the ethical rules governing CPAs that will be detailed in later chapters, it is important to have a better understanding of the value that the rules provide. As we discussed in Chapter 1, the field of ethics is involved in defining behavior as good or bad. People in business generally have as their primary motivation increasing profits. If we assume, contrary to some philosophical theories, that people will not behave ethically simply because it is the right thing to do, then there must be some additional incentive or motivation for people to act in an ethical manner. One obvious motivation is the fear of sanction or punishment that can come with non-compliance (Austin's theory discussed in Chapter 1). No CPA would reasonably do something that he knew could result in the loss of his license to practice because such action would threaten the person's livelihood. But there are other reasons that the CPA should be concerned about following ethical rules. First, being ethical is the right thing to do. Second, being ethical will often lead to greater professional success.

In the ideal world, ethical rules governing CPAs are available as guideposts, tools to turn to when one is faced with a predicament and is trying to determine the best, most ethical course of action. For example, if John, a CPA, has a client, Company Y, that offers John a bonus if he will agree not to report all of Company Y's income, John might be faced with a predicament. John might ask: "Who does it really hurt if we underreport our income and pay less corporate tax?" At the same time, John might need the extra money being offered by Company Y so that his son can get a potentially life-saving operation. It would certainly be tempting for anyone in John's position to take the money. In making his decision, John must carefully examine the true consequences of taking the money. There is little doubt that to accept the payment in return for signing a knowingly false return violates the professional rules of ethics (the specific rules are the subject of later chapters). But what else might motivate John to reject the payment?
If John is willing to accept payment in exchange for signing a false return, this means that there are probably other CPAs who would be willing to do the same thing. Once John does it the first time, it becomes easier for him to do it again. The more frequently CPAs are willing to sign false returns, the less value there is in having the return signed. Why? The tendency to rely on the signature as an affirmation of its truthfulness is diminished. Once enough people feel that the accuracy of a return cannot be relied on, the return will in fact have little practical value. In the absence of value, few people will be willing to pay for the preparation of the return. By a certain point in time, there will not be enough clients to keep John in business. What started out as a decision to lie on one return for an ostensibly good motive leads to the loss of his business.

Does it matter that John's decision not to sign the false return is motivated by a fear of sanction for violation of the professional rule of ethics? Certainly it is easy to say in the abstract that it would be better if John's decision not to sign the false return were motivated by his desire to do the right thing. And there will always be some people whose motivation in following the ethical rules is an altruistic desire to do the right thing rather than a fear of sanction. People who blindly adhere to the rules out of fear of sanction may indeed be ethical accountants, but on some level, there will always be those who decide to break the rules if they think they can get away with it. Therefore, in the ideal world accountants will follow ethical rules out of a desire to be an ethical accountant. And in the long run, the profession is benefited by such motivation because it will generally mean that less time is spent on policing professional conduct. In the long run, the profession also wins because the public recognizes CPAs as ethical people and is more likely to engage their services.

Ethical rules governing CPAs and other professionals therefore have a joint purpose. On the one hand, as we said earlier, the rules protect consumers. This is true regardless of what motivates the individual CPA to follow them. The rules also help to promote the profession by providing a consistency in the way that problems are approached. But since not all problems or predicaments are predictable, and therefore there is no rule to govern every potential contingency, the truly ethical accountant is one who understands the value of the rules and the basis behind them. That accountant is therefore better situated to determine the ethical course of action when faced with a difficult situation. The most important reason for CPAs to follow professional ethics is simply to behave in the most ethical manner.
CHAPTER 2 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following best describes how professional codes of ethics protect consumers:
   a) a professional who violates the rules could be barred from working
   b) ethical rules are available as guideposts when one is faced with a predicament and is trying to determine the best, most ethical course of action
   c) ethical codes often address the issue of excessive fees charged by professionals
   d) professionals that closely follow ethical codes often earn more than those that do not

2. What is the most important reason CPAs should follow professional ethics:
   a) to avoid monetary sanctions
   b) to avoid losing one’s license
   c) to make the most money
   d) to behave in the most ethical way
CHAPTER 2 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Although sanctioning violators does protect the public, only a very small number of professionals ever need to be sanctioned.

    B: Correct. All of the possible answers are true in certain circumstances. However, ethical codes provide a mechanism for self-policing behaviors and avoiding violations. The avoidance of possible violations and promoting a better profession is an immense consumer protection benefit.

    C: Incorrect. The issue of excessive fees is generally not directly addressed in professional codes of conduct. Even when excessive fees are addressed, it is not the best example of ethics codes protecting the public.

    D: Incorrect. Ethical CPAs are more likely to earn more throughout their careers than unethical CPAs. This has a long term effect of protecting consumers but is less likely to directly protect consumers than having CPAs constantly checking ethical rules in order to be the best they can be.

    (See page 2-1 of the course material.)

2. A: Incorrect. The professional ethics rules do not have monetary sanctions.

    B: Incorrect. The board of accountancy is the only entity with the authority to revoke one’s license.

    C: Incorrect. Making money is not the most important reason to act ethically.

    D: Correct. Following professional ethics rules will guide the CPA to behave in the most ethical way.

    (See page 2-2 of the course material.)
Objectives: After completing this chapter, you will be able to:

- Discuss the perception of the profession by the public.
- Explain the erosion of the integrity of the profession.
- Identify that ethical rules governing CPAs have a dual purpose.
- Recognize that not all ethical dilemmas will be covered by a published rule.
- Discuss the psychology of moral development.
- Describe the sociology of professions.
- Discuss the role of virtue in the rules of ethics.

Ethical Dilemmas

A CPA firm was about to acquire a prestigious new client, XYZ Company. XYZ Company is in a fast growing industry and is considered a "high flyer". The client calls a meeting of the engagement team which consists of a staff person, a senior staff person, a manager and of course the partner. The client announces that he has one last test that the CPA firm must pass before being awarded all of XYZ Company's work.

"I have here a stack of sales invoices" the client announces as he hands the stack to the staff member of the engagement team. I want each of you to tally up the sales figures and tell me the result.

The staff member thinks to herself that this must be a test of accuracy. She plugs in her 10 key adding machine and diligently begins tallying the figures. She completes the task in short order, hands the result to the client and even includes the adding machine tape to prove her accuracy.

The client then hands the same stack of invoices to the senior staffer and again asks her to tally the figures. She thinks to herself that this is really a test of her efficiency. She pulls out her laptop computer and in a short time has created an Excel spreadsheet that tallied all the figures.

Next, the client gives the invoices to the manager and again instructs him to tally the figures. The manager thinks to himself that this is really a test of his ability to delegate routine tasks to his subordinates. He splits the invoices into two piles and hands one pile to the staff person and the other to the senior staffer. He instructs each of them to tally their stack and give him the result, which they do. The manager then adds the two subtotals together and gives the result to the client.

Lastly, the client hands the stack of invoices to the seasoned partner and instructs him to again tally the invoices, which by now had been tallied three times. The partner picks up the invoices and then leans over and whispers in the client's ear "what do you want them to add up to?"
When I first heard this joke I was a staffer at a Big 5 firm. The person telling the joke spoke very softly, as if the subject matter were taboo. I may have laughed softly at the time but in retrospect, I did not really understand what was funny about it. After being promoted to senior, I heard the joke again but was not amused. The joke called into question the integrity of the CPA profession, to which I had devoted several years of my life. I heard the same joke several years later when I was a manager. However, this time the joke teller spoke louder as if the subject matter was no longer taboo. In an unusual twist, I found it much funnier than when I first heard it and laughed out loud.

I thought of this joke and my experience with it while pondering the scandals at Enron and WorldCom. How could an accounting powerhouse like Arthur Andersen & Co. implode in such a short period of time? I wonder if the implosion really began many years ago when the joke above started to become funny to more people than it offended and was readily understood by even the newest staffer.

If, in the real world, an accountant were faced with the facts of the joke above, would this amount to a true ethical dilemma? I would suggest not. When a client asks a CPA to do that which clearly contravenes accepted accounting principles or rules of conduct, the ethical CPA simply says no.

Sometimes, a CPA will confront an issue which is not so cut and dry. A client might ask a CPA to do something which seems to the CPA to be unethical but is not strictly proscribed by the applicable professional rules. This type of situation is more properly characterized as a dilemma. In such a situation, the ethical CPA finds the rules which most aptly apply to his situation and determines, based on the policy behind the rule, what the correct course of conduct should be. Later chapters will focus on the specific rules of New York and the AICPA.

Remember that ethical rules governing CPAs and other professionals have a joint purpose. On the one hand, as we have said earlier, the rules protect consumers. This is true regardless of what motivates the individual CPA to follow them. The rules also help to promote the profession by providing a consistency in the way that ethical problems are approached. But since not all problems or predicaments are predictable, and therefore there is no rule to govern every contingency, the truly ethical accountant is one who understands the value of the rules and the basis behind them. That accountant is better situated than others to determine the ethical course of conduct when faced with a true dilemma.

Miscellaneous Issues

A. The Psychology of Moral Development

Within the vast discussion of what constitutes moral or ethical behavior is the more basic question of what motivates someone to act in an ethical manner. Much scholarly work has been written, particularly since the 1950s, about the psychology of moral development and the works have been used in various ways, including tools for child rearing and educational curriculum. Suffice it to say, there are as many theories on what makes a person moral as there are on what constitutes moral behavior. In her article “Stages of Moral Development” from the Gale Encyclopedia of Psychology (2001), author Dianne K. Daeg de Mott suggests that the process of choosing how to act in any
particular circumstance is the same, regardless of the actor’s motivation. She summarizes this process into four components:

“Moral sensitivity - empathy (identifying with another’s experience) and cognition of the effect of the various possible actions on others;
Moral judgment – choosing which action is the most moral;
Moral motivation – deciding to behave in the moral way, as opposed to other options;
Implementation – carrying out the chosen or moral action.”

Daeg de Mott goes on to discuss the broad categories of motivating factors, including self-interest and the desire to fulfill ethical rules.

For purposes of this course, it may well be useful to think about this subject in several contexts: (1) if all CPA’s were moral, would it be necessary to have a vast array of rules of professional conduct? (2) should it matter whether a person is motivated to act in an ethical manner because of his superior moral development or out of some less stoic reason such as self-interest? and, (3) is there anything that professional organizations can do, other than through the institution of rules of conduct, to foster the moral development of its members?

B. The Sociology of Professions

In very general terms, a profession is an occupation usually characterized by specialized education and training, often requiring certification. A ‘professional’ is generally someone who is believed to have a high level of education and expertise in a particular area of enterprise, whether it be medicine or law. While historically the term ‘professional’ was generally reserved for those who had attained some particularly high level of training and expertise, e.g. a doctor, in today’s parlance the term is often applied to any type of job classification or occupation, e.g. carpenter.

Modern sociologists analyzing the role of professions tend to focus on the distinction between service to clients and customers and service to the profession itself. In the ideal world, according to many thinkers, the professional exists for the betterment of those he serves, whether they be the clients of an attorney or CPA or the patients of a physician. Many modern critics, however, have suggested that the trend of professions is to promote themselves, sometimes to the exclusion of helping others. One example of this is professional organizations and societies who exist to promote the profession as well as to select and govern its members.

To practice law or accounting, for example, one must pass a test and be admitted into practice by the governing body, generally at a statewide level. Thereafter, the individual’s practice is dependent on his or her continued membership within that professional organization which requires, among other things, adherence to that organization’s rules of conduct. On one level, the organization exists to promote the interests of its members, which often entails protecting the role served by its members (lawyers, for example, are vigilant to preventing non-lawyers from doing anything that appears to be the practice of law, as this ensures more work for them).
The role of a professional, and more particularly of the organizations they belong to, is to promote and protect the livelihood of its members and to protect the interests of the public at large who utilize the services of its members. The latter is arguably a necessary part of the former in that the public will be reluctant to place its trust in a professional if they do not believe that that individual is being regulated and is subject to rules of conduct which protect his interests. Arguably, therefore, CPAs and other professionals would not be able to prosper and serve their role in the community as effectively in the absence of the professional organizations that promulgate rules of conduct and otherwise regulate them.

C. Virtue and the Role and Rules of Ethics

“By virtue I mean nothing arcane or obscure. I mean good citizenship, whose principal components are moderation, social sympathy and willingness to sacrifice private desires for public ends.” -- George F. Will in “Statecraft as Soulcraft: What Government Does.”

The above definition suggests that the person who is virtuous is one who is following a society’s ethical principles. However, does following rules of ethics because it is required make a man virtuous or is a man virtuous who chooses to follow the rules of ethics of his own accord? This question can largely be translated into a matter of intent or motivation. Some thinkers have suggested that a person cannot be truly virtuous if they follow the rules of ethics for any selfish reason whatsoever: “It is the essence of virtue that the good is not to be done for the sake of a reward,” wrote Abraham Joshua Heschel (1907-1972) in “God in Search of Man: A Philosophy of Judaism” published in 1955. Does this mean that a person must be ethical because he knows it is the right thing to do in order to be considered virtuous? Or, put another way, is the person who follows the rules of ethics only to avoid the punishment that comes with breaking them not a virtuous man? In reality, the answer is of little consequence.

In general, the hope of all society is that a person will follow the rules of ethics because he believes it is the right thing to do. However, having such rules does compel some people to follow them and therefore to act in virtuous ways. As such, the role of rules of ethics is to compel people to act in ways which are best for society. In a more micro sense, the rules of professional responsibility applicable to CPAs are designed to protect the virtue, or integrity, of the profession by forcing members to act in the best interest of their clients and the profession as a whole. As William Goodwin (1756-1836) said in “Enquiry Concerning Political Justice and Its Influence on Morals and Happiness, 1793, “The virtue of a human being is the application of his capacity to the general good.” Thus, the CPA is virtuous when he follows professional ethics and acts in a manner which is best for his client and for the profession as a whole.

With all of this said, it is now incumbent to ask the question: “What is the value of professional codes of ethics?” As we have already tried to point out, professional ethical codes have been developed to protect consumers and promote particular professions. While not expressly set forth in codes such as the AICPA, these practical, often very specific ethical rules are based at least in part on abstract philosophical theories like those discussed above.
It is easy to say that professional ethical codes have been developed to protect consumers and to promote the business whose ethics are being regulated. Stated in the abstract, however, this is of limited value. To truly understand the ethical rules governing CPAs that will be detailed in later chapters, it is important to have a better understanding of the value that the rules provide. As we have already discussed, the field of ethics is involved, in part, in defining behavior as either good or bad. People in business generally have as their primary motivation making money. If we assume, contrary to some philosophical theories, that people will not behave ethically simply because it is the right thing to do, then there must be some additional incentive or motivation for people to act in an ethical manner. One obvious motivation is the fear of sanction or punishment that can come with non-compliance. No CPA would reasonably do something that he or she knew could result in the loss of his or her license because such action would threaten his or her livelihood. But there are other reasons that the ideal CPA should be concerned about following ethical rules. First, being ethical is the right thing to do. Second, being ethical will often lead to greater professional success.
CHAPTER 3 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. In the story about XYZ Company, which of the following was acting in an unethical manner:
   a) the staff person
   b) the senior staff person
   c) the manager
   d) the partner

2. Which of the following are valid roles for professional organizations to play in society:
   a) to promote the interests of its members
   b) to protect the interests of the consuming public
   c) to fight all regulation of its members
   d) both a and b above
CHAPTER 3 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. The staff person correctly added the invoices.

   B: Incorrect. The senior staff person correctly added the invoices.

   C: Incorrect. The manager delegated the task of adding the invoices.

   **D: Correct.** The partner subordinated his objectivity to that of the client. In doing so, he acted unethically.

   (See page 3-1 of the course material.)

2. A: Incorrect. Professional organizations do exist, in large part, to promote the interests of their members. There is, however, a better answer.

   B: Incorrect. Professional organizations do play an important role to protect the public that consumes the services of its members. There is, however, a better answer.

   C: Incorrect. To the contrary, the organization has a role in ensuring the public that its members are being regulated.

   **D: Correct.** Professional organizations have a valid role in both a) and b).

   (See pages 3-3 to 3-4 of the course material.)
Chapter 4: The Code of Professional Conduct

**Objectives:** After completing this chapter, you will be able to:

- List the six guiding principles in the AICPA Code of Professional Conduct.
- Explain the difference between the principles and the rules.
- Discuss how to apply the rules to specific actions common to the CPA community.

The Code of Professional Conduct provides guidelines for accounting practitioners in the conduct of their professional affairs. A member of the AICPA must observe all the Rules of Conduct unless an exception applies. The need to observe the Rules of Conduct also extends to individuals who carry out tasks on behalf of an AICPA member. A member may be held responsible for a violation of the rules committed by fellow partners, shareholders, or any other person associated with him who is engaged in the practice of public accounting. The bylaws of the AICPA provide the basis for determining whether a member has violated the Rules of Conduct. If a member is found guilty of a violation, he or she may be admonished, suspended or expelled.

A member of the AICPA also must be aware of Interpretations of the AICPA Rules of Conduct. After public exposure, Interpretations of the AICPA Rules of Conduct are published by the Executive Committee of the Professional Ethics Division. Interpretations are not intended to limit the scope or application of the Rules of Conduct. A member of the AICPA who departs from the guidelines provided in the Interpretations has the burden of justifying such departure.

**Question:** Why do I care about the AICPA rules if I am not a member of the AICPA?

**Answer:** Most states pattern their rules after the AICPA. In addition, when courts look at professional negligence, they will look to national standards such as the AICPA Code of Professional Conduct.

**OBSERVATION:** In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board (PCAOB), 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 AICPA.
AICPA ETHICS PYRAMID

A) Principles
The six principles of the Code of Professional Conduct provide the conceptual framework for the code. They are the cornerstone of ethical behavior.

B) Rules
The rules of the Code of Professional Conduct are more specific than the six principles. Members must observe the rules.

C) Interpretations
Interpretations are issued by the AICPA to better explain the Code of Professional Conduct. Only the principles and rules are considered part of the Code of Professional Conduct. Interpretations explain the code but are not part of it.

D) Rulings
The rulings apply the rules of conduct and interpretations to particular circumstances. AICPA members who depart from such rulings must justify their departures.

E) Your Behavior
The code, interpretations and rulings are meaningless if they do not impact your behavior. For this reason, your behavior is at the top of the pyramid.

PRINCIPLES

The Principles of the Code of Professional Conduct:

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

III. Integrity

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

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.

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.

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.

These principles establish the basis for characterizing the responsibilities the CPA has to clients, colleagues and the public at large. The fundamental theme of the six principles is to be committed to honorable behavior, even at the sacrifice of personal advantage.

RULES

The following definitions are used in the Rules of the Code of Professional Conduct:

*Practice of public accounting* - The practice of 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 Council.

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.
Below is a listing of the applicable rules followed by a discussion of each rule:

Rule 101  Independence
Rule 102  Integrity and Objectivity
Rule 201  General Standards
Rule 202  Compliance with Standards
Rule 203  Accounting Principles
Rule 301  Confidential Client Information
Rule 302  Contingent Fees
Rule 501  Acts Discreditable
Rule 502  Advertising and Other Forms of Solicitation
Rule 503  Commissions and Referral Fees
Rule 505  Form of Organization and Name

Rule 101 - Independence

A member in public practice shall be independent in the performance of professional services as required by the standards promulgated by bodies designated by Council.

*Independence* is a highly subjective term because it concerns an individual’s ability to act with integrity and objectivity. Integrity relates to an auditor’s honesty, while objectivity is the ability to be neutral during the conduct of the engagement and the preparation of the auditor’s report. Two facets of independence are independence in fact and independence in appearance. The second general standard of generally accepted auditing standards requires that an auditor be independent in mental attitude in all matters relating to the engagement. In essence, the second standard embraces the concept of independence in fact. However, independence in fact is impossible to measure, since it is a mental attitude; the Code of Professional Conduct takes a more pragmatic approach to the concept of independence.

Rule 101 is applicable to all professional services provided by a CPA that require independence.

*Observation:* A CPA may conduct a compilation engagement when he or she is not independent, but the compilation report must be modified to disclose the lack of independence.

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.
Rule 102 is very broad on purpose. The Code of Professional Conduct could not possibly proscribe every action that is to be avoided. Thus, Rule 102 could cover a variety of misconduct.

**Rule 201 - General Standards**

A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council.

**A. Professional Competence.** Undertake only those professional services that the member or the member’s 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.

In general, these standards are applicable to all professional services rendered by an accounting firm. For example, an accountant who performs a consulting services engagement must properly plan and supervise the job (ET 201.01).

Rule 201 requires that a firm have a certain level of expertise before an audit, tax, or consulting engagement is accepted. This does not suggest that an accounting firm must have complete knowledge in an area before the engagement is accepted -- a lack of competence is not apparent just because an accounting firm accepts a client knowing that additional research may be necessary to complete the job.

**Rule 202 - Compliance with Standards**

A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council.

Rule 202 requires members to observe technical standards promulgated by bodies designated by the AICPA Council. To date, the bodies designated by the Council are the Auditing Standards Board (ASB), Accounting and Review Services Committee (ARSC), Management Consulting Services Executive Committee (MCSEC), and Tax Executive Committee.

**OBSERVATION:** The Code of Professional Conduct does not refer to Audit and Accounting Guides that may be issued by a committee or task force established by the AICPA. Although each Audit Guide contains a preamble that states that a Guide does not have the authority of a pronouncement by the ASB, it does note that a member may be called upon to justify departures from the Guide if the member’s work is challenged.
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 bodies designated by Council to establish such principles that have 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.

**OBSERVATION:** The AICPA Council has designated the FASB, GASB, IASB, PCAOB, and FASAB as bodies to promulgate accounting principles. In addition, several AICPA committees have been designated to promulgate standards in their respective subject areas.

Rule 203 also provides flexibility in the application of accounting principles.

When the auditor concludes that a written accounting rule should not be followed, the auditor’s standard report must be expanded to include an explanatory paragraph. The explanatory paragraph would describe the nature of the departure; however, the opinion expressed would be an unqualified opinion and no reference to the explanatory paragraph would be made in the opinion paragraph.

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 the 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 division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

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.
NOTE: An auditor should have access to a variety of information held by the client if the engagement is to be successful. The client will grant the auditor access to sensitive files and reports only if it can expect the auditor to hold the information in confidence. The purpose of Rule 301 is to encourage a free flow of information from the client to the CPA; however, the rule makes it clear that the principle of confidentiality is not absolute. The confidentiality concept does not allow the client to omit information that is required by generally accepted accounting principles.

Rule 301 recognizes the confidentiality of client information, but makes it clear that the information does not constitute privileged communication. In most states, and most federal courts, the CPA can be forced to testify in a case involving the client. Thus, the rule recognizes that an auditor must respond to a subpoena or summons.

In recent years, the concept of peer review has been accepted by the profession. Rule 301 allows a peer or quality review of a CPA’s professional practice as part of an AICPA or state society of CPAs program.

Finally, Rule 301 states that it is not a violation of confidentiality when a member initiates a complaint with or responds to inquiries from a recognized investigative or disciplinary body such as the AICPA’s Professional Ethics Division or Trial Board.

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**Your Laptop: Physical Security, Data Protection, and Tracking/Recovery**

The theft of laptop computers and the sensitive data they contain is a growing problem for CPAs – in one week, three CPAs contacted the Board regarding the theft of laptops from their firms.

There are three major aspects to laptop security – physical security, data protection, and tracking/recovery.

One of the first things to do after purchasing a laptop is to make a copy of the purchase receipt, serial number, and description of the laptop and keep that information in a location separate from the laptop. This information will be invaluable if the laptop is lost or stolen.

In addition, asset tag or engrave the laptop. Engraving your firm name and phone number or address may increase the likelihood of getting the laptop returned if it is stolen and recovered. Tamper-proof asset tags may serve as a deterrent to a thief who must choose between stealing an unmarked laptop or a marked laptop. Why? Asset tags are difficult to remove and may hamper the thief’s ability to sell the laptop on the open market.

Industry experts estimate that one in eight laptops is at risk of theft. With such a daunting statistic, laptop users may feel resigned to being the victim of theft. However, one of the cheapest and most cost-effective solutions to deter the theft of a laptop is to attach a security cable (similar to the locks used on bicycles) to the laptop.
With cable locks, a steel clip provided by the manufacturer is installed in a security slot on the back or side of the laptop and a steel cable is threaded through the clip and wrapped around a heavy object such as a desk leg or support pole. The two ends of the cable are then secured with a locking device. If the laptop does not contain a security slot or if the desk does not provide a location for suitable anchorage, special adhesive pads containing an anchorage slot are available. Although cable locks are not infallible, they will at least make the thief work a little harder to get the laptop.

Another effective method of protecting a laptop is to use a laptop safe. An advantage of a laptop safe is that when the laptop is locked in a safe, the PC cards and peripherals are secure, a protection that is not available with cable locks.

The two main types of safes available are portable safes that can safely attach to most work surfaces and car safes which are designed to protect valuables while they are stored in the trunk of a vehicle. (NOTE: Never leave a laptop in plain sight in a vehicle; doing so is inviting a thief to break in the vehicle and take the laptop.)

Whereas cable locks and safes are designed to stop (or at least slow down) an opportunistic thief, alarms and motion detectors are intended to make the potential robber so conspicuous that he or she aborts the crime.

Products range from simple motion detectors to sensors that detect the unplugging of cables. Some products are designed to lock down the laptop if it is moved out of a designated range. Other products rely on nothing more than movement of the object to which it is attached; if the laptop to which the sensor is attached is moved, an alarm will sound.

Let’s assume that, despite taking the appropriate physical security measures, your laptop has been stolen. How worried would you be about the security of the data on the machine?

Safeguarding data when it is in unauthorized hands is a matter of controlling access and encrypting data. If the first thing a thief sees when turning on a laptop is, “please enter boot password,” he or she knows that it will take some effort to access the information on the machine.

Many machines allow the owner to set a boot password and a user will be prompted three times to enter the correct password. If there are three password failures, the machine will refuse to boot. However, if the machine is restarted, the user will have three more chances to enter the right password.

Removing a password-protected BIOS (basic input output system) and boot sequence typically involves physically opening the computer and removing the CMOS (complementary metal oxide semiconductor) battery (which may clear the BIOS information) or shorting some jumpers to reset the BIOS to a default state.

If you are running an operating system that supports proper logins (Windows NT/2000/XP or Linux), setting a password is not only a good idea, it is required. To successfully login to the computer, the user must provide a login name and password. If the information entered is incorrect, the operating system will refuse to allow the user to become an active user.
When creating a password, make sure you create a strong password. For a password to be considered strong, it must be eight or more characters (14 characters or longer is ideal); it must combine letters, numbers, and symbols; it must use a mix of uppercase letters and lowercase letters; and it should use words and phrases that are easy for you to remember, but difficult for others to guess. (NOTE: Avoid using your login name, your name, your birthday, anniversary, social security number, telephone number, etc., as part of your password.) Don’t forget to change your passwords on a regular basis.

Although applying strong passwords to your laptop will make it more difficult for a casual thief to log in as “you,” and therefore gain access to the information on your machine, passwords should not be relied upon as the sole piece of security on a laptop.

Even if an unauthorized user gains access to your laptop, encryption will protect the information stored on your machine. When you encrypt a file or folder, you are converting it to a format that can’t be read by another user. When a file or folder is encrypted, an encryption key is added to the files or folder that you selected to encrypt and the key is needed to read the file.

Although Microsoft provides a form of encryption through Windows Encrypted File Service (EFS), that encryption is keyed to your user login. If the intruder is able to login as “you,” he or she has access to your data even if it is encrypted with EFS.

Therefore, most firms who go this route will seek a third-party product which relies on encryption techniques above and beyond the Windows operating system.

CPAs using encryption technology need assurances that application databases such as tax, audit automation, and time and billing will operate correctly from encrypted disks or folders. The major software vendors test their products under a variety of scenarios and will be able to advise their customers of encryption solutions which are fully compatible with their products.

While encryption will protect the sensitive information on your laptop, it does nothing to retrieve the data on a lost or stolen machine. To do that, you must back up your files and store them in a secure location. Ideally, files should be backed up on a network server, but if that is not possible, there are other options.

External drives, flash drives, zip drives, and CDs are excellent choices for backing up your files. You can even use your digital music player to back up your data; these players don’t just copy music files, they can copy any data. Players are easily hooked up to a laptop through the USB port and have up to 20-gigabyte hard drives.

While encryption strategies will help safeguard the data on a lost or stolen notebook computer, they do nothing to help recover the missing machine – the FBI estimates that just 3% of stolen or lost laptops are recovered.

Until recently, luck was the determining factor in recovering a lost or stolen machine, but new technology is providing users with the ability to track stolen or lost laptops.
With tracking programs, once a computer is reported lost or stolen, the tracking company will wait for the laptop to send a location signal (sent whenever the machine is connected to the Internet). When a signal is retrieved, the program will be instructed to broadcast as much information as it can about the current connection (originating phone number, IP address, service provider, etc.). When enough information has been collected, the tracking company will notify the appropriate law enforcement agency which may be able to recover the machine.

Other programs provide the user with the ability to execute commands remotely to the missing machine (if connected to the Internet), theoretically allowing the user to delete all of the important information on the hard drive.

If you haven’t yet experienced the loss of a computer full of sensitive and confidential data, you are living on borrowed time. Plan ahead now to minimize the risk, reduce your exposure, and enhance your chances of recovery. Manage your risks through proactive strategies. Develop a security policy and implement it.

This is not an issue you can address once and have solved forever. Threats will change, risks will change, and requirements will change. Be sure your plans, your people, and your processes change along with them. Conduct periodic training updates, ensure software is kept up to date with the latest versions, and keep your emergency reaction checklists current.
Practice Pointer:  
The Ethics of Outsourcing Client Tax Returns

Business process outsourcing – contracting business processes to outside service vendors – is not a new concept, and the accounting industry has long taken advantage of the benefits of outsourcing. However, a growing trend among CPA firms is causing concern among regulators.

A number of CPA firms, both multi-state and local, have begun using the burgeoning outsourcing and technology markets in India to process client tax returns. Although the AICPA Code and Rules do not expressly prohibit the practice of outsourcing the preparation of client tax returns, there are several rules a CPA must consider when outsourcing services.

One prime concern is maintaining the confidentiality of client records. Pursuant to Rule 301, a CPA shall not disclose any confidential information except with the consent of the client.

To process the tax return, the preparer must have sensitive client information such as the client’s Social Security Number, date of birth, bank and brokerage statements, credit card information, salary, etc. In short, much of the information can be used to perpetrate identity theft.

If your CPA firm has professional liability insurance coverage, you should check with your insurance carrier to see if your policy covers the firm when using an outsource center.

The accuracy of the tax return remains the ultimate responsibility of the CPA firm, and all returns prepared by an outsource center must be reviewed by the CPA firm and the signing CPA.

If your CPA firm is considering outsourcing the preparation of client tax returns, remember that a CPA is responsible for ensuring that any partner, shareholder, officer, director, unlicensed principal, proprietor, employee or agent, including outsource personnel, comply with the AICPAs rules on Professional Ethics and Conduct. In 2004, the AICPA adopted revised ethics rulings to address these concerns.

In addition, the IRS and most states impose criminal and civil penalties for the unauthorized disclosure of tax return data.
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 the 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 on the complexity of services rendered.

NOTE: For example, charging a new client $500 for completing a tax return when a similar continuing client is charged only $300 for a similar tax return is permitted, since a first year engagement is more difficult than a repeat engagement.

The accounting profession has had a long-standing tradition that a contingent fee would infringe on the CPA’s ability to be independent. A contingent fee is based on an arrangement whereby the client is not required to pay the CPA unless a specified finding or result is attained. For example, a contingent fee arrangement would exist if the auditor’s fee is dependent on the net proceeds of a public stock offering. Engagement fees should be determined by such factors as the number of hours required to perform the engagement, the type of personnel needed for the engagement, and the complexity of the engagement.

Fees are not considered to be contingent if they are determined (1) by courts or other public authorities or (2) by judicial proceedings or governmental agencies in the case of tax matters.
Before 1991, Rule 302 prohibited contingent fees for all professional engagements (with the exception of certain fees fixed by the judicial or quasi-judicial process). In 1985, The Federal Trade Commission (FTC) challenged the position of the profession concerning contingent fees on the basis of restraint of trade. After prolonged negotiations between the AICPA and the FTC, Rule 301 (as reproduced above) was issued to modify the prior prohibition against contingent fees.

Rule 302 prohibits contingent fees for all additional professional services when the CPA has performed an attestation engagement, which includes audits, reviews, and examinations of prospective financial information. Also, the CPA may not perform any services for a client on a contingent fee basis when the CPA has performed a compilation engagement if the compilation report is expected to be used by a third party and does not disclose that the CPA is not independent with respect to the client.

The period of prohibition includes the date covered by the financial statements and the period during which the attestation service (and compilation service, as described above) is performed. For example, if the CPA is auditing a client’s financial statements for the year ended December 31, 2010, and the date of the auditor’s report is March 12, 2011, no services could be performed on a contingent fee basis by the auditor for the period from January 1, 2010, through March 12, 2011.

Rule 302 also prohibits the CPA from charging a contingent fee to prepare an original or amended tax return or claim for a refund. While independence is not an issue in performing tax services, the AICPA takes the position that it would be unprofessional to charge a fee, for example, based on the amount of refund that may be claimed on the tax return.

**Rule 501 - Acts Discreditable**

A member shall not commit an act discreditable to the profession.

**NOTE:** Rule 501 is very broad. It is basic to ethical conduct, and only through its observance can the profession expect to win the confidence of the public. What constitutes a discreditable act is highly judgmental. There has been no attempt to be specific about what constitutes a discreditable act; however, the AICPA bylaws (Section 7.3) state that the following actions will lead to membership suspension or termination, without the need for a disciplinary hearing:

- If a member commits a crime punishable by imprisonment for more than one year.
- If a member willfully fails to file an income tax return that he or she, as an individual taxpayer, is required by law to file.
- If a member files a false or fraudulent income tax return on his or her behalf, or on a client’s behalf.
- If a member willfully aids in the preparation and presentation of a false and fraudulent income tax return of a client.
- If a member’s certificate as a certified public accountant, or license or permit to practice as such, is revoked by a governmental authority as a disciplinary measure.
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.

**OBSERVATION:** Members who are not in public practice are exempt from much of Rule 502.

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 services.

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 disclose 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.

**NOTE:** A CPA cannot receive a commission for recommending a client’s product or services if the CPA audits or reviews that client’s financial statements or examines that client’s prospective financial information. In addition, no commissions can be received when the CPA compiles a client’s financial statements if the CPA believes that a third party will rely on the statements, unless any lack of independence is disclosed in the compilation report.
**OBSERVATION:** When a CPA sells products that the CPA has title to directly to clients, this is not considered a commission. However, care should be exercised to ensure that the arrangement does not violate Rule 101 (Independence).

**OBSERVATION:** As with contingent fees, the most important point for CPAs in public practice to remember is that the Boards of Accountancy may continue to prohibit commissions. Change is coming. However, the practitioner should not violate the law in anticipation of change.

**OBSERVATION:** The rule has never prohibited calculating the price to be paid for the purchase of an accounting practice as a percentage of fees the purchaser receives from these new clients over some specified period of time such as one, two, three or more years. The AICPA Ethics Executive Committee has stated that the rule does not prohibit the purchase of a portion of a practice (such as the tax practice related to individual returns) or even the purchase of a single client. Further, the purchase may be made through a non-CPA broker who will receive a portion of the purchase price. The rule also does not prohibit the payment of bonuses to employees even though practice development efforts on the part of the employee are a factor in determining the amount of the bonus.

**Rule 504 - Incompatible Occupations (Withdrawn)**

The concept of incompatible occupations is covered by Rule 101 (Independence).

**Rule 505 - Form of Organization and Name**

A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.

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.

**NOTE:** Also, an owner surviving the death or withdrawal of all other owners may continue to practice under a name which includes the name of past owners for up to two years after becoming a sole practitioner.

A firm may not designate itself as “Members of the American Institute of Certified Public Accountants” unless all of its CPA owners are members of the Institute.

**NOTE:** Over the past several decades, the character of the practice of accounting has broadened to include a variety of activities that are beyond the scope of accounting. These activities include, among others, environmental auditing, executive recruitment, and the design of sophisticated computer systems that are not part of the client’s accounting system. With the expansion of the types of services provided by accounting firms, there is an obvious need to recruit personnel who do not have an accounting/auditing background. For many accounting firms, these nontraditional professionals are increasingly important to their growth and development. However, because of the rules adopted by the AICPA, a nontraditional professional, no matter how competent or important to the firm, could not be an owner of the firm. These rules changed about ten years ago, and the updated rules follow.
Non CPA Ownership of CPA Firms

The AICPA allows a CPA firm to be owned by non-CPAs if the form of ownership is sanctioned by the particular state and if the following guidelines are observed:

- Fifty-one percent of the ownership (as measured by financial interest and voting rights) must be held by CPAs.
- A non-CPA owner must be actively engaged in providing services to clients of the firm.
- A CPA must be ultimately responsible for all services provided by the firm that involve financial statement attestation, compilation services, and “other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services.”
- A non-CPA may not hold him or herself out as a CPA, but may be referred to as a(n) principal, owner, officer, member, shareholder or other title allowed by state law.

While the resolution allows for accounting firm ownership by non-CPAs, those individuals are not eligible for membership in the AICPA.

**OBSERVATION:** Each state is responsible for determining what forms of ownership may be used to practice public accounting; however, the AICPA notes that a practitioner can practice only in a business organization form that conforms to resolutions of the AICPA Council.
CHAPTER 4 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. The fundamental theme of the six principles of the Code of Professional Conduct is:

   a) to be committed to honorable behavior  
   b) to sacrifice personal advantage  
   c) to be committed to honorable behavior, even at the sacrifice of personal advantage  
   d) to make the most money possible in the shortest possible time without violating any laws or standards of decency

2. Which of the following is true regarding Rule 102 – Integrity and Objectivity:

   a) Rule 102 is very broad on purpose  
   b) Rule 102 provides a “safe harbor” against allegations of possible violations provided a CPA is following the orders of one’s boss or another superior  
   c) Rule 102 provides a very long list of prohibited actions, but the list does not include every possible instance of possible violations  
   d) Rule 102 only applies to CPAs doing attest engagements

3. AICPA Rule 201 requires that a CPA be competent. Nash, CPA seeks to provide services to a new client in an industry that he has not previously served. Which of the following is true regarding Nash, CPA providing services to this client:

   a) Rule 201 requires that Nash, CPA have sufficient professional competence prior to accepting any engagement  
   b) Rule 201 would not apply in this case since Nash is a CPA. Rule 201 only applies to non-CPA subordinates  
   c) Rule 201 allows Nash, CPA to accept the engagement as long as it can be completed competently  
   d) Rule 201 would require Nash, CPA to engage the services of an expert in that industry prior to accepting the engagement but would not require that Nash, CPA be competent in that area
CHAPTER 4 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Being committed to honorable behavior is only a part of the fundamental theme.
   B: Incorrect. Personal sacrifice is only a part of the fundamental theme.
   C: Correct. Both honorable behavior and personal sacrifice together comprise the fundamental theme.
   D: Incorrect. Making money is not part of the fundamental theme.
   (See the discussion of the Six Principles in the course material.)

2. A: Correct. The AICPA Code of Professional Conduct could not possibly list every possible violation.
   B: Incorrect. Rule 102 specifies that a CPA must not subordinate his or her judgment to others. There is no “safe harbor."
   C: Incorrect. The AICPA Code of Professional Conduct could not possibly list every possible violation and therefore does not even begin to list possible violations.
   D: Incorrect. Rule 102 applies to all CPAs. CPAs in industry must not subordinate their judgment to others.
   (See Rule 102 in the course material.)

3. A: Incorrect. A CPA should undertake only those engagements that the firm reasonably expects can be completed competently. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate.
   B: Incorrect. Rule 201 clearly applies to all CPAs.
   C: Correct. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate.
   D: Incorrect. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate. Nash, CPA is ultimately responsible to ensure that competence is attained.
   (See Rule 201 in the course material.)
Chapter 5: Understanding the Code of Professional Conduct

Objectives: After completing this chapter, you will be able to:

- Discuss how rule interpretations apply to the rules themselves.
- Discuss the interpretations as they apply to your practice as a CPA.
- Discuss how you would apply the interpretations in a variety of specific circumstances.
- Describe the difference between principles, rules, and interpretations.

Introduction

The previous chapter outlined the Code of Professional Conduct as set forth by the AICPA. This chapter will assist in applying these Codes to the accounting profession. The Interpretations detailed in this chapter are issued by the AICPA to better explain the Code of Professional Conduct. This material should help illustrate how the codes relate to professional responsibility. The term “covered member” is used throughout the Interpretations. Since all states require a CPA to follow AICPA regulations (or state regulations that are similar), covered member in essence refers to all CPAs, as well as non-CPA owners of CPA firms.

Independence, Integrity, Objectivity

- Independence encompasses an impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to those who may otherwise use the CPA’s report. The CPA must be free from any obligation to or interest in the client, its management, or its owners.

- Integrity requires the CPA to be honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. A CPA has a dual responsibility – to the public and to the client.

- Objectivity is a state of mind and a quality that lends value to a CPA’s services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

AICPA Interpretations of Rules 101 and 102

RULE 101 - INDEPENDENCE

Interpretation 101-1 (Interpretation of Rule 101) Whereas Rule 101 establishes the broad principle that a CPA must be independent (independence in fact), this Interpretation provides more specific guidelines concerning the types of relationships that a CPA should avoid. Independence is considered to be impaired if:

A. During the period of a 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, or 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 five 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 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.

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 101-1C;
   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 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 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.

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1 See Ethics Ruling No. 107, “Participation in Health and Welfare Plan of Client,” for instances in which participation was the result of permitted employment of the individual’s spouse or spousal equivalent.

2 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.
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.

Q: A potential audit client is owned by the CPA’s stepbrother. Would the CPA be independent with regard to the potential client? What if the CPA is closer to the stepbrother than to his own brother?

A: A stepbrother is not considered a close relative under the independence rules and normally would not impair independence. However, if the relationship between the CPA and stepbrother was close enough to lead a reasonable person, aware of all the facts, to conclude that the situation poses an unacceptable threat to the appearance of independence and the CPA’s objectivity, then the relationship would impair independence.

Grandfathered Employment Relationships

Employment relationships of a covered member’s immediate family and close relatives with an existing attest client that impair independence under the interpretation and that existed as of November 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. In the absence of an independence interpretation or ruling under Rule 101 that addresses a particular circumstance, a member should evaluate whether that circumstance 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. When making that evaluation, members should refer to the risk-
based approach described in the Conceptual Framework for AICPA Independence Standards. If the threats to independence are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented.  

**Interpretation 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.

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3 A failure to prepare the required documentation would be considered a violation of Rule 202, **Compliance With Standards**, of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee.]
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\(^4\) or to the client company\(^5\) 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\(^6\) 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.

\(^4\) 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.

\(^5\) 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.

\(^6\) 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.
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\(^7\) 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.

\(^7\) 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.
RULE 102 – INTEGRITY AND OBJECTIVITY

OBSERVATION: It would be impractical to define all situations that would lead to an impairment of objectivity or integrity. Integrity is difficult to judge because any particular fault by omission or commission may be the result of either honest error or lack of integrity.

Interpretation 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

Interpretation 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 (PFP) 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 PFP 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 PFP 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 PFP or tax client to an insurance broker or other service provider, which 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.

Q: A CPA firm represents two clients. The clients have adverse interests in a controversy involving a limited partnership of which each client owns a percentage. Can the CPA continue to advise both clients? The work the CPA performs does not require independence.

A: The CPA would have a conflict of interest. If the relationships are disclosed to and consent is obtained from all appropriate parties, the CPA could continue to advise both parties. However, the CPA would have to observe Rule 301: Confidential Client Information.

Interpretation 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.

Interpretation 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:

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.

**OBSERVATION:** In an audit engagement, guidance established by SAS No. 108 (Planning and Supervision) with respect to the subordination of judgment should be observed.

Q: Cindy Steffen is a CPA and the controller of Company X Inc. In preparing the financial statements for the quarter ended March 31, 2011, Steffen proposes to reduce obsolete inventory to net realizable value. The obsolete items represent a significant amount of total inventory. The CFO concurs with Steffen’s position. However, he decides not to go against the CEO whose position is that reducing the inventory this quarter is a discretionary decision and the CEO would prefer to record any such reduction at year end, after Company X completes its anticipated public offering of stock later this year. What are the ethical obligations of Steffen’s in this situation?

A: To avoid subordinating her judgment, Steffen should first determine whether the inventory writedown is material. If so, she should restate her concerns to the CFO and CEO and, if the latter persists in not supporting the writedown, Steffen should bring the matter to the attention of the audit committee of the board of directors. She should document the understanding of the facts, the accounting principles involved, the application of the principles to the facts, and the parties with whom discussions were held. Steffen should consider any responsibility that may exist to go outside the company, although legal counsel should be sought on this matter.

Interpretation 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 ET section 92.11 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.
**Interpretation 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 client 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.

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**AICPA Interpretations of Rules 201 and 203**

**RULE 201 – GENERAL STANDARDS**

**Interpretation 201-1 (Competence)** A member's agreement to perform professional services implies that the member has the necessary competence to complete those professional services according to professional standards, applying his or her knowledge and skill with reasonable care and diligence, but the member does not assume a responsibility for infallibility of knowledge or judgment.

Competence to perform professional services involves both the technical qualifications of the member and the member's staff and the 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 the services in accordance with professional standards prior to performance. In some cases, however, additional research or consultation with others may be necessary during the performance of the professional services. This does not ordinarily represent a lack of competence, but rather is a normal part of the performance of professional services.
However, if a member is unable to gain sufficient competence through these means, the member should suggest, in fairness to the client and the public, the engagement of someone competent to perform the needed professional service, either independently or as an associate.

**OBSERVATION:** If a CPA is unable to obtain sufficient technical knowledge, he should refer the engagement to someone competent to perform the needed services.

**Case Study**

**Competency, Auditing Standards and Other Professional Standards**

Licensee was subject to a Quality Assurance Review by the U.S. Department of Housing and Urban Development, Real Estate Assessment Center (HUD). This review included licensee’s audit work for two county housing authorities. The opinion issued by HUD found that the licensee did not comply with all applicable audit standards while performing audits of HUD assisted properties. Documentation for the audit work was not of sufficient standard.

**LIKELY DISCIPLINARY ACTION:** Violation of Rule 201 – General Standards.

**RULE 203 – ACCOUNTING PRINCIPLES**

**Interpretation 203-1 (Departures from Established Accounting Principles)** Rule 203 was adopted to require compliance with accounting principles promulgated by the body designated by Council 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 men 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.
Interpretation 203-2 (Status of FASB, GASB and FASAB Interpretations) Council is authorized under Rule 203 to designate bodies to establish accounting principles. Council 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. Council 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. Council 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 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 division of professional ethics will construe such Statements, Bulletin or Opinion in the light of any interpretations thereof issued by the FASB or the GASB.

Interpretation 203-4 (Responsibility of Employees for 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 Council to establish such principles that has a material effect on the statements or data taken as a whole.

Rule 203 applies to all members with respect to any affirmation that financial statements or other financial data are presented in conformity with GAAP. Representation regarding GAAP conformity included in a letter or other communication from a client entity to its auditor or others related to that entity's financial statements is subject to Rule 203 and may be considered an affirmative statement within the meaning of the rule with respect to members who signed the letter or other communication; for example, signing reports to regulatory authorities, creditors and auditors.

_AICPA Interpretations of Rules 301 and 302_

RULE 301 – CONFIDENTIAL CLIENT INFORMATION

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

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.

Q: The IRS requested that a CPA provide copies of documents relating to a prior client of the CPA. The CPA is not able to locate the client to obtain permission to release the documents. Should the CPA turn the information over to the IRS?

A: No. A CPA cannot release confidential client information without the specific consent of the client unless the CPA receives a validly issued and enforceable subpoena or summons. Information obtained by a licensee can be disclosed in response to an official inquiry from a federal or state government regulatory agency. However, the IRS is considered to be a taxing agency and not a government regulatory agency.

RULE 302 – CONTINGENT FEES

Interpretation 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:

- 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.

Q: A CPA offers a new client a free one-hour consultation or a 10 percent discount on tax return preparation. Is this acceptable?

A: Yes. These are not prohibited transactions.

**OBSERVATION:** There are currently no rules in the 400 series.

**AICPA Interpretations of Rules 501, 502 and 505**

**RULE 501 – ACTS DISCREDITABLE**

**Interpretation 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 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:\(^8\)

• **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.

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\(^8\) 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.
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.

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;⁹ 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.

**Interpretation 501-2 (Discrimination 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.

**OBSERVATION:** These acts are also a violation of federal and state law.

**Interpretation 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 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 report the fact that such requirements were not followed and the reasons therefore.

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⁹ The member is not required to convert records that are not in 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.
Interpretation 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.

Interpretation 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, such as the Public Company Accounting Oversight Board, 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.

Case Study
Acts Discreditable
According to the Department of Labor, most SIMPLE IRA plans are also subject to Title I of ERISA. Under the Department of Labor regulations at 29 CFR 2510.3-102, salary reduction contributions to these plans must be made to the SIMPLE IRA as of the earliest date on which the contributions can reasonably be segregated from the employer’s general assets, but in no event later than the 30-day deadline described above.

A CPA firm was required to make contributions to the financial institution that managed the CPA firm’s employee SIMPLE IRA plan no later than the close of the 30 day period following the last day of the month in which amounts would otherwise have been payable to the employee in cash. The CPA firm informed employees that SIMPLE IRA funds would not be deposited by the date required. For a period of two years, the CPA firm did not make timely contributions to the financial institution managing the SIMPLE IRA plan. When the CPA firm deposited the funds, the CPA firm also deposited interest into each employee’s SIMPLE IRA plan.
Interpretation 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 question(s) and/or answer(s) without the written authorization of the AICPA shall be considered to have committed an act discreditable to the profession in violation of Rule 501.

**OBSERVATION:** Prior to May 1996, exam questions were released after each exam. Accordingly, the prohibition does not apply to exam review courses utilizing pre-1996 exam questions.

Interpretation 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.

Interpretation 501-8 (Failure to Follow Requirements of Governmental Bodies, Commissions, or Other Regulatory Agencies on Indemnification and Limitation of Liability Provisions in Connection With Audit and Other Attest Services) Certain governmental bodies, commissions, or other regulatory agencies (collectively, regulators) have established requirements through laws, regulations, or published interpretations that prohibit entities subject to their regulation (regulated entity) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators or that provide that the existence of such provisions causes a member to be disqualified from providing such services to these entities. For example, federal banking regulators, state insurance commissions, and the Securities and Exchange Commission have established such requirements.

If a member enters into, or directs or knowingly permits another individual to enter into, a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the member should not include, or knowingly permit or direct another individual to include, an indemnification or limitation of liability provision that would cause the regulated entity or a member to be in violation of such requirements or that would cause a member to be disqualified from providing such services to the regulated entity. A member who enters into, or directs or knowingly permits another individual to enter into, such an agreement for the performance of audit or other attest services that would cause the regulated entity or a member to be in violation of such requirements, or that would cause a member to be disqualified from providing such services to the regulated entity, would be considered to have committed an act discreditable to the profession.

RULE 502 – ADVERTISING AND OTHER FORMS OF SOLICITATION

Interpretation 502-2 (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:

- Create false or unjustified expectations of favorable results
- Imply the ability to influence any court, tribunal, regulatory agency or similar body or official
- 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
- Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

Case Study

Public Communications and Advertising

Smith CPA LLC circulated an advertisement in a local newspaper that stated the following:

“Professional Service Warranty which guarantees you the largest refund possible with the lowest tax liability.”

The advertisement guaranteed the reader the largest refund possible with the lowest tax liability. The advertisement did not state or explain how the services could be verified to provide the largest refund or the lowest tax liability.

Interpretation 502-5 (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.
RULE 505 – FORM OF ORGANIZATION AND NAME

A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.

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 American Institute of Certified Public Accountants” unless all of its CPA owners are members of the Institute.

Firm Names

No firm title need name every owner. Such a requirement could become unworkable. The firm may use the names of all or some of the owners. Or the firm may follow the name of one or more owners with designations “Company”, “and Company”, or “associates.” Thus, the firm “Howard, Fine and Howard” could choose instead to describe itself (among other possibilities) as “The Mo Howard Company,” “Mo Howard and Company,” “Howard, Fine and Associates,” or “Fine, Howard and Company.”

The firm name is a valuable asset, protected by law; it represents the professional competence and reliability of each member of the firm, whether the member’s own name is included in the title or not. No wonder the firm is slow to change it – even when individual owners die, retire or strike out on their own.

Rule 505 acknowledges this concern for continuity:

Names of one or more past owners may be included in the firm name of a successor organization. Also, an owner surviving the death or withdrawal of all other owners may continue to practice under a name which includes the name of past owners for up to two years after becoming a sole proprietor.

Fictitious Names

The rules over the years have historically prohibited the use of fictitious names or names that indicated a specialty.

It was felt that the rule regarding firm name should be consistent with the rule on advertising. The only restriction now left on advertising is that it not be false, misleading or deceptive. Since a member may now advertise a specialty, there is no reason a firm name should not be allowed to do so if the false, misleading, or deceptive test is met.

Q: Three CPA firms wish to form an association – not a partnership – to be known as “Smith, Jones and Assoc.” Is there any impropriety in this?

A: The use of such a title is not permitted since it might mislead the public into thinking a true partnership exists. Instead, each firm is advised to use its own name on its letterhead, indicating the other two as correspondents.
Interpretation 505-1 Deleted.

Interpretation 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 Council. 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, its interpretations and rulings. 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.

Interpretation 505-3 (Application of Rule 505 to Alternative Practice Structures) Rule 505, Form of Organization and Name, states, “A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.” The Council Resolution requires, among other things, that a majority of the financial interests in a firm engaged in attest services (as defined therein) be owned by CPAs. In the context of alternative practice structures (APS) in which: 1) the majority of the financial interests in the attest firm is owned by CPAs; and 2) all or substantially all of the revenues are paid to another entity in return for services and the lease of employees, equipment, and office space, questions have arisen as to the applicability of Rule 505.

The overriding focus of the Resolution is that CPAs remain responsible, financially and otherwise, for the attest work performed to protect the public interest. The Resolution contains many requirements that were developed to ensure that responsibility. In addition to the provisions of the Resolution, other requirements of the Code of Professional Conduct and bylaws ensure that responsibility:
a. Compliance with all aspects of applicable state law or regulation.
b. Enrollment in an AICPA-approved practice monitoring program.
c. Membership in the SEC practice section if the attest work is for SEC clients (as defined by Council).
d. Compliance with the independence rules prescribed by Rule 101, Independence.
e. Compliance with applicable standards promulgated by Council-designated bodies (Rule 202, Compliance With Standards) and all other provisions of the Code, including, Applicability.

Taken in the context of all the above-mentioned safeguards of the public interest, if the CPAs who own the attest firm remain financially responsible, under applicable law or regulation, the member is considered to be in compliance with the financial interests provision of the Resolution.
CHAPTER 5 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. A potential audit client is owned by the CPA’s stepsister. Which of the following is true regarding Rule 101 (independence):
   a) a stepsister is considered a close relative and would impair independence
   b) a stepsister is not considered a relative and would never impair independence
   c) if the CPA’s relationship to the stepsister is very close, independence may be impaired
   d) none of the above

2. A CPA represents two clients. The clients have adverse interest involving a limited partnership of which both clients own a percentage. Which of the following is true regarding Rule 102:
   a) the CPA lacks independence and may not do any work for either of the clients
   b) the CPA lacks independence and must cease working for one of the clients
   c) although the CPA has a conflict of interest, he may continue working for both clients provided: 1) the work performed does not require independence, and 2) the relationships are disclosed to and consent is obtained from all appropriate parties
   d) none of the above

Use the following fact pattern for the next 4 questions

Jim Smith, CPA (Smith) prepares tax returns for a large number of clients. Smith has prepared the Form 1040 and Schedule C for Joe Jones for the last ten years. Joe Jones (Jones) keeps no business records except for a profit/loss summary that Jones’s wife prepares using Quicken. Smith has always calculated depreciation and made all other tax related adjustments to Jones’s Quicken report to prepare Jones’s Form 1040. Jones provides all the necessary documents to Smith and asks Smith to prepare Jones’s current year tax return. Smith prepares Jones’s current year tax return even though Jones still owes Smith fees for preparing last year’s tax return as well as year-end tax planning. Jones has not communicated any reason why he has not paid the past due fees, and Smith has not discussed the unpaid fee issue with Jones. Smith does not use any type of client engagement letter since he only prepares tax returns.
3. Assume that Smith demands payment of all past due fees as well as payment for the current year tax return preparation prior to releasing the tax return to Jones. Which of the following is true regarding releasing the current year tax return to Jones under AICPA rules:

   a) the AICPA does not have any rules relating to releasing client records
   b) Smith must release the current year tax return regardless of the status of unpaid fees
   c) Smith may withhold releasing the current year tax return pending the payment of past due fees but may not demand payment of current year fees prior to issuing the tax return
   d) Smith may withhold releasing the current year tax return until all current and past due fees are paid

4. Jones refuses to pay any of the current or past due fees and demands a copy of all of Smith’s workpapers as well as the return of all documents provided to Smith. Which of the following is true under AICPA rules:

   a) Smith need not return any client records nor supply copies of any workpapers
   b) Smith must return any client supplied records but need not provide copies of any workpapers
   c) Smith must return any client supplied records and prior year depreciation records that are in Smith’s prior year workpapers but not contained in the prior year tax return
   d) Smith must return any client supplied records and copies of all workpapers

5. Jones decides to prepare his current year tax return himself. Jones does not have a copy of his prior year tax return, and a copy is not available from the IRS. Jones was due a small refund and never filed his prior year tax return and subsequently lost his copy. Jones demands that Smith provide a copy of Jones’s prior year tax return and the depreciation workpapers for the current year that Smith prepared for Jones’s current year tax return. Which of the following is true:

   a) Smith is not required to provide Jones a copy of the prior year tax return or the current year depreciation workpapers
   b) Smith must provide Jones a copy of the current year depreciation workpapers but not a copy of the prior year tax return
   c) Smith must provide Jones a copy of the prior year tax return but not the current year depreciation work papers
   d) Smith must provide Jones a copy of the prior year tax return and the current year depreciation workpapers

6. At this point, both Smith and Jones have spent numerous unproductive hours arguing over client records, releasing tax returns, and collecting payment. Jones has threatened to file a complaint against Smith with the AICPA. Smith has looked into filing a lawsuit in Small Claims Court against Jones. What could Smith and Jones have done to avoid this mess:

   a) probably nothing; problems like this occur in business and are simply a fact of life
   b) use an engagement letter to outline the obligations and expectations of both client and CPA
   c) communicated with each other before the problem arose
   d) both b and c would have helped
CHAPTER 5 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. A stepsister is not automatically considered a close relative.
   B: Incorrect. A stepsister could be a close relative.
   C: Correct. Independence is impaired only if the relationship is close.
   D: Incorrect. Independence may be impaired.
   (See Interpretation 101-1 in the course material.)

2. A: Incorrect. The clients have the adverse interest, not the CPA.
   B: Incorrect. A CPA may do work for two clients with adverse interests.
   C: Correct. The clients are better served by allowing the CPA to continue serving them both.
   D: Incorrect. The CPA has a conflict but may continue working for both clients.
   (See Interpretation 102-2 in the course material.)

3. A: Incorrect. The AICPA has extensive rules relating to CPA workpapers and the return of client records. In fact, failure to return client records is one of the most common complaints received by the AICPA ethics committee.
   B: Incorrect. Prior to being released, the completed tax return is considered to be part of the CPA’s workpapers and is the property of the CPA. Accordingly, the tax return need not be released to the client. The CPA may set the terms for releasing the tax return. Such terms may include receiving payment for some or all fees. The client has no right to demand the release of the return prior to paying fees as required by the CPA.
   C: Incorrect. Prior to being released, the completed tax return is considered to be part of the CPA’s workpapers and is the property of the CPA. Accordingly, the tax return need not be released to the client. The CPA may set the terms for releasing the tax return. Such terms may include receiving payment for some or all fees. The client has no right to pay only a portion of the fees and demand release of the tax return.
   D: Correct. Prior to being released, the completed tax return is considered to be part of the CPA’s workpapers and is the property of the CPA. Accordingly, the tax return need not be released to the client. The CPA may set the terms for releasing the tax return. Such terms may include receiving payment for some or all fees. A completed tax return is not considered to be client records until released to the client.
   (See Rule 501 and Interpretation 501-1 in the course material.)
4. A: Incorrect. Rule 501 requires the return of all client provided records upon request. Client provided records may not be withheld pending payment of current or prior engagement fees.

   B: Correct. Rule 501 requires the return of all client provided records upon request. Under Interpretation 501-1, CPA workpapers including CPA prepared client records may be withheld pending payment of fees related to that engagement. Note that some state laws require CPA prepared client records like depreciation records be released to the client regardless of the payment status.

   C: Incorrect. Rule 501 requires the return of all client provided records upon request. Under Interpretation 501-1, CPA workpapers including CPA prepared client records may be withheld pending payment of fees related to that engagement. Note that some state laws require CPA prepared client records like depreciation records be released to the client regardless of the payment status. Under AICPA rules, the CPA may withhold the depreciation schedules pending payment of the fees from the engagement to prepare those records, but may not withhold the depreciation records pending payment of fees from another engagement.

   D: Incorrect. Rule 501 requires the return of all client provided records upon request. Under Interpretation 501-1, CPA workpapers including CPA prepared client records may be withheld pending payment of fees related to that engagement. Under AICPA rules, the CPA may withhold the depreciation schedules pending payment of the fees from the engagement to prepare those records, but may not withhold the depreciation records pending payment of fees from another engagement. Likewise, other supporting documents may be withheld pending payment of the fees related to the engagement that created the supporting documents. Under no circumstances, per AICPA Rule 501, is the CPA required to release the remainder of the CPA's workpapers. Note that some state laws require that CPA prepared client records like depreciation records and other supporting records must be released to the client regardless of the payment status of current or past due fees.

(See Interpretation 501-1 in the course material.)
5. A: Incorrect. The prior year tax return has already been issued and therefore must be provided upon request. Smith may require payment of a reasonable charge for copying the return, but may not hold the return hostage pending payment of other outstanding fees. The current year depreciation schedule is considered to be part of Smith’s work product, and is the property of Smith. Since the current year tax return was never provided to Jones, the depreciation records are not considered client records and Smith need not release them.

B: Incorrect. The current year depreciation is considered to be part of Smith’s work product and is the property of Smith. Since the current year tax return was never provided to Jones, the depreciation records are not considered client records and Smith need not release them. The prior year tax return has already been issued and therefore must be provided upon request. Smith may require payment of a reasonable charge for copying the return but may not hold the return hostage pending payment of other outstanding fees.

C: Correct. The prior year tax return has already been issued and therefore must be provided upon request. Smith may require payment of a reasonable charge for copying the return but may not hold the return hostage pending payment of other outstanding fees. The current year depreciation schedule is considered to be part of Smith’s work product and is the property of Smith. Since the current year tax return was never provided to Jones, the depreciation records are not considered client records and Smith need not release them.

D: Incorrect. The prior year tax return has already been issued and therefore must be provided upon request. Smith may require payment of a reasonable charge for copying the return but may not hold the return hostage pending payment of other outstanding fees. The current year depreciation is considered to be part of Smith’s work product and is the property of Smith. Since the current year tax return was never provided to Jones, the depreciation records are not considered client records and Smith need not release them.

(See Interpretation 501-1 in the course material.)
6. A: Incorrect. Problems like this do occur, but they are not unavoidable. A good engagement letter would have specified when payment was due and otherwise specified the expectations and obligations of both CPA and client. Also, good communication goes a long way in avoiding problems.

B: Incorrect. Although this is true, it is not the best answer. A good engagement letter would have specified when payment was due and otherwise specified the expectations and obligations of both the CPA and client. The fact that Smith’s practice is limited to preparing tax returns is not an excuse for not using an engagement letter. Although sending out a separate engagement letter might seem awkward, Smith could incorporate it into the annual client organizer that Smith sends out to clients.

C: Incorrect. Although this is true, it is not the best answer. Good communication goes a long way in avoiding problems. Jones could have disclosed additional facts, such as the fact that he has a gambling problem and this has left him broke, but that he no longer gambles and hopes to begin making payments to Smith and the many others that Jones owes debts to.

D: Correct. Using an engagement letter along with effective communication could have avoided this problem. A good engagement letter would have specified when payment was due and otherwise specified the expectations and obligations of both CPA and client. By communicating information, such as that a gambling problem had left Jones broke, but that he no longer gambles and hopes to begin making payments to Smith, Jones could have avoided this mess. Likewise, if Smith had communicated his displeasure in not receiving payment from Jones instead of holding the tax return hostage, Smith might have avoided this mess, helped a client, collected some of the past due debt, and saved valuable billable hours.

In addition, the CPA should consult his state board of accountancy rules regarding client records. Most states have more stringent rules requiring the unconditional release of client records prepared by the CPA and supporting records found in CPA workpapers.

(See Rule 501 in the course material.)
Chapter 6: Code of Professional Conduct of the New York State Society of Certified Public Accountants

Objectives: After completing this chapter, you will be able to:

- Describe the structure of the NYSS CPA’s Code of Professional Conduct.
- Identify where to research the NYSS CPA’s Code of Professional Conduct.
- Discuss when the code applies, who it applies to and when departures must be justified.

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 the 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 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.
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 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 the 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 (as defined in interpretation 101-9) 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.** Attest means providing the following public accountancy services:

- a. Any audit to be performed in accordance with generally accepted auditing standards or other similar standards, developed by a federal governmental agency, commission or board or a recognized international or national professional accountancy organization, that are designated by the Board of Directors of the NYSSCPA and in compliance with New York State Education Law section 7401-a;
- b. Any review of a financial statement to be performed in accordance with standards, developed by a federal governmental agency, commission or board or a recognized international or national professional accountancy organization, that are designated by the Board of Directors of the NYSSCPA and in compliance with New York State Education Law section 7401-a;
- c. Any examination to be performed in accordance with attestation standards developed by a federal governmental agency, commission or board or a recognized international or national professional accountancy organization, that are designated by the Board of Directors of the NYSSCPA and in compliance with New York State Education Law section 7401-a; or
- d. Any engagement to be performed in accordance with the auditing standards of the Public Company Accounting Oversight Board.

**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.

**Best practices.** Those procedures and behaviors generally agreed upon by reasonably prudent and competent persons to be the preferred approach to providing a particular professional service. So called “best practices” relevant to a professional service provided by a member may be promulgated by other professional associations or similar organizations. Best practices will vary depending upon the skill level and position of the member, the nature of the engagement, the industry, practicality and cost-benefit among other factors.
Client. A client is any person or entity that directly 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, other than the member’s employer, student or the public.

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

Commissions and Referral Fees. Commission means any compensation paid by a third party to the member, 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.

Compilation. “Compilation” means providing a service that presents, in the form of financial statements, information that is the representation of the management or owners of the client without undertaking to express any assurance of the accuracy of the information in the statements, to be performed in accordance with standards, developed by a federal governmental agency, commission or board or a recognized international or national professional accountancy organization, that are designated by the Board of Directors of the NYSSCPA and in compliance with New York State Education Law section 7401-a.

Confidential Client Information. Any information obtained from current, former, and prospective clients in a professional capacity which is not generally available to the public, whether or not the CPA is actually formally engaged to provide professional services. Information obtained from a person seeking to engage a member to offer professional services falls within this definition.

Confidential Employer Information. Any information obtained during the course of employment if use of such information is restricted by the employer through a written policy, or law, and if such information is not generally available to the public.

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.

**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 102: Independence, the firm includes the individual partners thereof.

**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 includes, but is 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 Accountancy.** The practice of public accountancy is defined in Section 70.1 of the Regulations of the Commissioner of Education of the State of New York.

**Professional Services.** Professional services include all services performed by a member in the practice of public accountancy.

**Professional skills and competencies of a licensed accountant.** This term has the meaning given to it under the Regulations of the Commissioner of Education of the State of New York Section 70.1, subdivision C, paragraph 1.

**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**

**I – Public Interest**

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 places in them, members should seek continually to demonstrate their dedication to professional excellence.

II – 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 and employer 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.

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

III – Objectivity

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.

Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members render attest, tax, and management advisory services as well as 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.

All members 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 who perform attest services and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members who perform external attest services.
IV – Due Professional Care

The quest for excellence is the essence of due professional care. Due professional care 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.

Due professional care also imposes the obligation to seek out and implement best practices when appropriate, as well as requires a member to plan and supervise adequately any professional activity for which he or she is responsible. Furthermore, members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services in a timely fashion, to be thorough, and to observe applicable technical and ethical standards.

V – Competence

Competence is derived from a synthesis of education and experience. It is a member's individual responsibility which 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. 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. However, meeting minimum standards of education and experience under applicable laws, regulations and professional standards is generally required to demonstrate competence.

VI – Confidentiality

Accounting professionals depend upon the free transfer of information from clients and employers in order to properly perform their jobs. In order to preserve client trust and provide the best possible service to clients and employers, members should closely guard client and employer information and treat it as confidential.

Confidentiality is the cornerstone of a trusting relationship between a member and client or employer. In order to constructively grow that relationship, the client or employer must have confidence that information provided to the member will be treated respectfully, and not disclosed to outside parties. The careful handling of client or employer affairs allows the member to develop a more meaningful relationship with the client or employer, and serve them more effectively.
A member should be fully informed of all the facts pertaining to an engagement, task, or client relationship in order to obtain optimum results for the member’s client or employer. The fact that information will be kept confidential not only allows the member to competently complete the assigned task, but also encourages the public to seek appropriate assistance when necessary.

VII – Independence

Independence precludes relationships that may impair or appear to impair a member’s objectivity in rendering attestation services.

For a member rendering attest services, the maintenance of 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 who are employed in industry, academia, or other non-attest practice areas 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 internal auditing, tax, or consulting services are charged with the same responsibility for objectivity as members who provide attest services and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members who act as third-party auditors.

ET Section 502

Advertising and Other Forms of Solicitation

Rule 502 – Advertising and Other Forms of Solicitation. A member in the practice of public accounting 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 the practice of public accounting 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. Attest services; 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.

The prohibition in A above applies during the period in which the member or the member’s firm

- Is engaged to perform any of the services listed above
- Reasonably should expect to be engaged to perform any of the services listed above, and
- The period covered by any historical financial statements involved in any such listed services.

**B. Disclosure of permitted commissions**

A member in the practice of public accountancy, who is not prohibited by this rule from performing professional services for or receiving a commission, and who is paid or expects to be paid a commission shall, unless otherwise exempted from such disclosure requirements by applicable state law or regulations, 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. Such disclosure shall:

a. Occur prior to the performance of the professional service which will trigger the commission or referral fee;
b. Be written in 12-point font or larger on the letterhead of the member, or otherwise on the letterhead of a firm licensed in the practice of public accountancy that employs the member and be signed by the member, and be countersigned and dated by the client in order to evidence the client's receipt and understanding of the information contained in the disclosure;

c. Contain the following information:

- A description of the product(s) or service(s) which the member is recommending to the client, the identity of the third party that is expected to provide the product or service, the business relationship between the member and the third party, a description of any commission which may be received by the member or the member’s firm. Where the product(s) or service(s) cannot be specifically identified at the time of the initial disclosure, this information shall be included in a supplemental disclosure which the member shall provide to the client within 30 days of the receipt of the commission;
- The dollar amount or value of the commission or the basis on which such commission shall be computed.

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 103-3 Applicability of Rule 103 when receiving a commission or referral fee.

Interpretation 103-3

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 101 to maintain 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 and Practice Name

Rule 505 – Form and Practice 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 or deceptive as to the legal form; as to persons who are partners, officers, shareholders or members of the firm; or as to any other matter. Names of one or more past owners may be included in the firm name of a successor organization. Firms may be named only in the fashion permitted by law or regulation.
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 102 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.
New York State Society of CPAs – 2010 Changes

In October 2010, NYSSCPA members overwhelmingly voted to approve proposed revisions to Code of Professional Conduct definitions and rules. The changes were in response to state legislative changes that greatly expanded the scope of public accountancy in New York. In addition, the six principles were expanded to seven with the addition of confidential information.

The principles highlight and outline the essential concepts that guide behavior. The revised principles highlight responsibilities to the public while expanding the concepts of integrity and objectivity. New sections on confidentiality and independence highlight these obligations as the basis of trusting client relationships.

The revised rules did the following:

- Expanded upon the concepts of integrity and objectivity.
- Objectivity is attained by performing services with impartiality.
- Independence is revised to apply only to attest work as the definition of public accountancy expanded.
- Compliance with standards applies to all professional services.
- Confidential information excludes knowledge of fraud or illegal activities which must be reported to appropriate supervisors.
- A new rule covers the determination of fees.

For more information, check the society’s comprehensive website at www.nysscpa.org.
CHAPTER 6 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following has the authority to revoke a New York CPA's license:
   a) NYSSCPAs
   b) AICPA
   c) the Board of Regents of the State of New York
   d) all of the above

2. Which of the following is true regarding departures from the Society's rules:
   a) any departure will subject a member to disciplinary action
   b) departures will be reported to the Board for Public Accountancy
   c) members must justify departures from the rules
   d) none of the above
CHAPTER 6 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. The NYSSCPA’s most severe sanction is expulsion from the Society.
   B: Incorrect. The AICPA’s most severe sanction is expulsion from the Institute.
   C: Correct. Only the Board of Regents may revoke a CPA’s license.
   D: Incorrect. Only the Board of Regents may revoke a CPA’s license.
   (See page 6-1 of the course material.)

2. A: Incorrect. Only unjustified departures will subject a member to disciplinary action.
   B: Incorrect. Society ethics rule violations are handled internally.
   C: Correct. The ethics rules cannot cover all possible situations, therefore, justifiable departures from the rules are permissible.
   D: Incorrect. Justifiable departures are permitted.
   (See page 6-2 of the course material.)
Chapter 7: Professional Regulation in New York State

Objectives: After completing this chapter, you will be able to:

- Describe the structure of professional regulation in New York.
- Discuss the responsibilities of the Board.
- Explain the procedure for investigating and prosecuting professional misconducts.
- Identify the specific items that constitute professional misconduct.
- Describe the complaint procedure.
- Discuss the consequences of disciplinary actions.

Introduction

In 1891, medicine became the first profession licensed by the New York State Board of Regents. New York’s unique system of professional regulation, recognized as a model for public protection, has grown to encompass more than 645,000 practitioners and over 30,000 professional practice business entities in thirty-eight professions. Accountancy became regulated in 1896.

Guided by the Regents, a citizen body, the professions are within New York State’s unified system of education – The University of the State of New York. This recognizes the key role education plays in both preparing licensed professionals and in ensuring their continuous development.

The State Education Department, under the Regents direction, administers professional regulation through its Office of the Professions, assisted by the 25 State Boards for the Professions. The 25 State Boards for the Professions and the Committee for Professional Assistance are comprised of professional members and one or more representatives of the general public. The composition of each board and the Committee is specified in Title VIII of Education Law. In addition, Board and Committee composition should reflect the State’s regions, cultural diversity, and the various aspects of the professions.

Licensing, registration, and related fees are the sole means of support for professional regulation in New York State. These fees support comprehensive services to the public and the professions. The Office of the Professions provides a number of services to the public and the professions, including the following:

The Board of Regents, on the recommendation of the Commissioner of Education, appoints a State Board for each licensed profession to advise and assist the Board of Regents and the State Education Department on matters of professional regulation. The Board of Regents also appoints a Committee for Professional Assistance to advise them on matters relating to practice by professional licensees with alcohol or other drug abuse problems.
Professional board members must be New York State-licensed professionals who are residents of the State. For many boards, professional member appointees must have at least five years of experience. Committee members are not required to be licensed professionals.

Every State Board must also have at least one public representative (and in some cases up to five public members), who is a consumer of services of the profession(s) on which the board advises. The individual must be a New York State resident and meet various requirements to ensure that the public perspective is not compromised.

**Responsibilities of Boards**

All professional and public members of the State Boards and the Committee for Professional Assistance must be dedicated to public protection and quality professional preparation and conduct. Depending on the particular board, members of the State Boards advise on licensing requirements, licensing examinations and practice issues, and provide community outreach, as well as participate in licensure disciplinary and/or restoration and moral character proceedings. Members of the Committee for Professional Assistance advise on matters relating to impaired practice, administer the Professional Assistance Program, and serve on panels for Program admission or professional license reinstatement.

**Terms**

A board or committee member is appointed for a five-year term and may be reappointed for a second term, receives a honorarium and is reimbursed for basic expenses. The number of meetings, professional discipline proceedings, etc. varies from board to board.

**Nominations**

Information on existing and expected vacancies on the State Boards for the Professions is listed in the Office of the Professions’ publication, *The Update*. Nominations for membership on all State Boards, as well as the Committee for Professional Assistance, are accepted continuously.

Applications for board membership may be submitted directly by interested individuals, or nominations may be made by colleagues, professional associations, consumer groups, etc. All nominees will receive full consideration for current and expected board vacancies. The Office strives to have board composition reflect the State's judicial districts, New York’s cultural diversity, and the various aspects of the profession(s). Nominations of and applications from individuals with diverse backgrounds and individuals with disabilities are encouraged. Submit nominations or applications for board membership to the appropriate board office. For details about the responsibilities and needs of the particular board/committee, please contact the respective executive secretary.
Enforcement of Rules of Ethics
The Role of the Office of Professions

To ensure public protection in New York State, the New York State Education Department’s Office of the Professions (OP) investigates and prosecutes professional misconduct in all professions except medicine. Professional misconduct is the failure of a licensed professional to meet expected standards of practice.

The Board of Regents, which licenses individuals in 38 professions defined in Education Law, is responsible for the final disposition of all disciplinary matters.

Professional misconduct is defined in Education Law and in the Rules of the Board of Regents. Professional misconduct includes the following:

- Engaging in acts of gross incompetence or gross negligence on a single occasion, or negligence or incompetence on more than one occasion
- Permitting or aiding an unlicensed person to perform activities requiring a license
- Refusing a client or patient service because of race, creed, color, or national origin
- Practicing beyond the scope of the profession
- Releasing confidential information without authorization
- Being convicted of a crime
- Failing to return or provide copies of records on request
- Being sexually or physically abusive
- Abandoning or neglecting a patient in need of immediate care
- Performing unnecessary work or unauthorized services
- Practicing under the influence of alcohol or other drugs

A range of penalties that includes censure and reprimand, fines (up to $10,000 for each violation), suspensions and/or probationary terms may be imposed on licensees who have committed misconduct. The Board of Regents may revoke the professional’s license. Information on uncontested determinations in which a licensee has been assessed a fine for committing an infraction of a minor and technical nature are available by phone: 518-474-3817, fax: 518-474-1419 or e-mail: op4info@mail.nysed.gov, or by writing to the Office of the Professions.

OP’s Professional Assistance Program allows licensees who abuse alcohol or other drugs to surrender their licenses voluntarily and confidentially while progressing through an acceptable course of treatment; it is available to licensees who have not harmed clients. Successful completion of the program may act as an alternative to disciplinary action.

OP also investigates allegations of legal (unlicensed) practice in all 38 licensed professions, including medicine. These cases may be handled administratively or referred to the State Attorney General for criminal prosecution. Practicing a profession without a license and current registration is a felony in New York State.
Frequently Asked Questions

Researching a Licensed Professional

Q: How can I find out if an individual is licensed?

A: You may verify a license through our online license verification service. If you need to contact OP directly about the status of a license, e-mail our customer service representatives at op4info@mail.nysed.gov, call (518) 474-3817 (TDD/TTY: 518-473-1426), fax 518-474-1449, or contact the specific State board for the profession.

Q: How can I learn more about services offered by licensed professionals within a profession?

A: Please visit our consumer information page for more information about the services offered by licensed professionals.

Q: How can I find out if there have been any disciplinary actions against a licensee?

A: You may search our site by name or by month of action for summaries of Regents disciplinary actions taken since 1994. Complaints are accusations of professional misconduct; those that do not result in disciplinary action are confidential.

If action has been taken against a licensee for professional misconduct, you may contact OP’s Public Information Unit by e-mail at dplsd@nysed.gov or call 518-474-3817 ext. 330 for a copy of the official disciplinary record.

Q: What does it mean when a professional is in “good standing?”

A: “Good standing” means that the licensee is permitted to practice. Licensees who have been the subject of disciplinary action are considered to be in “good standing” unless they have had their license revoked or suspended.

Q: Can I find out if a licensee has been sued for malpractice?

A: Malpractice suits are different from complaints about professional misconduct. Malpractice is handled by the insurance and court systems; for information about malpractice actions, you may wish to contact your County Clerk’s office or local court system.
Filing a Complaint

Q: How do I file a complaint?

A: You will need to complete a complaint form. Send your completed form directly to the regional office nearest you or fax it to our main professional discipline office at 212-951-6537.

If you would like to speak with someone first about professional misconduct or unlicensed practice, you may call our complaint hotline at 1-800-442-8106, contact our nearest regional office, or e-mail conduct@mail.nysed.gov for more information.

Q: If I want to file a complaint, do I have to be sure the professional is guilty?

A: No. If you think you may have been the victim of professional misconduct, file a complaint form. The Office of the Professions will look into the complaint and determine if misconduct has occurred.

Q: Can you order a licensed professional to give me my money back?

A: OP does not have the authority to get involved in fee disputes; except for programs such as Worker's Compensation and Medicaid, where fees are set by law, licensees can charge whatever they believe appropriate. We can assist you, however, if you believe that you were charged for work that was not done or which was done poorly.

Following Up on a Complaint

Q: What happens after I file a complaint?

A: Staff in the appropriate regional office follow up on each complaint. Members of the State Board for the profession may be consulted during the investigation. If substantial evidence of misconduct is found, we will pursue disciplinary action. Cases of illegal (unlicensed) practice may be handled administratively, or they may be referred after investigation to the State Attorney General for criminal prosecution.

Q: Can I get information about a complaint when it is under investigation?

A: You may contact the investigator assigned to your complaint at any time during the investigation to learn about the status of your complaint. You will also be informed if the complaint has been referred for further action.

Q: How long does an investigation take? When will I hear about the outcome?

A: Almost all investigations are completed within 9 months or less. The time needed to prosecute cases varies, although many cases are concluded through negotiated settlements. Complicated cases may take 2 years or more (from initial complaint to final action) to resolve. If you file a professional misconduct complaint, you will be informed of the status of your complaint and the final outcome.
Disciplinary Actions

Q: What happens when a licensed professional is the subject of disciplinary action?

A: Minor forms of misconduct may be handled through advisory letters or administrative warnings issued by the Office of the Professions; these administrative actions are confidential. The penalties for more serious misconduct range from a fine to the revocation of the license to practice, in accordance with the nature of the misconduct and its consequences. The Board of Regents, which oversees the State Education Department and its Office of the Professions, reviews and takes final action on the most serious professional discipline cases.

If the disciplined professional’s license to practice has not been revoked or suspended, the Office of the Professions may monitor the professional to ensure that probationary terms – such as periodic employer reports or retraining courses – are met.

Q: If a license is revoked or suspended, is it permanent?

A: With limited exceptions, individuals who have surrendered their licenses or had their licenses revoked must wait at least three years to apply for license restoration. While the Board of Regents has the authority to restore a professional license, such restoration is not a right. The former licensee must prove that he or she is worthy of the privilege of having a professional license.

Professional Assistance Program

The Professional Assistance Program (PAP) assists professionals who have substance abuse problems but who have not harmed patients or clients. Such professionals may voluntarily surrender their licenses while receiving treatment rather than face charges of professional misconduct. All applications to the program are confidential.

A three-member panel of the Committee for Professional Assistance interviews applicants for admission to PAP and considers petitions for license restoration. A member of the State Board for the profession of the licensee whose case is being considered is also present to help address issues which may be specific to that profession. The meetings are informal and confidential, and no transcript is made.

The criteria for admission to the PAP include:

- Total abstinence from all mood-altering substances including alcohol;
- Temporary, voluntary surrender of the professional license;
- Participation in treatment at an agency approved by the PAP; and
- An agreement to be monitored by the PAP for at least two years after reinstatement of the license.
Monitoring includes toxicology reports, work-site reports, and random observed drug screens at specified frequencies. Other conditions may apply as appropriate to the individual situation and the recommendations of the treatment provider.

For further information to help yourself, a colleague, or a friend, telephone or write the professional Assistance Program at:

Professional Assistance Program  
80 Wolf Road, Suite 204  
Albany, New York 12205-2643  
(518) 474-3817, ext. 480 (voice)  
(518) 485-9378 (fax)  
e-mail: pap@mail.nysed.gov

You may also print out and mail an application form for the program.
CHAPTER 7 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. The New York State Education Department Office of the Professions investigates and prosecutes professional misconduct. Which of the following is the most accurate definition of professional misconduct for a CPA:

   a) charging different fees to clients for similar engagements based on the client’s ability to pay
   b) the failure of a CPA to meet expected standards of practice
   c) hiring inexperienced staff
   d) performing additional audit procedures that may not be required and which the client is not billed for
CHAPTER 7 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. A CPA may generally determine fees charged for services rendered. Giving a discount to a client is not professional misconduct.

B: Correct. The course material gives numerous examples of professional misconduct that all stem from the failure to meet expected standards.

C: Incorrect. All staff were inexperienced at some point in their careers. Hiring, training and mentoring inexperienced staff is a hallmark of the profession.

D: Incorrect. Many firms require that certain firm-wide quality control procedures be followed that may not have a direct impact on an engagement. In this example where the client is not billed for the extra procedures performed, there can be no claim of misconduct.

(See page 7-3 of the course material.)
Objectives:

After completing this course, you will be able to:

- Discuss the general provisions of the Board of Regents rules on unprofessional conduct.
- Identify the rules on advertising.
- Recognize the specific provisions of unprofessional conduct in the practice of public accountancy.
- Identify which client records must be returned upon request.
- Compare the rules of the AICPA, New York State Society of CPAs, and the state.

Part 29, Unprofessional Conduct

Section 29.1 General provisions.
Section 29.10 Special provisions for the profession of public accountancy.

§ 29.1 General provisions.

a. Unprofessional conduct shall be the conduct prohibited by this section. The provisions of these rules applicable to a particular profession may define additional acts or omissions as unprofessional conduct and may establish exceptions to these general prohibitions.

b. Unprofessional conduct in the practice of any profession licensed, certified or registered pursuant to title VIII of the Education Law, except for cases involving those professions licensed, certified or registered pursuant to the provisions of Article 131 or 131-B of such law in which a statement of charges of professional misconduct was not served on or before July 26, 1991, the effective date of Chapter 606 of the Laws of 1991, shall include:

1. Willful or grossly negligent failure to comply with substantial provisions of Federal, State or local laws, rules or regulations governing the practice of the profession;

2. Exercising undue influence on the patient or client, including the promotion of the sale of services, goods, appliances or drugs in such manner as to exploit the patient or client for the financial gain of the practitioner or of a third party;

3. Directly or indirectly offering, giving, soliciting, or receiving or agreeing to receive, any fee or other consideration to or from a third party for the referral of a patient or client or in connection with the performance of professional services;

4. Permitting any person to share in the fees for professional services, other than: a partner, employee, associate in a professional firm or corporation, professional subcontractor or consultant authorized to practice the same profession, or a
legally authorized trainee practicing under the supervision of a licensed practitioner. This prohibition shall include any arrangement or agreement whereby the amount received in payment for furnishing space, facilities, equipment or personnel services used by a professional licensee constitutes a percentage of, or is otherwise dependent upon, the income or receipts of the licensee from such practice, except as otherwise provided by law with respect to a facility licensed pursuant to Article 28 of the Public Health Law or Article 13 of the Mental Hygiene Law;

5. Conduct in the practice of a profession which evidences moral unfitness to practice the profession;

6. Willfully making or filing a false report, or failing to file a report required by law or by the Education Department, or willfully impeding or obstructing such filing, or inducing another person to do so;

7. Failing to make available to a patient or client, upon request, copies of documents in the possession or under the control of the licensee which have been prepared for and paid for by the patient or client;

8. Revealing of personally identifiable facts, data or information obtained in a professional capacity without the prior consent of the patient or client, except as authorized or required by law;

**PRACTICE POINTER:** The July 6, 1998 issue of *Sports Illustrated* included a book review on a book written by a CPA in public practice. The book by a Chicago based sports accountant included the names of many well known and relatively unknown sports personalities. No confidential information was released; however, I believe the CPA profession was harmed by the book’s publication, even though all applicable ethical guidelines were met. The release of client names may lead the public to distrust the CPA.

I propose you adhere to a higher standard in your practice such as the following:

- Public companies – public company client names may be released since the public is relying on your firm’s attestation of the client’s financial statements.
- Non-Public companies and individuals – keep confidential unless the client has released your name or you have received permission to speak.

9. Practicing or offering to practice beyond the scope permitted by law, or accepting and performing professional responsibilities which the licensee knows or has reason to know that he or she is not competent to perform, or performing without adequate supervision professional services which the licensee is authorized to perform only under the supervision of a licensed professional, except in an emergency situation where a person’s life or health is in danger;
Case Study

Competence and Technical Standards

Brown prepared Client’s 2010 tax returns and calculated that Client would receive a $6,000 tax refund from Arizona, owe $7,000 in taxes to New York, and owe $6,500 in taxes to the Internal Revenue Service. Client took tax information to another Certified Public Accountant who completed the returns and made the following determination: Client would receive a $10,000 refund from Arizona, owe $6,000 to New York, and owe $5,500 to the IRS.

Brown agreed that he did not prepare Client’s tax return correctly.

LIKELY BOARD ACTION: Violation of Part 29, Unprofessional Conduct

Case Study

Competency and Technical Standards

Able Accountants, CPAs (Firm) audited XYZ Company in 2008 and 2009. XYZ Company provided investment and money management services to clients, many of which were union pension trusts and health and welfare plans. XYZ Company managed a total portfolio of about one billion dollars.

A division of Firm prepared a valuation report of XYZ Company that valued XYZ Company at just under $5 million dollars. XYZ Company’s growth in fee income was fueled by a collateralized note program that was critical to Firm’s valuation. The collateralized note program included loans made by XYZ Company to its affiliate ABC Company. By 2009, the collateralized note program with its affiliate ABC Company had accounted for 25% of the total assets managed by XYZ Company and 45% of the fees charged by XYZ Company.

ABC Company suffered losses during the years 2008 through 2010 and had a stockholders’ deficit of $109 million at the end of September 2010. ABC Company filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. The 2010 audit report for ABC Company was prepared by another firm. The audit report expressed substantial doubt about ABC Company’s ability to continue as a going concern.

Firm audited XYZ Company during calendar years 2008 and 2009 and issued unqualified opinions for both years.

BOARD ACTION: Violations of Generally Accepted Auditing Standards in both 2008 and 2009.

10. Delegating professional responsibilities to a person when the licensee delegating such responsibilities knows or has reason to know that such person is not qualified, by training, by experience or by licensure, to perform them;

11. Performing professional services which have not been duly authorized by the patient or client or his or her legal representative;
12. Advertising or soliciting for patronage that is not in the public interest:

i. Advertising or soliciting not in the public interest shall include, but not be limited to, advertising or soliciting that:

   a. Is false, fraudulent, deceptive or misleading;
   b. Guarantees any service;
   c. Makes any claim relating to professional services or products or the cost or price therefore which cannot be substantiated by the licensee, who shall have the burden of proof;
   d. Makes claims of professional superiority which cannot be substantiated by the licensee, who shall have the burden of proof; or
   e. Offers bonuses or inducements in any form other than a discount or reduction in an established fee or price for a professional service or product.

ii. The following shall be deemed appropriate means of informing the public of the availability of professional services:

   a. Informational advertising not contrary to the foregoing prohibitions; and
   b. The advertising in a newspaper, periodical or professional directory or on radio or television of fixed prices, or a stated range of prices, for specified routine professional services, provided that if there is an additional charge for related services which are an integral part of the overall service being provided by the licensee, the advertisement shall so state, and provided further that the advertisement indicates the period of time for which the advertised prices shall be in effect.

iii. All licensees placing advertisements shall maintain, or cause to be maintained, an exact copy of each advertisement, transcript, tape or videotape thereof as appropriate for the medium used, for a period of one year after its last appearance. This copy shall be made available for inspection upon demand of the Education Department;

   b. A licensee shall not compensate or give anything of value to representatives of the press, radio, television or other communications media in anticipation of or in return for professional publicity in a news item;

iv. Testimonials, demonstrations, dramatizations, or other portrayals of professional practice are permissible provided that they otherwise comply with the rules of professional conduct and further provided that the following conditions are satisfied:

   a. The patient or client expressly authorizes the portrayal in writing;
   b. Appropriate disclosure is included to prevent any misleading information or imagery as to the identity of the patient or client;
c. Reasonable disclaimers are included as to any statements made or results achieved in a particular matter;  
d. The use of fictional situations or characters may be used if no testimonials are included; and  
e. Fictional client testimonials are not permitted;

Case Study

Advertising by Firm


Stating that “AB&C LLC” was established in 1984 is a misrepresentation of fact.

LIKELY BOARD ACTION: Using the “established date” of 1984 is misleading and a violation of Section 29.1 (12) Advertising.

13. Failing to respond within 30 days to written communications from the Education Department or the Department of Health and to make available any relevant records with respect to an inquiry or complaint about the licensee’s unprofessional conduct. The period of 30 days shall commence on the date when such communication was delivered personally to the licensee. If the communication is sent from either department by registered or certified mail, with return receipt requested, to the address appearing in the last registration, the period of 30 days shall commence on the date of delivery to the licensee, as indicated by the return receipt;

Case Study

Failure to Respond to a Board Communication and Investigation

A complaint was filed against Brown. The Board notified Brown of the complaint and requested that Brown respond within 31 days. Brown did not respond within 31 days.

LIKELY BOARD ACTION: Violation of Section 29.1 (13) failure to respond to written communications.

14. Violating any term of probation or condition or limitation on the licensee by the Board of Regents pursuant to Education Law, Section 6511.
§ 29.10 Special provisions for the profession of public accountancy.

a. Unprofessional conduct in the practice of public accountancy shall include all conduct prohibited by Section 29.1 of this Part, except as provided in this section, and shall also include the following:

1. In expressing an opinion on representations in the financial statements which the public accountant examined:
   i. Failing to disclose a material fact known to the licensee which is not disclosed in the financial statements but disclosure of which is necessary to make the financial statements not misleading;
   ii. Failing to report any material misstatement known to the licensee to appear in the financial statements;
   iii. Failing to acquire sufficient information to warrant the expression of an opinion, or the licensee’s exceptions are sufficiently material to negate the expression of an opinion; or
   iv. Failing to direct attention to any material departure from generally accepted accounting principles or to disclose any material omission of generally accepted auditing procedures applicable in the circumstances;

2. Allowing any person other than a partner or a duly authorized employee to engage in the public practice of accountancy in the licensee’s name or in the name of his or her firm, this paragraph not being intended to apply to the use of firm names by successors;

3. Issuing in the public accountant’s name, or permitting his or her firm to issue in its name, a report purporting to be based upon an examination by the licensee or his or her firm of financial statements, when any material portion of the examination of such statements and related records, including the examination of any material, financial statements or data incorporated in the financial statements reported upon, has not been made either:
   i. By the public accountant or a partner or an employee; or
   ii. With the approval of the public accountant or his or her firm, by a certified public accountant of a state, territory or possession of the United States or the District of Columbia or the holder of an equivalent certificate issued by the proper authorities of another country, or a firm partially composed of such certified public accountants or holders of equivalent certificates, or by a public accountant of the State of New York;

4. Making a written forecast of future transactions or permitting such a forecast to be issued in the licensee’s name or his or her firm’s name without setting forth:
   i. The character of work performed;
   ii. The sources of information used and major assumptions made, and the degree of responsibility taken with respect thereto; and
   iii. A statement that the public accountant or firm does not vouch for the achievability of the forecast;
5. Expressing an independent opinion or knowingly permitting his or her firm to express an opinion on financial statements of an enterprise, whether such enterprise is a for-profit or a not-for-profit enterprise, if the licensee or a partner or employee in the firm is not independent with respect to such enterprise. Independence will be considered to be impaired if the public accountant, or a partner in the firm, owns or is committed to acquire any direct or material indirect financial interest in the enterprise or had a direct or material indirect financial relationship with any officer, director, employee or principal stockholder of the enterprise. Independence will be considered to be impaired if the licensee, a partner in the firm or a member of his or her or the partner’s immediate family, is or has been a director or officer of the enterprise, or is or has been involved in any situation creating a conflict of interest, during the period covered by the examination or at the time of issuance of a report.

6. Offering or rendering professional services under a contingency fee arrangement when serving a client for whom the licensee performs: an audit or review of a financial statement; or a compilation of a financial statement when the licensee knows or has reason to know that a third party will use the financial statement and the licensee’s compilation report does not disclose a lack of independence; or an examination of prospective financial information; or an original or amended tax return or claim for a tax refund; or any public accounting services for a client during the period in which the licensee is engaged in the foregoing services for that client or for any period covered by historical financial statements involving such foregoing services. For the purposes of this paragraph, a *contingency fee* shall mean a fee established for the performance of any service pursuant to an arrangement whereby no fee, or lesser fee, will be charged unless a specified finding or result is attained, or where the fee is otherwise contingent upon the finding or result of such service. Fees are not regarded as contingent if fixed by courts or other public authorities or, in tax matters, if determined on the basis of the results of judicial proceedings or the findings of governmental agencies. Fees charged may vary depending on the complexity of the service rendered;

**Case Study**

**Contingent Fees**

Section 29.10 (a)(6) describes the circumstances when licensees are prohibited from receiving contingent fees. The prohibitions apply when the holder of a permit or any partner, officer, shareholder, member, manager or owner of the firm performs any of the following services for a client who is also the subject of the contingent fees:

- Audit, review or agreed-upon-procedures of a financial statement,
- Examination of prospective financial information, or
- Compilation of a financial statement if the compilation report does not disclose a lack of independence between the client and the licensee.

The prohibitions also apply during the period in which the certified public accountant, public accountant or firm is engaged to perform the services listed, including the period that is subject of the report and the period covered by any historical financial statements involved in the listed services.
What Is Meant By “During the Period”

The period of prohibition begins at the time the licensee has accepted an engagement to perform attest or compilation services, includes the period covered by the engagement, and extends through the report date on the engagement.

If the licensee is engaged to do attest or compilation services for a subsequent period, there would be no period of time that the licensee is not covered by this prohibition. The prohibition could extend until it is implicit that the firm is no longer providing attest or compilation services for the client, especially if the firm has been providing such services on an on-going periodic basis. Issuing a letter of resignation from providing the services would be considered reasonable documentation of the termination.

7. Permitting the public accountant’s name to be associated with statements purporting to show financial position or results of operations in such a manner as to imply that he or she is acting as an independent certified public accountant or public accountant, unless:

i. The licensee has complied with generally accepted auditing standards. The State Board for Public Accountancy may consider statements on auditing standards promulgated by the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board for licensees subject to such requirements, or a recognized national accountancy organization whose standards are generally accepted by other regulatory authorities in the United States, including but not limited to: the American Institute of Certified Public Accountants to be interpretations of generally accepted auditing standards. Departures from such standards, or other standards considered by the State Board to be applicable in the circumstances, must be justified by a licensee who does not follow them; and

ii. The licensee expresses an opinion on financial statements or financial data presented in conformity with generally accepted accounting principles. The State Board for Public Accountancy may consider those principles promulgated by a recognized national accountancy organization whose standards are generally accepted by other regulatory authorities in the United States, including but not limited to: the Financial Accounting Standards Board, the Government Accounting Standards Board, and the International Accounting Standards Board, to be generally accepted accounting principles. If financial statements or data contain departures from generally accepted accounting principles but the licensee can demonstrate that the financial statements or data would have been misleading had generally accepted accounting principles been followed, the licensee’s opinion should describe the departure, its approximate effect if practicable, and the reasons why compliance with generally accepted accounting principles would have otherwise been misleading;
8. Refusing to furnish to a client upon request:

   i. Copies of tax returns; or
   ii. Copies of reports or other documents that were previously issued to or for such client; or
   iii. Any accounting or other records belonging to or obtained for the client which the public accountant may have had occasion to remove from the client’s premises or to receive for the client’s account; but this shall not preclude making copies of such documents when they form the basis for work done by the licensee; but in no event shall the public accountant have a lien on these accounting or other records; or
   iv. Copies of information contained in an accountant’s working papers, if such information would ordinarily constitute part of the client’s books and records and is not otherwise available to the client. Such information shall include client owned records or records which the licensee receives from a client. In addition, it shall include any records, tax returns, reports, or other documents and information which are contained in an accountant’s working papers that were prepared for the client by the accountant and for which the accountant has received payment from the client;
   v. After the licensee has complied with the foregoing requirements by providing information to a client, it shall not constitute unprofessional conduct for an accountant to refuse to provide the same information to the client pursuant to a subsequent request by that client;
   vi. This paragraph shall apply in lieu of Section 29.1(b)(7) of this Part;

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**Case Study**

**Client Records and Working Papers**

Licensees may not withhold client records and working papers based on the client’s refusal to pay the licensee’s fees.

Section 29.10 (a)(8) requires licensees to provide to a client or former client any records belonging to or obtained from or on behalf of the client, and a copy of the licensee’s working papers, to the extent that the working papers include records that would ordinarily constitute part of the client’s records and are not otherwise available to the client.

The requirement to return client records and working papers differs depending on whether or not the licensee has issued the work product that is the subject of the engagement.

- A client’s request for return of records that is made within a reasonable time and that occurs prior to the issuance of tax return, financial statement, report or other document prepared by a licensee: the licensee shall furnish, within a reasonable time to the client or former client any accounting or other records belonging to, or obtained from or on behalf of the client, that the licensee received for the client’s account or removed from the client’s premises.

**Explanation:** If the CPA or PA received any records owned by the client, the records must be returned. Client records do not include the work product or working papers of the CPA/PA.
A client’s request for return of records that is made within a reasonable time and that occurs after the issuance of a tax return, financial statement, report or other document prepared by a licensee: the licensee shall furnish, within a reasonable time to the client or former client:

1. A copy of a tax return, financial statement, report or other document issued by a licensee to or for such client or former client;

2. Any accounting or other records belonging to or obtained from or on behalf of the client that the licensee removed from the client’s premises or received for the client’s account; and

3. A copy of the licensee’s working papers, to the extent that the working papers include records that would ordinarily constitute part of the client’s records and are not otherwise available to the client.

4. Working papers, for this rule, include but are not limited to all statements, records, schedules, general ledgers, journals, trial balances and depreciation schedules made by a licensee incident to or in the course of rendering services to a client or former client. Working papers are and shall remain the property of the licensee in the absence of an express agreement to the contrary between the licensee and the client.

**Explanation:** The licensee is required to provide a copy of the work product that was issued for the engagement and return any records obtained from the client. The requirement to return the working papers may vary; for example, if the client has a complete accounting system including a general ledger, sub ledgers, a fixed asset accounting process and maintains their own account analysis and reconciliations, only copies of the adjusting entries with explanations and any supporting working papers would be necessary.

The client may have a general ledger, but may depend on the CPA/PA to adjust and close the general ledger. In that event, copies of both adjusting entries, with explanations and any supporting papers, and closing entries would be provided to the client.

If the client does not have a general ledger and only provides the CPA/PA with transaction summaries that the CPA/PA uses to prepare a working trial balance, copies of the adjusted working trial balance, transaction entries, adjusting entries with explanations and any supporting working papers, and closing entries would be provided to the client.

If the CPA/PA prepared the fixed asset depreciation schedule because the client does not have one, or because the CPA/PA adjusted the client’s schedule, a copy must be provided.

If the CPA/PA prepared a bank reconciliation because the client did not do one, a copy must be provided.

If the CPA/PA determines and prepares schedules of account balances that the client does not ordinarily prepare, and the CPA/PA reported on such schedules, copies must be provided to the client. Examples of such schedules include, but are not limited to:

- Investments
- Accounts payable
- Prepaid expenses
- Accrued liabilities
- Owner’s equity
- Current portion of long-term debt
- Accounts receivable
- Bad debts
- Income tax expenses and payable

If the client determined the account balances and provided schedules, copies of the schedules with the CPA/PA notes and conclusions are not required to be provided.
Copies of the CPA/PA notes, or conclusions on any accounts or transactions, are only required to be provided to the client if the account balances or transactions reported on cannot be understood without consulting the CPA/PA notes or conclusions.

The decision whether to provide copies of all or part of the accountant's work papers depends on whether the client's records include the same information as the licensee's work product. The client must have sufficient documentation to explain or prove transactions or events that are reported by the licensee in the client's tax returns or financial statements when called upon to do so. If the documentation is sufficient and can be used for such explanation and proof, copies of work papers are not necessary. If the documents are not sufficient, copies of the appropriate work papers are required.

### Case Study

**Client records**

In 2009, Green decided to close her public accounting office and accept a position in private industry. Green notified clients that she was closing her office and referred clients to another Certified Public Accountant.

Client “A” received the notification from Green. In 2011, Client “A” needed a copy of her depreciation schedule to complete 2009 and 2010 tax returns. Client “A” left telephone messages for Green. Green did not return Client’s calls and did not provide Client with a copy of the requested depreciation schedule.

Green was required to provide Client “A” with a copy of the depreciation schedule.

**POSSIBLE BOARD ACTION:** Violation of Section 29.10 (a)(8) Client records.

9. Permitting any partner, or employee acting as such, to perform any service for his or her client which the licensee or the firm is not permitted to perform;

10. Soliciting or advertising for clients in violation of Section 29.1(b)(12) of this Part, which shall be interpreted as follows: soliciting and advertising not in the public interest shall include, but not be limited to, obtaining clients through any other corporation or business used as a “feeder”; using the title of certified public accountant or public accountant together with that of any other business or occupation on any letterhead, card, circular or other media, if the certified public accountant or public accountant conjointly engages in such business or occupation with his or her public accounting practice; provided, however, that nothing herein shall prohibit a certified public accountant or public accountant licensed to practice another profession from including such professional designation on his or her letterhead or business card or upon any listing or other designation of his or her office;
11. Failing to maintain and/or submit work papers in accordance with the requirements of this paragraph.

i. Applicability of the requirement. The documentation requirements of subparagraph (iii) shall apply to work papers in support of work products issued on or after January 3, 2003. The retention requirements of subparagraph (iv) of this paragraph shall apply to the licensee's work papers that exist on or after January 3, 2003.

ii. Definition. As used in this paragraph:

a. Work papers means the licensee's records of the procedures applied, the tests performed, the information supporting, and the material conclusions reached for a work product produced in the practice of public accountancy as defined in section 7401 of the Education Law, including but not limited to an audit, review, compilation, forecast or projection. Work papers may include, but are not limited to, programs used to perform professional services, analyses, memoranda, letters of confirmation and representations, copies or abstracts of company documents and schedules or commentaries prepared or obtained by the licensee. Work papers may be in handwritten, typewritten, printed, photocopied, photographed, or electronic form, or in any other form of letters, words, pictures, sounds, or symbols.

b. Substantive alterations to work papers means changes to work papers that alter the nature, timing, extent, and results of the procedures performed for the work product; alter the information obtained and the conclusions reached for the work product; and alter the identity of the persons who performed and reviewed the work for the work product.

iii. Documentation in work papers.

a. Work papers shall contain sufficient documentation to enable a reviewer with relevant knowledge and experience, but having no previous connection with the specific work product, to understand the nature, timing, extent, and results of the procedures performed for the work product, information obtained and conclusions reached for the work product, and the identity of the persons who performed and reviewed the work for the work product.

b. Within 45 days of the issuance of the work product, a complete set of work papers shall be retained. Any substantive alteration to work papers made subsequent to the issuance of the work product shall be clearly documented by indicating the subject of the alteration, the date of the alteration, and the reason for the alteration.

c. Substantive alterations to work papers resulting from post-issuance review procedures shall be identified in an addendum to the work papers. Such alterations shall be clearly documented by indicating the subject of the alteration, the date of the alteration, and the reason for the alteration.
iv. Retention of work papers.
   a. Licensees shall ensure that a formal written policy is established for the retention of work papers that is in accordance with the requirements of this subparagraph. Licensees employed by an employer authorized to practice public accountancy shall have met this requirement for a formal written policy, for work papers produced under such employment, if their employer has established a formal written policy for the retention of work papers that is in accordance with the requirements of this subparagraph. Such written policy shall identify the process and authorization requirements for the destruction of work papers after the expiration of the retention period.
   b. Licensees shall ensure that work papers are retained for a minimum of seven years after the date of issuance of the work product, unless licensees are required by law to retain such records for a longer period. Work papers may be retained for a period that is longer than seven years from the date of the issuance of the work product and may be retained permanently.
   c. Licensees shall ensure that work papers are retained during the term of a New York State Education Department investigation or disciplinary proceeding by the New York State Education Department that is reasonably related to such work papers. Licensees shall not dispose of such work papers until notified in writing by the New York State Education Department of the closure of the investigation or until final disposition of the disciplinary proceeding.
   d. If work papers are retained in an electronic form, the licensee shall ensure that such work papers are capable of being accessed, for read-only purposes, throughout the required retention period established for the work papers and are safeguarded through sound computer security procedures to prevent the unauthorized modification of the work papers.
   e. Work papers shall not be destroyed or otherwise disposed of at a time or in a manner that is inconsistent with applicable requirements of the law.

v. Availability of work papers to the department. A licensee shall make available to the New York State Education Department at its request work papers that the department determines to be relevant to an inquiry or complaint about a licensee's unprofessional conduct, in accordance with the requirements of section 29.1(b)(13) of this Part.
Summary
Workpaper Retention Rules

Below is a brief summary of the workpaper retention rules discussed previously.

- Must establish formal written policy on workpaper retention.
- Retain workpapers for a minimum of seven years after the date the report is issued.
- Retain all workpapers if under investigation.
- Electronic records must be accessible.
- Other laws may require a longer retention period.
- Workpapers must be made available upon request by the NYS Education Department.

12. In determining “incompetence” or “negligence” within the meaning of Section 6509(2) of the Education Law, the Board of Regents and the Education Department may consider among others, the generally accepted auditing standards and accounting principles promulgated by the American Institute of Certified Public Accountants and by the Financial Accounting Standards Board (as referenced in paragraph 7 of this subdivision);

Case Study
Integrity and Objectivity

Brown CPA provided tax services to Mr. and Mrs. Taylor for the last 14 years of their marriage. Brown CPA had knowledge of financial information that related to both husband and wife based on Brown’s prior services to Mr. and Mrs. Taylor.

When the couple decided to divorce, Brown CPA accepted an engagement from Mr. Taylor to assist him with consultation and tax matters related to the divorce proceedings.

Brown CPA prepared the final joint tax return for Mr. and Mrs. Taylor after the date of the divorce.

While Brown CPA represented the couple, Brown CPA was also representing Mr. Taylor with services that were related to the divorce proceedings. These separate services were adversarial to Mrs. Taylor.

Brown CPA did not request permission of Mrs. Taylor to represent only Mr. Taylor. Brown CPA accepted the engagement with Mr. Taylor even though it was adverse to Mrs. Taylor.

Brown CPA violated the rule on integrity and objectivity by accepting a separate engagement from Mr. Taylor which was adversarial to his engagement to Mr. and Mrs. Taylor.

POSSIBLE BOARD ACTION: Violation of Section 29.10 Unprofessional Conduct.

13. Failing to meet the competency requirements of this paragraph when supervising attest or compilation services or signing or authorizing someone to sign an accountant's report on the financial statements of a client for such services.
i. Applicability of the requirement. Effective July 26, 2009, each licensee shall be subject to the competency requirements of this paragraph when supervising attest or compilation services or signing or authorizing someone to sign an accountant’s report on the financial statements of a client for such services, unless the certified public accountant or public accountant was licensed in New York State prior to July 26, 2009. For certified public accountants or public accountants licensed prior to July 26, 2009, the licensee shall be subject to the competency requirements of this paragraph beginning January 1, 2011.

ii. Any licensee who supervises attest services or signs or authorizes someone to sign an accountant’s report on the financial statements of a client for such services shall:
   a. Have at least 1,000 hours of experience within the previous five years in providing attest services or reporting on financial statements gained through employment in government, private industry, public practice or an educational institution satisfactory to the State Board for Public Accountancy; or
   2. Be employed by a firm registered with the Department pursuant to section 70.8 of the Regulations of the Commissioner of Education that has undergone a peer review satisfactory to the Department which indicates that the firm has received a rating of pass or pass with deficiencies; and
   b. Have completed at least 40 hours of continuing education in the area of accounting, auditing or attest during the prior three calendar years or in the calendar year in which the service is performed; and
   c. Have maintained the level of education, experience and professional conduct required by generally accepted professional standards as described in paragraph (7) of this subdivision, relating to the attest services performed.

iii. Any licensee who supervises a compilation engagement or signs or authorizes someone to sign an accountant’s report on financial statements of a client for such compilation services shall:
   a. Have completed at least 40 hours of continuing education in the area of accounting, auditing or attest during the prior three calendar years or in the calendar year in which the service is performed; and
   b. Have maintained the level of education, experience and professional conduct required by generally accepted professional standards as described in paragraph (7) of this subdivision, relating to the compilation services performed.
Summary

Competency Requirement for Supervising Attest and Compilation Services

- Effective January 1, 2011 for all licensees.
- Requires at least 1,000 hours of experience within the previous five years.
- Must be part of a firm that is properly registered and has successfully undergone peer review.
- Completed at least 40 hours of accounting, auditing, or attest CE during the prior three years.
- Must comply with generally accepted professional standards.

14. Failing to maintain an active registration with the Department in accordance with the requirements of this paragraph when a licensee engages in the practice of public accountancy pursuant to Education Law section 7401 or uses the title "certified public accountant" or the designation "CPA" or the title "public accountant" or the designation "PA".
   i. Applicability of the requirement. Effective July 26, 2009, all certified public accountants and public accountants licensed in New York State who are either engaged in the practice of public accountancy pursuant to Education Law section 7401 of the Education Law or use the title "certified public accountant" or "public accountant" shall register with the Department.
   ii. Any certified public accountant or public accountant licensed in New York State who is not practicing public accountancy pursuant to Education Law section 7401 and does not use the title "certified public accountant" or the designation "CPA" or the title "public accountant" or designation "PA" may request an inactive status and will not be required to register with the Department.
   iii. Definition: As used in this paragraph:
       a. Inactive status shall mean that a certified public accountant or public accountant has requested, and the Department has approved, an inactive status because the certified public accountant or public accountant does not use the title "certified public accountant" or the designation "CPA" or the title "public accountant" or designation "PA" and does not practice public accountancy pursuant to Education Law section 7401.
       b. Use of the title "certified public accountant" or "public accountant" or designation "CPA" or "PA" shall mean any representation that a person holds a license as a certified public accountant or public accountant, provided that representation is made by the licensee, or by someone associated with the licensee who the licensee has knowingly allowed to make such representation, or by someone serving as the licensee's agent who the licensee has knowingly allowed to make such representation.
c. A representation shall include, but not be limited to, any oral, electronic, or written communication within the control of the licensee, indicating that the person holds a license, including without limitation the use of titles or designations on letterheads, reports, business cards, brochures, resumes, office signs, telephone directories, websites, the Internet, or any other advertisement, news article, publication, listing, tax return signature, signature on experience certifications for licensure applicants, the display of licenses as a certified public accountant or public accountant from this or any other jurisdiction, or the display of certificates or licenses from other organizations which have the designation "CPA" or "PA" or use of the title "certified public accountant" or "public accountant" with the licensee's name.

Summary
Failing to Maintain an Active Registration When Using the Title or Designation

- New law effective July 26, 2009.
- Must register active if you practice public accountancy or use the title "certified public accountant" or use the designation "CPA".
- "Using the title" includes any representation that the individual holds a CPA or PA license including cards, brochures, resumes, phone directories, websites, tax return signature or simply displaying the CPA certificate.
- The definition of "Public Accountancy" is greatly expanded as follows:

§7401. Definition of practice of public accountancy.

The practice of the profession of public accountancy is defined as:

1. Offering to perform or performing attest and/or compilation services, as defined in section seventy-four hundred one-a of this article;
2. Incident to the services described in subdivision one of this section, offering to perform or performing professional services for clients, in any or all matters relating to accounting concepts and to the recording, presentation, or certification of financial information or data; or
3. Offering to perform or performing, for other persons one or more types of the following services including but not limited to accounting, management advisory, financial advisory, and tax exclusive of services within subdivisions one and two of this section, involving the use of professional skills or competencies of the licensed accountant as described in the rules of the board of regents, including professional services rendered to one's employer not required to register under section seventy-four hundred eight of this article, in any and all matters related to accounting concepts and to the recording of financial data or information or the preparation or presentation of financial statements.

b. Unprofessional conduct shall also include permitting any person to share in the income of a firm practicing public accountancy other than a person authorized to practice public accountancy who is a sole proprietor, a partner, or an officer, director or shareholder of a professional corporation or an employee thereof. This prohibition
shall not prevent the payment of salaries or other compensation to employees of a public accounting firm, provided that the total of salaries and other compensation of unlicensed employees which is computed in whole or in part on the basis of a percentage of the income or receipts of the firm does not exceed 35 percent of the annual net income of the firm. For the purposes of this subdivision, annual net income of the firm shall be computed without deduction for total compensation paid to a sole proprietor, partners, or officers, directors or shareholders of professional corporations. Except as provided in this subdivision, it shall be unprofessional conduct for a licensee or professional accounting firm to enter into any arrangement or agreement whereby the amount to be paid for furnishing of space, facilities, equipment or personnel services to the licensee or firm is computed in whole or in part on the basis of a percentage of, or is otherwise dependent upon, the income or receipts of the licensee or firm. The provisions of this subdivision shall apply in lieu of Section 29.1(2)(d) of this Part.

c. Unprofessional conduct shall also include revealing of personally identifiable facts, data or information obtained in a professional capacity without the prior consent of the client, except such information may be disclosed as necessary to other licensees of the profession conducting professional standards or ethics reviews, or as otherwise authorized or required by law.

d. The definitions of unprofessional conduct prescribed in sections 29.1 and 29.10 of this Part that apply to licensees shall also apply to public accountancy firms, meaning any form of business organization that is authorized to engage in the practice of public accountancy and is subject by law to Regents disciplinary proceedings and penalties in the same manner and to the same extent as licensees, unless public accountancy firms are specifically exempted from the definitions of unprofessional conduct in such sections of this Part.

e. Reportable events.
   1. For purposes of this subdivision, public accountancy firm shall have the meaning defined in subdivision (d) of this section.

   2. Unprofessional conduct in the practice of public accountancy shall include failure of a licensee or public accountancy firm to submit a written report, as prescribed in paragraph (3) of this subdivision, to the department within 45 days of the occurrence of any of the following events, even though all available appeals have not yet been exhausted, unless exempted from disclosure pursuant to paragraph (5) of this subdivision or excused for good cause as determined by the department, such as a circumstance beyond the licensee's or public accountancy firm's control that prevented timely compliance:
      i. Conviction of a licensee, a registered partnership, or public accountancy firm in New York State or any other jurisdiction of a crime that constitutes a felony or misdemeanor in the jurisdiction of conviction. For purposes of this subparagraph, conviction shall include a plea of guilty or no contest, or a verdict or finding of guilt that has been accepted and entered by a court of competent jurisdiction;
ii. Receipt of a court decision awarding a monetary judgment in excess of twenty-five thousand dollars in a civil action brought in a court of competent jurisdiction or an award in excess of twenty-five thousand dollars in an arbitration proceeding in which the licensee, the registered partnership, or public accountancy firm is found to be liable for:
   a. Negligence, gross negligence, recklessness, or intentional wrongdoing relating to the practice of public accountancy in New York State;
   b. Fraud or misappropriation of funds relating to the practice of public accountancy in New York State;
   c. Breach of fiduciary responsibility relating to the practice of public accountancy in New York State; or
   d. Preparation, publication, and/or dissemination of false, fraudulent, and/or materially incomplete or misleading financial statements, reports, or information relating to the practice of public accountancy in New York State;

iii. Receipt of written notice of imposition of a disciplinary penalty upon the licensee, the registered partnership, or public accountancy firm, including but not limited to, censure, reprimand, sanction, probation, monetary penalty, suspension, revocation, or other limitation on practice, relating to the practice of public accountancy, issued by:
   a. The United States Securities and Exchange Commission or the Public Company Accounting Oversight Board;
   b. Another agency of the United States government that regulates the practice of public accountancy;
   c. An agency of the government of another state or territory of the United States that regulates the practice of public accountancy; or
   d. An agency of the government of another country that regulates the practice of public accountancy;

3. The report to the department shall consist of the following:
   i. For a conviction as prescribed in subparagraph (i) of paragraph (2) of this subdivision, the report shall consist of a copy of the certificate of conviction, or comparable document of the court;
   ii. For a court decision or arbitration award as prescribed in subparagraph (ii) of paragraph (2) of this subdivision, the report shall consist of a copy of the court decision or arbitration award and any findings of facts or special verdict form;
   iii. For a written notice of imposition of a disciplinary penalty upon the licensee, as prescribed in subparagraph (iii) of paragraph (2) of this subdivision, the report shall consist of a copy of the notice; or
   iv. In lieu of the documentation described in subparagraphs (i), (ii), or (iii) of this paragraph, a narrative statement on a form prescribed by the department setting forth information specified by the department, including but not limited to the date and jurisdiction of the court decision and/or judgment, conviction, arbitration award, or notice of imposition of disciplinary penalty, as applicable.
4. A public accountancy firm shall be responsible for reporting reportable events relating to the public accountancy firm, and shall designate an individual to make such reports. An individual licensee shall be responsible for reporting those reportable events specifically relating to the licensee. Licensees who are partners in a registered partnership may designate an individual to report reportable events relating to the registered partnership, but each such licensee shall be responsible for ensuring the reporting of the reportable events.

5. Failure to submit a report which is subject to a confidentiality order, clause or provision in a court decision or arbitration award under subparagraphs (i) or (ii) of paragraph (2) of this subdivision shall not be deemed to constitute unprofessional conduct under the following conditions:
   i. The court or arbitrator has included language in such decision that specifically provides that the decision shall not be reported to the department pursuant to this subdivision; or
   ii. The licensee or firm demonstrates to the satisfaction of the department that the licensee or firm explicitly informed the court or arbitrator in writing prior to execution of any confidentiality order, clause or provision of the duty to report such decision to the department and the effect of any confidentiality order, clause or provision on such duty of disclosure, and the confidentiality order, clause or provision does not expressly provide for disclosure to the department.

6. Reports submitted to the department in accordance with this subdivision shall be files of the department relating to the investigation of possible instances of professional misconduct and shall be confidential in accordance with the provisions of subdivision (8) of section 6510 of the Education Law.

7. Nothing in this subdivision shall have any effect upon the duty of the licensee or firm to respond fully to all questions on any re-registration application which shall become due, or to respond to written communications from the department pursuant to section 29.1(b)(13) of this Part.

**Summary**

**Reportable Events**

- Reports due within 45 days.
- Reportable events include criminal convictions, certain civil judgments in excess of $25,000, and disciplinary actions by other governmental bodies.

f. Unprofessional conduct in the practice of public accountancy shall include:

1. Having admitted guilt to or having been found guilty of improper professional practice or professional misconduct in a disciplinary proceeding brought by the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board, where the conduct upon which the finding or admission of guilt was based would, if committed in New York State, constitute professional misconduct under the laws of New York State, provided that in any adversary
proceeding conducted pursuant to subdivision (3) of section 6510 of the Education Law, the individual licensee or public accountancy firm shall have the rights set forth in that subdivision; or

2. Having voluntarily consented to a revocation or temporary or permanent suspension of the authority to appear or practice as an accountant before the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board, or having voluntarily surrendered such authority; or having voluntarily consented to a revocation or temporary or permanent suspension from further association with any public accounting firm registered pursuant to Chapter 98 of Title 15 of the United States Code, or having voluntarily surrendered such authority; or having voluntarily consented to a revocation or temporary or permanent suspension of registration under Chapter 98 of Title 15 of the United States Code, or a voluntary surrender of such registration; all after a disciplinary action was commenced by the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board where any conduct charged resulting in the consent to such revocation or temporary or permanent suspension or surrender would, if committed in New York State, constitute professional misconduct under the laws of New York State; and where the date of such consent or surrender is on or after January 1, 2007. In any adversary proceeding conducted pursuant to subdivision (3) of section 6510 of the Education Law, the individual licensee or public accountancy firm shall have the rights set forth in that subdivision.

g. Unprofessional conduct in the practice of public accountancy, as such practice relates to the audit in the practice of public accountancy of an issuer of publicly traded securities that is subject to the Federal Sarbanes-Oxley Act of 2002, shall include, for purposes of subdivision (f) of this section, a failure of a licensee or public accountancy firm, as appropriate, to meet the standards prescribed in the following provisions of Federal law: subdivisions (a), (b), (g), (h), (i), (j), (k), and/or (l) of section 78j-1 of Title 15 of the United States Code (United States Code, 2000 edition, Volume 7, and Supplement II, Volume 1 to the 2000 edition; Superintendent of Documents, U.S. Government Printing Office, Stop SSOP, Washington, DC 20402-0001; available at the NYS Education Department, Office of the Professions, 2M West Wing, Education Building, 89 Washington Avenue, Albany, NY 12234). To the extent that the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board have exempted or excepted licensees or public accountancy firms from these standards, such exemptions or exceptions shall also apply to the requirements of this subdivision.

h.

1. Unprofessional conduct in the practice of public accountancy shall include:

i. Any willful or grossly negligent failure to comply with substantial provisions of Federal, State or local laws, rules or regulations governing the practice of the profession, by a certified public accountant licensed in another state who is performing non-attest services in New York pursuant to Education Law section 7406-a or any firm as defined in Education Law section 7401-a(4) that
employs such certified public accountant to perform non-attest services pursuant to Education Law section 7406-a; or

ii. The failure of any individual licensed as a certified public accountant in another state, who is performing non-attest services pursuant to Education Law section 7406-a and uses the title "certified public accountant" or the designation "CPA" to identify his or her state of principal place of business in parentheses following his or her title or designation.

2. Any certified public accountant licensed by another state, who performs non-attest services pursuant to Education Law section 7406-a, and any firm that employs such certified public accountant to provide such services in New York State, is subject to the disciplinary authority of the Board of Regents pursuant to Education Law section 7406-a.

i. Definition.

i. As used in this subdivision, commission shall mean any compensation, including a referral fee, paid by a third party to the licensee and the public accounting firm that employs such licensee, for recommending or referring any product or service to be supplied by another person.

2. It shall be unprofessional conduct in the practice of public accountancy for:

i. A licensee or the public accountancy firm employing such licensee to directly or indirectly, offer, give, solicit, or receive or agree to receive, a commission for the referral of any product or service to a client if the licensee is performing any of the following services:
   a. Audit or review of a financial statement;
   b. Compilation of a financial statement when the licensee expects, or reasonably might expect that a third party will rely upon the financial statements and the licensee's compilation report does not disclose a lack of independence; or
   c. An examination of prospective financial information;
   d. And/or any other attest service.

ii. Except as otherwise provided in this subdivision, a licensee to receive a commission for recommending the products or services of a third party to his/her client without providing a written disclosure to the client to notify the client of the receipt of a commission in accordance with the provisions of paragraph (5) of this subdivision.

3. This subdivision does not prohibit the receipt of a payment by a licensee or firm for the purchase of a public accounting practice or retirement payments paid to individuals presently or formerly engaged in the practice of public accountancy or payments to their heirs or estates.

4. These prohibitions apply during the period in which the licensee is engaged to perform any of the services described in subparagraph (i) of paragraph (2) of this subdivision and the period covered by any financial, accounting or related statements involved in such services.
5. A licensee who is not performing any of the services described in subparagraph (i) of paragraph (2) of this subdivision for the client, but is performing other professional services for that client, may accept a commission for recommending the products or services of a third party to the client, provided that the licensee discloses the receipt of the commission to the client by way of a written disclosure statement in 12 point type or larger containing the following information:

i. A description of the product(s) or service(s) which the licensee is recommending to the client, the identity of the third party that is expected to provide the product or service, the business relationship between the licensee and the third party, a description of any commission which may be received by the licensee and/or the licensee’s firm. Where the product(s) or service(s) cannot be specifically identified at the time of the initial disclosure, this information shall be included in a supplemental disclosure which the licensee must provide to the client within 30 days of receipt of the commission; and

ii. The dollar amount or value of the commission or the basis on which such commission shall be computed.

6. The written disclosure statements prescribed in paragraph (5) of this subdivision shall be on letterhead of the licensee, if a sole proprietor, or otherwise on the letterhead of the firm authorized to practice public accountancy that employs the licensee, and shall be signed by the licensee. The disclosure statement shall be signed and dated by the client and contain an acknowledgment by the client that the client has read and understands the information contained in the disclosure. Any supplemental disclosures described in subparagraph (i) of paragraph (5) of this subdivision are not required to be signed by the client or by the licensee. The licensee shall retain disclosure statements for a period of seven years and shall provide copies to clients upon request.

7. The provisions of this section do not apply to licensees who perform accounting, management advisory, financial advisory, consulting or tax services for an entity that is not required to register with the department under Education Law section 7408.

8. This subdivision shall apply in lieu of section 29.1(b)(3) of this Part.

**Summary**

**Commissions**

- Commission is widely interpreted and includes any compensation including referral fees paid by a third party for recommending a product or service.
- Prohibited for attest clients.
- Permitted for non-attest clients under certain circumstances.
- Written disclosure must meet applicable standards, be on letterhead, and include the dollar amount or basis for computing the commission.
- New York rules generally follow AICPA rules you studied previously.
Recent Amendments to the Professional Conduct Rules –
Guidelines/Questions and Answers

General Information

1. What changes are included in the amendments?

The amendments strengthen the Regents oversight of the public accounting profession by:

- Updating the list of recognized professional standard setting bodies that promulgate generally accepted auditing standards and generally accepted accounting principles.
- Establishing a list of "reportable events" that all licensees and registered firms must report to the Department within 45 days of occurrence. The occurrence of one of these events does not, in itself, constitute unprofessional conduct. Failure to report one of the listed events within 45 days, however, will constitute unprofessional conduct.
- Revising the definition of unprofessional conduct in the practice of public accountancy to include violations of key practice standards established by the United States Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB). This will enable the Department to take disciplinary action when a licensee or firm has admitted to or been found guilty of a violation of these Federal practice standards or has consented to a penalty that suspends them from appearing or practicing before the United States Securities and Exchange Commission or the Public Company Accounting Oversight Board.

Reportable Events

2. How are these new reportable events different from the events that licensees currently report on their triennial registration form?

The Department currently requires licensed Certified Public Accountants and Public Accountants to disclose information regarding felony and misdemeanor convictions; disciplinary action taken by any licensing body; pending criminal charges; or pending professional misconduct charges in any jurisdiction on a triennial basis at re-registration.

The enacted amendments will require all licensees and registered firms to report any criminal convictions; civil action judgments and arbitration proceedings in excess of $25,000 that relate to the practice of public accountancy in NYS; or a disciplinary penalty by a governmental entity that relates to the practice of public accountancy within 45 days of their occurrence. (Please read the questions below for detailed explanations of each reportable event) In addition to these specific reporting requirements, licensed Certified Public Accountants and Public Accountants will continue to answer questions regarding convictions, disciplinary actions and pending charges on their registration renewal forms.
3. What is the Department going to do if I report an event?

It is important to remember that the occurrence of a reportable event, in and of itself, does not constitute unprofessional conduct. These amendments make failure to report that event the unprofessional conduct. Reporting of these events by individual licensees and firms will allow the Department to pursue timely investigations into possible instances of unprofessional conduct. Reports will be reviewed by staff in the Office of Professional Discipline (OPD) in the same way that disclosure on the triennial registration forms is currently reviewed.

The information submitted by a licensee or firm to meet the reporting requirement is immediately placed into an investigatory file. By law, all information in an investigatory file is confidential and cannot be disclosed except in the unlikely event that it is introduced in evidence in an OPD disciplinary hearing or upon court order in a pending action or proceeding. If it appears that unprofessional conduct pursuant to NYS regulations and rules has occurred, OPD will open an investigatory file, the contents of which are confidential while the investigation is being pursued. If it appears, after review of the submitted report, that there is no unprofessional conduct, pursuant to NYS rules and regulations, the documents constituting the report will be disposed of. If it appears, after review of the submitted report, that unprofessional conduct pursuant to NYS rules and regulations has occurred, the Office for Professional Discipline will conduct an investigation. All investigations are conducted pursuant to Section 6510 of the State Education Law. In the event that the investigation leads to disciplinary proceedings that result in a finding, the report of such disciplinary proceeding or voluntary settlement will become public information.

4. I am going to appeal my conviction/civil action judgment/arbitration decision/disciplinary action. Do I still need to report it?

Yes. The amendments specify very clearly that you need to report each event to the Department within 45 days of occurrence even though all available appeals have not yet been exhausted.

While not required by these rules, you may voluntarily provide notice to the Department that you have filed an appeal. This notice will be added to the investigatory file and will be taken into consideration when the file is reviewed.

5. What happens if my court decision or arbitration award includes a confidentiality clause? How can I disclose a reportable event to the Department without violating that clause?

The regulations require the licensee or public accounting firm to proactively notify the court or arbitrator that there is a New York reporting requirement for court decisions and arbitration proceedings awarding a monetary judgment in excess of $25,000 in a civil action or arbitration proceeding.
This particular reporting requirement applies if the licensee or public accounting firm is found liable for:

- Negligence, gross negligence, recklessness, or intentional wrongdoing relating to the practice of public accountancy in New York State;
- Fraud or misappropriation of funds relating to the practice of public accountancy in New York State;
- Breach of fiduciary responsibility relating to the practice of public accountancy in New York State; or
- Preparation, publication, and/or dissemination of false, fraudulent, and/or materially incomplete or misleading financial statements, reports, or information relating to the practice of public accountancy in New York State.

After notification of the reporting requirement by the licensee or firm, the court or arbitrator could choose to:

1. Specifically exempt from the confidentiality clause, notification of the reportable event to the State Education Department, or
2. Specifically include the State Education Department, in the confidentiality clause, or
3. Issue a confidentiality clause that does not expressly provide for disclosure to the State Education Department (neither exempts nor specifically includes the Department).

See the Board’s website for more information.

6. Who is responsible for reporting events that relate to me as an individual?

The amendments specify quite clearly that the individual licensee is responsible for reporting events that relate specifically to that licensee.

7. Who is responsible for reporting events that relate to a firm and/or partnership?

The amendments specify that a public accountancy firm (PC, LLC or LLP) shall designate an individual who shall be responsible for reporting events on behalf of the firm. In the case of a registered partnership, the licensed partners may designate an individual to report reportable events relating to the partnership, however, each licensed partner is responsible for ensuring the reporting of any reportable events. This responsibility to ensure reporting can be met by making sure that there is are established procedures for reporting events on a timely basis and periodically checking to ensure that the established procedures are being followed.

8. I am not sure if I need to report a particular event, what documentation I need to submit, or where I should send it. Can you provide additional details for reporting each type of event?

Yes. The amendments provide certain detail and limiting factors for each type of event, they also specify the report format for each type of event.
Conviction of a Crime

Any conviction of a felony or misdemeanor in any jurisdiction must be reported, regardless of the nature of the crime.

Monetary Judgment in a Civil Court or Arbitration Proceeding

A licensee or firm must report a court decision awarding in excess of $25,000 in a civil action brought in a court of competent jurisdiction or an award in excess of $25,000 in an arbitration proceeding if the licensee or firm is found to liable for:

- Negligence, gross negligence, recklessness, or intentional wrongdoing relating to the practice of public accountancy in NYS; or
- Fraud or misappropriation of funds related to the practice of public accountancy in New York State; or
- Breach of fiduciary responsibility relating to the practice of public accountancy in NYS; or
- Preparation, publication, and/or dissemination of false, fraudulent and/or materially incomplete or misleading financial statements, reports, or information relating to the practice of public accountancy in NYS.

Disciplinary Penalty by a Regulatory Entity

A licensee or firm must report the receipt of written notice of a disciplinary penalty (including, but not limited to censure, reprimand, sanction, probation, monetary penalty, suspension, revocation or other limitation on practice) if it relates to the practice of public accountancy and is issued by one of the following entities:

- The SEC or the PCAOB; or
- Another agency of the U.S. government that regulates the practice of public accountancy; or
- An agency of the government of another state or territory of the U.S. that regulates the practice of public accountancy; or
- An agency of the government of another country that regulates the practice of public accountancy.

See the Board’s website for more information.
## COMPARISON OF STATE AND PROFESSIONAL SOCIETIES RULES ON ETHICS

<table>
<thead>
<tr>
<th>ITEM</th>
<th>AICPA</th>
<th>NEW YORK STATE SOCIETY OF CPAS</th>
<th>STATE RULES</th>
</tr>
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<tbody>
<tr>
<td>1. Who rules apply to</td>
<td>Only AICPA members. Membership is voluntary</td>
<td>Only members of NYSCPA. Membership is voluntary</td>
<td>State rules apply to all CPAs</td>
</tr>
<tr>
<td>2. Departing from rules</td>
<td>Members must justify departures from rules or face disciplinary procedure</td>
<td>Members must justify departures or face disciplinary procedures</td>
<td>CPAs may not depart from rules</td>
</tr>
<tr>
<td>3. Maximum disciplinary sanctions</td>
<td>Revocation of AICPA membership</td>
<td>Revocation of NYSCPA membership</td>
<td>Revocation of CPA license; criminal penalties including prison; civil penalties; censure and reprimand; fines up to $10,000</td>
</tr>
<tr>
<td>4. Client Records</td>
<td>Must return client records upon request</td>
<td>Must return client records upon request</td>
<td>Must return client records upon request</td>
</tr>
<tr>
<td>5. CPA workpapers that are needed to make a client’s records complete</td>
<td>A member may require that fees due the member with respect to complete engagements be paid before such information is provided</td>
<td>Same as AICPA</td>
<td>Same as AICPA</td>
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<tr>
<td>6. Failure to pay child support</td>
<td>No provision</td>
<td>No provision</td>
<td>Possible loss of license</td>
</tr>
<tr>
<td>7. Failure to pay certain student loans</td>
<td>No provision</td>
<td>No provision</td>
<td>Possible loss of license</td>
</tr>
<tr>
<td>8. Partnerships</td>
<td>AICPA does not require the registration of partnerships</td>
<td>Same as AICPA</td>
<td>The state requires partnerships to register and provide notification of changes to the partnership</td>
</tr>
<tr>
<td>9. Advertising</td>
<td>Advertising may not be false or misleading</td>
<td>Same as AICPA</td>
<td>In addition to prohibiting false and misleading advertising, the state requires CPAs to keep a copy of all advertisements for at least one year</td>
</tr>
<tr>
<td>10. Non licensee ownership</td>
<td>Allows minority ownership of CPA firms by non licensees</td>
<td></td>
<td>Non licensee ownership prohibited; however, profit sharing with non-licensees is permitted in certain circumstances</td>
</tr>
</tbody>
</table>
The Board receives frequent inquiries regarding fees charged by New York accountants. Many times the caller is surprised by the amount of a bill they have received for CPA services and report it to the Board as a complaint.

It is up to the accountant to determine the appropriate fee to charge for services provided. Licensees can avoid this situation by providing an engagement letter that spells out the fee arrangement during the initial appointment.

An engagement letter describes the services to be performed, the amount to be charged and other provisions that may affect the services provided.

Common provisions in an engagement letter include the following:

- identification of the client
- description of the agreement and its limitations
- timing of the work and staffing of the engagement
- client information and responsibilities
- designation of the party to work with the CPA
- identification of intended users of the CPA’s work product
- fees and payments
- withdrawing from and/or terminating the engagement
- responding to discovery requests, subpoenas, and outside inquiries
- alternative dispute resolution as a means of resolving disputes
- where applicable, disclosures recommended or required by the AICPA
- client signature

Take time to review the engagement letter with the client before services are performed and provide a copy with the client’s signature and your signature to the client with a copy for the file.

Well-structured engagement letters help reduce misunderstandings regarding fees and services to be performed, decreasing the likelihood that the client will have complaints about fees charged.
2009 Revision to Accountancy Law

In 2009, Governor Patterson signed a bill expanding the regulation of CPAs in New York. This is the first substantial change to the law since 1947. Following is a summary of the changes.

Scope of Practice

The scope of practice is broadened to include the types of services that involve the use of professional skills and competencies in matters related to accounting concepts, including but not limited to management advisory, financial advisory, and tax preparation and advisory services.

Oversight is expanded to include the use of the CPA title or the performance of services by a licensed CPA or PA.

Practice Privilege

Out of state CPAs may provide services within New York as long as they agree to be subject to the jurisdiction of the Board of Regents.

CPA Firm Requirements

Modifies firm name requirements. At least one firm owner must be a New York CPA. Firms other than sole proprietorships must have at least two owners. Firms must annually notify the Board of Regents regarding any changes in the number of owners or the number or location of offices within the state.

CPE Changes

- CPAs and PAs who are not engaged in professional practice are exempt from CPE if they file a written statement with the department.

- CPAs and PAs may take 24 hours of concentrated CE in any of the recognized areas of study including accounting, attest, auditing, taxation, advisory services, specialized knowledge, and other areas acceptable to the department.

- The CPE due date is changed from August 31 to December 31.

- No CPE is required in the first renewal period after first becoming licensed by the department.
Quality Review

Firms other than sole proprietorships and firms with two or fewer professionals that perform attest engagements must participate in mandatory quality review.

Firms that perform attest engagements for New York governmental entities must undergo an external peer review.

These two provisions are effective January 1, 2012.

Service by Inactive CPAs as Members of Boards of Directors or Board Committees

Retired CPAs serving on boards of directors of both for-profit and not-for-profit organizations may do so in “retired” or inactive status as long as they are not providing attest or compilation services and are not the designated financial expert where required by the Sarbanes-Oxley Act of 2002 and its implementing rules. Inactive CPAs may also serve as members of an officially designated committee of the board without being a board member, provided that the committee does not have independent authority to act and instead gives advice to the board for board action. However, inactive CPAs who serve as members of boards or board committees must be aware that services are limited to those they provide to the board as a board or board committee member and do not extend to services performed in any other capacity, such as services provided as an employee of the board.

Inactive CPAs must disclose to the board and to any third parties with whom they communicate on behalf of the board the fact that they are not actively registered or required to take continuing education. Disclosure would be adequate if it reasonably informed both the board and any such third parties that the inactive CPA is acting solely in the capacity of a board member or board committee member and not acting as a CPA, is not registered to practice, and is not required to take continuing professional education (CPE) course work.

Inactive CPAs may file documents on behalf of the corporation, but they should not include the CPA designation on corporate letterhead, in correspondence, or on forms submitted on behalf of the corporation. However, their licensure as a CPA may be referenced in any biographical information about board members.

Additionally, inactive CPAs should not accept salaries or compensation for providing professional services while not registered. This, however, would not prohibit an inactive CPA from receiving board member compensation that is offered to all board members with similar levels of responsibility and/or time commitment.

Inactive CPAs serving on boards must be careful not to independently engage in providing CPA services to third parties, such that they could be deemed to be practicing. Finally, please be aware that any CPA wishing to change to inactive status must affirmatively notify the NYS Board for Public Accountancy in writing of their intention to do so.
CHAPTER 8 – REVIEW QUESTIONS

The following questions are designed to ensure that you have a complete understanding of the information presented in the chapter. They do not need to be submitted in order to receive CPE credit. They are included as an additional tool to enhance your learning experience.

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Advertising or soliciting not in the public interest includes advertising which:
   a) is false, fraudulent, deceptive or misleading
   b) guarantees any service
   c) makes claims of professional superiority which cannot be substantiated by the licensee
   d) all of the above

2. Which of the following would be considered a contingent fee:
   a) charging a fee for preparation of a tax return based on 10% of the client’s refund
   b) fees in a bankruptcy case that are determined by the court after completion of the engagement
   c) the IRS is auditing a client’s return and has proposed an assessment of $10,000. You represent the client in exchange for a percentage of any decrease in the assessment
   d) you charge a different hourly rate to different clients
CHAPTER 8 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Advertising or soliciting that is false, fraudulent, deceptive or misleading is not in the public interest, but this is not the only correct answer.

   B: Incorrect. Advertising or soliciting that guarantees any service is not in the public interest, but this is not the only correct answer.

   C: Incorrect. Advertising or soliciting that makes claims of professional superiority which cannot be substantiated by the licensee is not in the public interest, but this is not the only correct answer.

   D: Correct. Advertising or soliciting that is false, fraudulent, deceptive or misleading, that guarantees any service, or that makes claims of professional superiority which cannot be substantiated by the licensee are all considered not in the public interest.

   (See page 8-4 of the course material.)

2. A: Correct. Filing a tax return in exchange for a percentage of any refund is a prohibited contingent fee.

   B: Incorrect. Fees set by courts are not considered to be contingent.

   C: Incorrect. Fees based on the findings of governmental agencies are not considered to be contingent.

   D: Incorrect. Charging different fees to different clients is in no way a contingent fee.

   (See page 8-7 of the course material.)
## Glossary of Ethics Terms

The terms included in this glossary are related to the ethics area in general, but may not be specifically used in this material. They are provided for greater clarification and educational purpose.

<table>
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<tr>
<th>TERM</th>
<th>DEFINITION</th>
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<tr>
<td>Alternative Practice Structures (APS)</td>
<td>A nontraditional structure for the practice of public accounting in which a traditional CPA firm engaged in auditing and other attestation services might be closely aligned with another organization, public or private, that performs other professional services (e.g., tax and consulting).</td>
</tr>
<tr>
<td>American Institute of Certified Public Accountants (AICPA)</td>
<td>The national professional organization for all certified public accountants (CPAs).</td>
</tr>
<tr>
<td>Client’s records</td>
<td>Any accounting or other records belonging to the client that were given to the member by, or on behalf of, the client.</td>
</tr>
<tr>
<td>Close relative</td>
<td>Close relatives are the member’s nondependent children (including grandchildren and stepchildren), brothers and sisters, grandparents, parents, and parents-in-law. Spouses of any of the above are also close relatives. The SEC definition of close relatives expands the above to include a spouse’s brothers and sisters and their spouses.</td>
</tr>
<tr>
<td>Code of Professional Conduct (the Code)</td>
<td>The Code was adopted by the membership of the AICPA to provide guidance and rules to all members on various ethics requirements. The Code consists of: 1) Principles, 2) Rules, 3) Interpretations, and 4) Ethics Rulings.</td>
</tr>
<tr>
<td>Conflict of interest</td>
<td>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.</td>
</tr>
</tbody>
</table>
| Consulting process                            | The analytical approach applied in performing a consulting service. The process typically involved some combination of the following:  
  • Determining the client’s objective  
  • Fact-finding  
  • Defining problems or opportunities  
  • Evaluating alternatives  
  • Formulating proposed actions  
  • Communicating results  
  • Implementing  
  • Following up                                                                                                                                             |
<table>
<thead>
<tr>
<th>Consulting services</th>
<th>Professional services that use the practitioner’s technical skills, education, observations, experiences, and knowledge of the consulting process.</th>
</tr>
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<tr>
<td>Contingent fee</td>
<td>A fee for performing any service in which the amount of the fee (or whether a fee will be paid) depends on the results of the service.</td>
</tr>
<tr>
<td>Direct financial interest</td>
<td>A direct financial interest is created when a member invests in a client entity.</td>
</tr>
<tr>
<td>Disqualifying services</td>
<td>Term used to refer to the following services, which when performed for a client prohibit the member from accepting a contingent fee or commission:</td>
</tr>
<tr>
<td>a. An audit or a review of a financial statement.</td>
<td></td>
</tr>
<tr>
<td>b. An examination of prospective financial information.</td>
<td></td>
</tr>
<tr>
<td>c. A compilation of a financial statement expected to be used by third parties except when the compilation report discloses a lack of independence.</td>
<td></td>
</tr>
<tr>
<td>Ethics Rulings</td>
<td>Part of the Code of Professional Conduct. Rulings summarize the application of rules and interpretations to a particular set of factual circumstances.</td>
</tr>
<tr>
<td>Firm</td>
<td>A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.</td>
</tr>
<tr>
<td>Former practitioner</td>
<td>A proprietor, partner, shareholder or equivalent of a firm, who leaves by resignation, termination, retirement, or sale of all or part of the practice.</td>
</tr>
<tr>
<td>Holding out as a CPA</td>
<td>Includes any action initiated by a member, whether or not in public practice, that informs others of his or her status as a CPA.</td>
</tr>
<tr>
<td>Independence in appearance</td>
<td>If there are circumstances that a reasonable person might believe are likely to impair independence, the CPA is not independent in appearance. To be recognized as independent, the auditor must be free from any obligation to or interest in the client, its management, or its owners.</td>
</tr>
<tr>
<td>Independence in fact</td>
<td>To be independent in fact (mental independence), the CPA must have integrity and objectivity. If there is evidence that independence is actually lacking, the auditor is not independent in fact.</td>
</tr>
<tr>
<td>Indirect financial interest</td>
<td>An indirect financial interest is created when a member invests in a nonclient entity that has a financial interest in a client.</td>
</tr>
<tr>
<td>Integrity</td>
<td>An element of character fundamental to professional recognition. It is the quality from which public trust derives and the benchmark against which a member must ultimately test all decisions.</td>
</tr>
<tr>
<td><strong>Internal audit outsourcing</strong></td>
<td>Internal audit outsourcing involves performing audit procedures that are generally of the type considered to be extensions of audit scope applied in the audit of financial statements. Examples of such procedures might include confirming receivables, analyzing fluctuations in account balances, and testing and evaluating the effectiveness of controls.</td>
</tr>
<tr>
<td><strong>Interpretations of rules of conduct</strong></td>
<td>Part of the Code of Professional Conduct. Interpretations are pronouncements issued by the AICPA’s Division of Professional Ethics to provide guidelines concerning the scope and application of the rules of conduct.</td>
</tr>
<tr>
<td><strong>Joint closely held business investment</strong></td>
<td>An investment that is subject to control by the member, or the member’s firm, client or its officers, directors, or principal stockholders, or any combination of the above.</td>
</tr>
<tr>
<td><strong>Joint Ethics Enforcement Program (JEEP)</strong></td>
<td>The AICPA and most state societies cooperate in the Joint Ethics Enforcement Program (JEEP) in bringing enforcement actions against their members.</td>
</tr>
<tr>
<td><strong>Member</strong></td>
<td>In its broadest sense, “member” is a term used to describe a member, associate member, or international associate of the AICPA. All members must adhere to the AICPA’s Code of Professional Conduct. For the purposes of applying the independence rules, the term “member” identifies the people in a CPA firm and their spouses, dependents, and cohabitants who are subject to the independence requirements.</td>
</tr>
<tr>
<td><strong>Multidisciplinary practices (MDP)</strong></td>
<td>Arrangements in which CPAs share fees with attorneys or other professionals.</td>
</tr>
<tr>
<td><strong>National Association of State Boards of Accountancy (NASBA)</strong></td>
<td>A voluntary organization composed of the state boards of accountancy. It promotes communication, coordination, and uniformity among state boards.</td>
</tr>
<tr>
<td><strong>Objectivity</strong></td>
<td>The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Objectivity is a state of mind, a quality that lends value to a member’s services.</td>
</tr>
<tr>
<td><strong>Period of professional engagement</strong></td>
<td>The period of engagement starts when the member begins the service requiring independence and ends upon termination of the relationship (by the member or the client) or, if later, when the report is issued. The period does not stop when the report is issued and restart with the beginning of the next engagement. The period of engagement typically covers many periods.</td>
</tr>
<tr>
<td><strong>Practice of public accounting</strong></td>
<td>According to the Code of Professional Conduct, the practice of public accounting consists of the performance for a client, by a member or a member’s firm, while holding out as CPAs, 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 Council, 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 on Standards for Tax Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements. However, a member or member’s firm, while holding out as CPAs, 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.</td>
</tr>
<tr>
<td><strong>Principles</strong></td>
<td>Positive statements of responsibility in the Code of Professional Conduct that provide the framework for the rules, which govern performance.</td>
</tr>
<tr>
<td><strong>Professional services</strong></td>
<td>Includes all services performed by a member while holding out as a CPA.</td>
</tr>
<tr>
<td><strong>Rules</strong></td>
<td>Broad but specific descriptions of conduct that would violate the responsibilities stated in the principles in the Code of Professional Conduct.</td>
</tr>
<tr>
<td><strong>Securities and Exchange Commission (SEC)</strong></td>
<td>A federal government regulatory agency with responsibility for administering the federal securities laws.</td>
</tr>
<tr>
<td><strong>State boards of accountancy</strong></td>
<td>State government regulatory organizations. Each state government issues a license to practice within the particular state under that state’s accountancy statute.</td>
</tr>
<tr>
<td><strong>State societies of CPAs</strong></td>
<td>Voluntary organizations of CPAs within each individual state.</td>
</tr>
<tr>
<td><strong>Statements on Standards for Tax Services (SSTS)</strong></td>
<td>SSTS superseded and replaced the AICPA’s Statements on Responsibilities in Tax Practice (SRTP). They are enforceable standards of conduct for tax practice under the Code of Professional Conduct.</td>
</tr>
<tr>
<td><strong>Unpaid fees</strong></td>
<td>Fees for: 1) audit, and 2) other professional services that relate to certain prior periods that are delinquent as of the date the current year’s audit engagement begins, if the client is an SEC registrant, or the date the audit report is issued for non-SEC clients (i.e., AICPA rule).</td>
</tr>
<tr>
<td><strong>Yellow Book</strong></td>
<td>Governmental Auditing Standards issued by the Government Accountability Office.</td>
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<td>non-attest services, 5-3, 6-4</td>
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<td>non CPA ownership, 4-16</td>
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