# Ohio Professional Standards and Responsibilities

(Course #4850H)

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Almost all states require that CPAs pass an ethics course prior to obtaining their initial CPA certificate. More and more states are adopting regulations mandating ethics CPE as a condition of renewing one’s right to practice. CPAs often ask, “Why an ethics course – I’ve been practicing for years.” The answer is simple. The accounting industry is undergoing change at a rapid pace.

Ohio law is often different from the AICPA. Thus, while you could be acting ethically in the eyes of the AICPA, you could be in violation of Ohio law.

**HOW THIS COURSE IS ORGANIZED**

Because it is designed as a three CPE hour course, the course focuses on the actual Ohio rules. These “rules” have three sources:

**Chapter 1: Ohio Accountancy Law** – this is the law the General Assembly wrote. It is often vague and leaves much room for interpretation.

**Chapter 2: Rules of the Accountancy Board of Ohio** – these rules were drafted by the Board in order to interpret and clarify the statutes. The rules are based on the statutes but are generally more meaningful because they explain the statute and enumerate special actions which are allowed or prohibited. The rules were adopted only after public hearings and comment.

**Chapter 3: Professional Ethics / Professional Standards Rules** – a portion of the rules specifically related to professional standards.

The statutes, rules and policies can be compared to a pyramid:

![Diagram of a pyramid with Ohio Statutes at the base, Board Rules in the middle, and Professional Standards at the top.]

**NOTE:** This course will examine many of the statutes and rules in numerical order. In each instance, the actual statute, rule or professional standard will be provided followed by a discussion of its relevance, including examples, observations, and practice pointers.
BOARD OF ACCOUNTANCY

The State Board of Accountancy of Ohio regulates the profession of certified public accountants, both individuals and public accounting firms. The practice of public accounting includes the issuance of reports on financial statements, management advisory or consulting services, preparation of tax returns and furnishing advice on tax matters.

Its mission is to...

- Identify, examine and license qualified practitioners;
- Identify and license qualified public accounting firms;
- Conduct investigations to ensure that practitioners comply with generally accepted standards of practice or conduct; and
- Restrict or revoke licenses when generally accepted standards of practice or conduct are not met.

In July 2011, there were over 21,000 permit holders and 4,800 active registered public accounting firms on record.

The Board is responsible for:

- Licensing and regulating individual Certified Public Accountants (CPAs);
- Licensing and regulating Certified Public Accounting Firms;
- Administering the Uniform CPA Examination;
- Investigating complaints against its licensees;
- Conducting disciplinary hearings against licensees who are alleged to have violated the Accountants Law or the Board’s Rules and Regulations;
- Issuing disciplinary action against licensees who violate the Accountants Law or the Board’s Rules and Regulations;
- Renewing individual and firm licenses;
- Making rules and regulations for the orderly conduct of its affairs and for the administration of the Accountants Law;
- Making appropriate rules of professional conduct in order to establish and maintain a high standard of integrity in the profession of public accounting; and
- Monitoring continuing education of its licensees.
Chapter 1: Professional Ethics Statutes

Objectives:

After completing this chapter, you will be able to:

- Identify the professional ethics statutes as enacted by the General Assembly.
- Differentiate between the Ohio statutes and the Board rules.
- Describe how the statutes define false advertising and unlawful practice.

INTRODUCTION

The author has often heard CPAs mention that they are not members of the AICPA (or the state Society) so that they would have more flexibility in practicing accountancy. While it is true that the AICPA Code of Professional Conduct applies only to AICPA members, they fail to realize that most (if not all) of the AICPA principles have, in one form or another, been codified as law by the General Assembly.

In order to remain licensed, an Ohio CPA must abide by the law. In instances where the law and the AICPA Code of Professional Conduct conflict, the CPA must follow the law.

The law relating to CPAs can be divided into two parts. This chapter will discuss the law as passed by the General Assembly known as the Professional Ethics Statutes Act. The next chapter will cover the administrative law as promulgated by the Board of Accountancy as regulations.
PROFESSIONAL ETHICS AND PROFESSIONAL STANDARDS
LAWS AND RULES

PROFESSIONAL ETHICS STATUTES (OHIO REVISED CODE)

- **Sec. 4701.12. FALSE ADVERTISING.** Definition.

- **Sec. 4701.14. UNLAWFUL PRACTICE; SUBSTANTIAL EQUIVALENCY.** Unlawful practice defined; conditions under which a CPA of another state who substantially complies with the Ohio requirements may be exempted from the CPA certificate and Ohio permit.

- **Sec. 4701.15. EMPLOYEES OF PUBLIC ACCOUNTANTS; INCIDENTAL PRACTICE.** Employees of public accounting firms need not be public accountants; out-of-state public accounting firms or foreign firms may practice in Ohio on business incidental to their home-state business without registering in Ohio.

- **Sec. 4701.16. DISCIPLINE OF REGISTRANT OR CERTIFICATE HOLDER.** Conditions under which a certified public accountant, public accountant, or public accounting firm may be disciplined by the Accountancy Board.

- **Sec. 4701.17. REISSUE OF REVOKED CERTIFICATE.** Conditions under which a certificate or registration which has been revoked or suspended may be reinstated by the Accountancy Board.

- **Sec. 4701.18. INJUNCTIONS OR RESTRAINING ORDERS.** Authority for the Accountancy Board to seek injunctions and restraining orders for unlawful practice.

- **Sec. 4701.19. RECORDS.** Working papers are defined as the property of the licensed accountant.

- **Sec. 4701.28. CERTIFICATE OR PERMIT HOLDERS IN DEFAULT ON CHILD SUPPORT ORDERS.** This establishes section 2301.373 of the Ohio Revised Code as the controlling statute regarding the revocation of licenses for default on child support payments.

- **Sec. 4701.29. BOARD INVESTIGATIONS.** This section permits the Board to conduct more extensive investigations, issue subpoenas, compel the testimony of witnesses and the production of documents, and conduct depositions. In addition, investigative proceedings under this section are excluded from classification as public records.
Sec. 4701.12. FALSE ADVERTISING

The display or uttering by a person of a card, sign, advertisement, or other printed, engraved, or written instrument or device, bearing a person's name in conjunction with the words "certified public accountant" or any abbreviation of those words, or "public accountant" or any abbreviation of those words, shall be prima-facie evidence in any action brought under section 4701.18 or 4701.99 of the Revised Code that the person whose name is so displayed caused or procured the display or uttering of that card, sign, advertisement, or other printed, engraved, or written instrument or device, and that the person is holding self out to be a certified public accountant or a public accountant holding an Ohio permit. In any action, evidence of the commission of a single act prohibited by this section shall be sufficient to justify an injunction or a conviction without evidence of a general course of conduct.

OBSERVATION: A single act of holding out as a CPA by an unlicensed person is a crime.

Sec. 4701.14. UNLAWFUL PRACTICE; SUBSTANTIAL EQUIVALENCY

(A) Except as permitted by rules adopted by the accountancy board, no individual shall assume or use the title or designation "certified public accountant," "certified accountant," "chartered accountant," "enrolled accountant," "licensed accountant," or "registered accountant," or any other title or designation likely to be confused with "certified public accountant," or any of the abbreviations "CPA," "PA," "CA," "EA," "LA," or "RA," or similar abbreviations likely to be confused with "CPA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the individual is a certified public accountant, unless the individual holds a CPA certificate and holds an Ohio permit. However, an individual who possesses a foreign certificate, has registered under section 4701.09 of the Revised Code, and holds an Ohio permit may use the title permitted under the laws of the individual's other licensing jurisdiction, followed by the name of the jurisdiction.

OBSERVATION: Section 4701.14 in its present form is quite cumbersome. Much of the language in that section was “model language” in the 1950s and was formerly present in nearly all the state accountancy laws. Since then, most of the provisions have been repealed by all the large states except one. For example, Ohio does not enforce the provisions concerning the terms LA, EA, etc., as the courts (not to mention the IRS) have decided this issue. Ohio does not enforce the prohibition on the use of the words “accountant” or “auditor,” because the courts have ruled that these terms cannot be restricted to CPAs and that persons need not use any disclaimers with these terms. The only reason this language is still in the statute is because the controversial parts have never been enforced.

OBSERVATION: An enrolled agent licensed by the Internal Revenue Service may use the initials E.A. in conjunction with providing tax services.
(B) Except as permitted by rules adopted by the board, no individual shall assume or use the title or designation "public accountant," "certified public accountant," "certified accountant," "chartered accountant," "enrolled accountant," "registered accountant," or "licensed accountant," or any other title or designation likely to be confused with "public accountant," or any of the abbreviations "PA," "CPA," "CA," "EA," "LA," or "RA," or similar abbreviations likely to be confused with "PA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the individual is a public accountant, unless the individual holds a PA registration and holds an Ohio permit, or unless the individual holds a CPA certificate. An individual who holds a PA registration and an Ohio permit may hold self out to the public as an "accountant" or "auditor."

(C) Except as provided in divisions (C)(1), (2), (3), and (4) of this section, no partnership, professional association, corporation-for-profit, limited liability company, or other business organization not addressed in this section that is practicing public accounting in this state shall assume or use the title or designation "certified public accountant," "public accountant," "certified accountant," "chartered accountant," "enrolled accountant," "licensed accountant," "registered accountant," or any other title or designation likely to be confused with "certified public accountant" or "public accountant," or any of the abbreviations "CPA," "PA," "CA," "EA," "LA," or "RA," or similar abbreviations likely to be confused with "CPA" or "PA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the business organization is a public accounting firm.

**OBSERVATION:** A CPA firm must have a majority of its partners be CPAs.

(1)(a) A partnership may assume or use the title or designation "certified public accountant," the abbreviation "CPA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the partnership is composed of certified public accountants if it is a registered firm, if a majority of its partners who are individuals hold a CPA certificate or a foreign certificate, and if a majority of the owners of any qualified firm that is a partner hold a CPA certificate or a foreign certificate.

**OBSERVATION:** In order to use the "certified public accountant" title, a partnership must:
- be registered with the Board; and
- have an ownership structure where a majority of the owners are CPAs (2 out of 3, 3 out of 5, etc.).

This requirement is different from the AICPA requirement that a majority of the "ownership" of the firm must be held by CPAs.

(b) A partnership may assume or use the title or designation "public accountant," the abbreviation "PA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the partnership is composed of public accountants if it is a registered firm, if a majority of its partners who are individuals hold a PA registration, a CPA certificate, or a foreign certificate, and if a majority of the owners of any qualified firm that is a partner hold a PA registration, a CPA certificate, or a foreign certificate.
(2)(a) A professional association incorporated under Chapter 1785. of the Revised Code may assume or use the title or designation "certified public accountant" the abbreviation "CPA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the professional association is composed of certified public accountants if it is a registered firm, if a majority of its shareholders who are individuals hold a CPA certificate or a foreign certificate, and if a majority of the owners of any qualified firm that is a shareholder hold a CPA certificate or a foreign certificate.

(3)(a) A corporation-for-profit incorporated under Chapter 1701. of the Revised Code may assume or use the title or designation "certified public accountant," the abbreviation "CPA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the corporation is composed of certified public accountants if it is a registered firm, if a majority of its shareholders who are individuals hold a CPA certificate or a foreign certificate, and if a majority of the owners of any qualified firm that is a shareholder hold a CPA certificate or a foreign certificate.

(4)(a) A limited liability company organized under Chapter 1705. of the Revised Code may assume or use the title or designation "certified public accountant," the abbreviation "CPA," or any other title, designation, words, letters, abbreviation, sign, card, or device tending to indicate that the limited liability company is composed of certified public accountants if it is a registered firm, if a majority of its members who are individuals hold a CPA certificate or a foreign certificate, and if a majority of the owners of any qualified firm that is a member hold a CPA certificate or a foreign certificate.

(D) No individual shall sign, affix, or associate the individual's name or any trade or assumed name used by the individual in the individual's profession or business to any attest report with any wording indicating that the individual is an accountant or auditor, or with any wording accompanying or contained in the attest report which indicates that the individual has expert knowledge in accounting or auditing or expert knowledge regarding compliance with conditions established by law or contract, including but not limited to statutes, ordinances, regulations, grants, loans and appropriations, unless the individual holds an Ohio permit. However, this division does not prohibit any officer, employee, partner or principal of any organization from affixing the officer's, employee's partner's, or principal's signature to any statement or report in reference to the financial affairs of that organization with any wording designating the position, title or office that the individual holds in that organization. This division also does not prohibit any act of a public official or public employee in the performance of the public official's or public employee's duties.

(E) No person shall sign, affix, or associate the name of a partnership, limited liability company, professional association, corporation-for-profit, or other business organization not addressed in this section to any attest report with any wording accompanying or contained in the attest report that indicates that the partnership, limited liability company, professional association, corporation-for-profit, or other business organization is composed of or employs accountants or auditors or persons having expert knowledge in accounting or auditing or expert knowledge regarding compliance with conditions established by law or contract, including but not limited to statutes, ordinances, regulations, grants, loans and appropriations, unless the partnership, limited liability company, professional association, corporation-for-profit, or other business organization is a registered firm.
**OBSERVATION:** The key section is (E) regarding “expert” knowledge. This enables the Board to define nonstandard reports that mimic compilation, review, audit, etc. reports, but nevertheless refer to the AICPA, “professional standards,” “generally accepted accounting principles,” “auditing standards,” and similar wording, as being prohibited by law.

(F) No individual who does not hold an Ohio permit shall hold self out to the public as an "accountant" or "auditor" by use of either or both of those words on any sign, card or letterhead, in any advertisement or directory, or otherwise, without indicating on the sign, card, or letterhead, in the advertisement or directory, or in the other manner of holding out that the person does not hold an Ohio permit. An individual who holds a CPA certificate and an Ohio permit may hold self out to the public as an "accountant" or "auditor." However, this division does not prohibit any officer, employee, partner, or principal of any organization from describing self by the position, title or office the person holds in the organization. This division also does not prohibit any act of a public official or public employee in the performance of the public official's or public employee's duties.

**OBSERVATION:** The use of the titles, “Accountant” and “Auditor” may be used by non-CPAs. Refer to the observation after Section 4701.14(A).

(G) No partnership, professional association, corporation-for-profit, limited liability company, or other business organization not addressed in this section that is not entitled to assume or use the title "certified public accountant" or "public accountant" under division (C) of this section shall hold itself out to the public as a partnership, professional association, corporation-for-profit, limited liability company, or other business organization not addressed in this section as being composed of or employing "accountants" or "auditors" by use of either or both of those words on any sign, card, letterhead, or in any advertisement or directory, or otherwise, without indicating on the sign, card, or letterhead, in the advertisement or directory, or in the other manner of holding out that the partnership, professional association, corporation-for-profit, limited liability company, or other business organization is not a registered firm and is not permitted by law to practice as a public accounting firm.

(H) No person shall assume or use the title or designation "certified public accountant" or "public accountant" in conjunction with names indicating or implying that there is a partnership or in conjunction with the designation "and Company" or "and Co." or a similar designation if, in any of those cases, there is in fact no bona fide partnership entitled to designate itself as a partnership of certified public accountants under division (C)(1)(a) of this section or as a partnership of public accountants under division (C)(1)(b) of this section. However, a sole proprietor or partnership that was on October 22, 1959, or a corporation that on or after September 30, 1974, has been, lawfully using a title or designation of those types in conjunction with names or designations of those types, may continue to do so if the sole proprietor, partnership, or corporation otherwise complies with this section.
(I)(1) Notwithstanding any other provision of this chapter, an individual whose principal place of business is not in this state and who holds a valid foreign certificate as a certified public accountant shall be presumed to have qualifications substantially equivalent to this state's CPA requirements and shall have all of the privileges of a holder of a CPA certificate and an Ohio permit without the need to obtain a CPA certificate and an Ohio permit if the accountancy board has found and has specified in its rules adopted pursuant to division (A) of section 4701.03 of the Revised Code that the CPA requirements of the state that issued the individual's foreign certificate are substantially equivalent to this state's CPA requirements.

**OBSERVATION:** “Substantial equivalency” vs. “incidental practice” (Section 4701.15) refers to CPAs from any state, and permits temporary or incidental practice in Ohio. Section 4701.14(I) refers to “substantially equivalent” states, and does not restrict the practice rights of the out-of-state CPA. To the extent the statutes overlap, Section 4701.14(I) controls, since in Ohio the most liberal application of a statute is controlling.

(2) Any individual exercising the privilege afforded under (I)(1) of this section hereby consents and is subject, as a condition of the grant of the privilege, to all of the following:

(a) The personal and subject matter jurisdiction of the accountancy board;

(b) All practice and disciplinary provisions of this chapter and the accountancy board's rules;

(c) The appointment of the board that issued the individual's foreign certificate as the individual's agent upon whom process may be served in any action or proceeding by the accountancy board against the individual.

(3) The holder of a CPA certificate and an Ohio permit who offers or renders attest services or uses the holder's CPA title in another state shall be subject to disciplinary action in this state for an act committed in the other state for which the holder of a foreign certificate issued by the other state would be subject to discipline in the other state.

(4) The holder of a foreign certificate who offers or renders attest services or uses a CPA title or designation in this state pursuant to the privilege afforded by division (I)(1) of this section shall be subject to disciplinary action in this state for any act that would subject the holder of a CPA certificate and an Ohio permit to disciplinary action in this state.

**Sec. 4701.15. EMPLOYEES OF PUBLIC ACCOUNTANTS; INCIDENTAL PRACTICE**

Nothing contained in sections 4701.01 to 4701.19, inclusive, of the Revised Code, shall prohibit any person not a certified public accountant or public accountant from serving as an employee of, or an assistant to, a certified public accountant or public accountant or partnership composed of certified public accountants or public accountants or a foreign accountant registered under section 4701.09 of the Revised Code; provided that such employee or assistant does not issue any accounting or financial statement over his name.
OBSERVATION: CPAs may hire non-CPAs to perform client services provided they are adequately supervised and do not practice public accounting under their own name.

Nothing contained in sections 4701.01 to 4701.19, inclusive, of the Revised Code, shall prohibit a certified public accountant or a registered public accountant of another state, or any accountant who holds a certificate, degree, or license in a foreign country, constituting a recognized qualification for the practice of public accounting in such country, from temporarily practicing in this state on professional business incident to his regular practice outside the state; provided, that such temporary practice is conducted in conformity with the regulations and rules of professional conduct promulgated by the accountancy board.

OBSERVATION: Ohio has somewhat liberal rules permitting out of state CPAs with incidental practice rights to serve Ohio clients as part of their home state practice. It should be noted that, although these out of state CPAs do not have any registration requirements, they must still comply with all Board regulations.

Sec. 4701.16. DISCIPLINE OF REGISTRANT OR CERTIFICATE HOLDER.

(A) After notice and hearing as provided in Chapter 119. of the Revised Code, the accountancy board may discipline as described in division (B) of this section a person holding an Ohio permit, an Ohio registration, a firm registration, a CPA certificate, or a PA registration or any other person whose activities are regulated by the board for any one or any combination of the following causes:

(1) Fraud or deceit in obtaining a firm registration or in obtaining a CPA certificate, a PA registration, an Ohio permit, or an Ohio registration;

(2) Dishonesty, fraud, or gross negligence in the practice of public accounting;

(3) Violation of any of the provisions of section 4701.14 of the Revised Code;

(4) Violation of a rule of professional conduct promulgated by the board under the authority granted by this chapter;

(5) Conviction of a felony under the laws of any state or of the United States;

(6) Conviction of any crime, an element of which is dishonesty or fraud, under the laws of any state or of the United States;

(7) Cancellation, revocation, suspension, or refusal to renew authority to practice as a certified public accountant, a public accountant, or a public accounting firm by any other state, for any cause other than failure to pay registration fees in that other state;

(8) Suspension or revocation of the right to practice before any state or federal agency;

(9) Failure of a holder of a CPA certificate or PA registration to obtain an Ohio permit or an Ohio registration, or the failure of a public accounting firm to obtain a firm registration;
(10) Conduct discreditable to the public accounting profession or to the holder of an Ohio permit, Ohio registration, or foreign certificate;

(11) Failure of a public accounting firm to comply with section 4701.04 of the Revised Code.

(B) For any of the reasons specified in division (A) of this section, the board may do any of the following:

(1) Revoke, suspend, or refuse to renew any CPA certificate or PA registration or any Ohio permit, Ohio registration, or firm registration;

(2) Disqualify a person who is not a holder of an Ohio permit or a foreign certificate from owning an equity interest in a public accounting firm or qualified firm;

(3) Publicly censure a registered firm or a holder of a CPA certificate, a PA registration, an Ohio permit, or an Ohio registration;

(4) Levy against a registered firm or a holder of a CPA certificate, a PA registration, an Ohio permit, or an Ohio registration a penalty or fine not to exceed one thousand dollars for each offense. Any fine shall be reasonable and in relation to the severity of the offense;

(5) In the case of violations of division (A)(2) or (4) of this section, require completion of remedial continuing education programs prescribed by the board in addition to those required by section 4701.11 of the Revised Code;

(6) In the case of violations of division (A)(2) or (4) of this section, require the holder of a CPA certificate, PA registration, or firm registration to submit to a peer review by a professional committee designated by the board, which committee shall report to the board concerning that holder's compliance with generally accepted accounting principles, generally accepted auditing standards, or other generally accepted technical standards;

(7) Revoke or suspend the privileges to offer or render attest services in this state or to use the CPA title or designation in this state of an individual who holds a foreign certificate.

(C) If the board levies a fine against or suspends the certificate of a person or registration of a person or firm for a violation of division (A)(2) or (4) of this section, it may waive all or any portion of the fine or suspension if the holder of the CPA certificate, PA registration, or firm registration complies fully with division (B)(5) or (6) of this section.

BOARD INVESTIGATIONS

The Board’s primary function is that of a regulatory agency that monitors compliance with the accountancy law and Board regulations governing the practice of public accounting. Board investigations are of four types: 1) failure to comply with individual license requirements; 2) failure to comply with firm registration and peer review
requirements; 3) the unlawful practice of public accounting; and 4) complaints from the general public against CPAs and CPA firms.

INVESTIGATIONS CONCLUDED OVER A TWO-YEAR PERIOD

Cases involving:

<table>
<thead>
<tr>
<th>Cases involving</th>
<th>Count</th>
</tr>
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<tbody>
<tr>
<td>Unethical Conduct</td>
<td>427</td>
</tr>
<tr>
<td>Unlawful Practice</td>
<td>197</td>
</tr>
<tr>
<td>Firm Registration Compliance</td>
<td>81</td>
</tr>
<tr>
<td>Records Retention</td>
<td>59</td>
</tr>
<tr>
<td>Unlawful Advertising</td>
<td>47</td>
</tr>
<tr>
<td>Criminal Conviction</td>
<td>11</td>
</tr>
<tr>
<td>Federal Agency Referral</td>
<td>9</td>
</tr>
<tr>
<td>Continuing Education Compliance</td>
<td>8</td>
</tr>
<tr>
<td>Other State Board Referral</td>
<td>5</td>
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<tr>
<td>Child Support Default</td>
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<tr>
<td><strong>Total Cases</strong></td>
<td><strong>845</strong></td>
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INVESTIGATIVE ACTIVITY

In a recent year, a total of 74 cases were open at the beginning of the year. Of these, 63 were closed in that same year, and 11 of these cases remained open at the end of the fiscal year. These remaining cases all involved some type of litigation. During the year, a total of 139 cases were opened and 102 cases were closed, leaving 48 cases open at the end of the fiscal year. Field calls were, on average, one per day.

Most Frequent Complaints

- Unethical conduct
- Unlawful practice
- Unlawful advertising
- Records retention
- Firm registration compliance (including peer review)

For violations of the accountancy law, the Board may hold a hearing and take disciplinary action against the CPA certificate of an individual or a public accounting firm’s registration. For violations of the unlawful practice section of the accountancy law, a first degree misdemeanor, the Board may file charges with the appropriate local prosecutor against the firm or individual that unlawfully advertises as a CPA or CPA firm.

Note: Since the number of open investigations is constantly changing, the tables above are presented solely to give you an idea of the most common violations. The investigation activity and types of cases remain consistent from year to year.
Sec. 4701.17. REISSUE OF REVOKED CERTIFICATE

Upon application in writing and after hearing pursuant to notice, the accountancy board may reissue or reinstate a certificate to a certified public accountant whose certificate has been revoked or suspended or reregister anyone whose registration has been revoked or suspended.

The board may require a reasonable waiting period, commensurate with the offense, before a certificate holder or registrant whose certificate or registration has been revoked or suspended may apply to have the certificate or registration reissued or reinstated. The board may require compliance with any or all requirements of section 4701.06 of the Revised Code, including the taking of any examination described in division (E) of that section as a prerequisite for recertification. The board may require compliance with any or all of the requirements of section 4701.07 of the Revised Code, including the taking of any examination described in division (E) of that section as a prerequisite for reregistration.

OBSERVATION: The Board has been granted broad authority by the General Assembly to determine when and if to reissue revoked and suspended certificates.

Sec. 4701.18. INJUNCTIONS OR RESTRAINING ORDERS

Whenever in the judgment of the accountancy board any person has engaged, or is about to engage, in any acts or practices which constitute, or will constitute, a violation of section 4701.14 of the Revised Code, the board may make application to the appropriate court for an order enjoining such acts or practices, and upon a showing by the board that such person has engaged, or is about to engage, in any such acts or practices, an injunction, restraining order, or such other order as may be appropriate shall be granted by such court without bond.

OBSERVATION: The Board has the authority to seek to enjoin the future unlawful practice of accounting. This is in addition to the authority to prosecute individuals for prior acts.

Sec. 4701.19. RECORDS

(A) All statements, records, schedules, working papers, and memoranda made by a certified public accountant or public accountant incident to or in the course of professional service to clients by such accountant, except reports submitted by a certified public accountant or public accountant to a client shall be and remain the property of such accountant, in the absence of an express agreement between such accountant and the client to the contrary. No statement, record, schedule, working paper or memorandum of that nature shall be sold, transferred or bequeathed without the consent of the client or the client's personal representative or assignee to any person other than one or more surviving partners or new partners of such accountant.
**OBSERVATION:** In general, reports submitted to clients are the client’s property, while all workpapers used to create the report are the property of the CPA.

(B) The statements, records, schedules, working papers, and memoranda made by a certified public accountant or public accountant incident to or in the course of performing an audit of a public office or private entity, except reports submitted by the accountant to the client, are not a public record. Statements, records, schedules, working papers, and memoranda that are so made in an audit by a certified public accountant or public accountant and that are in possession of the auditor of state also are not a public record. As used in this division, "public record" has the same meaning as in section 149.43 of the Revised Code.

**OBSERVATION:** Ohio has a public records law which requires state agencies to allow public inspection of most state records. The provision above provides that a CPA’s workpapers are not a public record. Therefore, CPA workpapers are not open to the public.

**Sec. 4701.28 CERTIFICATE OR PERMIT HOLDERS IN DEFAULT ON CHILD SUPPORT ORDERS**

On receipt of a notice pursuant to section 3123.43 of the Revised Code, the accountancy board shall comply with sections 3123.41 to 3123.50 of the Revised Code and any applicable rules adopted under section 3123.63 of the Revised Code with respect to a certificate or permit issued pursuant to this chapter.

**PRACTICE POINTER:** Failure to pay child support will result in the suspension or revocation of your certificate and/or permit to practice. If a CPA in violation of this provision is a partner in a CPA firm, the firm permit will also be suspended.

**Sec. 4701.29 BOARD INVESTIGATIONS**

(A) The accountancy board may investigate whether a person has violated any provision of this chapter or rule adopted under it before commencing a disciplinary proceeding pursuant to section 4701.16 of the Revised Code or taking legal action pursuant to section 4701.18 of the Revised Code. An investigation under this section is not subject to Chapter 119. of the Revised Code.
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. Section 4701.14 regulates the use of certain titles. The prohibition on the use of which of the following titles is not enforced:
   a) CPA
   b) PA
   c) LA
   d) none of the above

2. A registered CPA partnership may use the designation “CPA” if ______ of its partners are CPAs.
   a) 25%
   b) a majority
   c) 66 2/3%
   d) all of the above

3. What happens if two statutes conflict with each other:
   a) the court must decide which statute controls
   b) the court may order the General Assembly to correct the conflict but may not decide which statute is controlling
   c) the more restrictive of the two statutes controls
   d) in Ohio, the most liberal application of a statute is controlling

4. Which of the following types of Board investigations is the most common:
   a) unethical conduct
   b) records retention
   c) unlawful advertising
   d) none of the above
CHAPTER 1 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. The Board vigorously prosecutes the unlawful use of the “CPA” title.
   
   B: Incorrect. The Board vigorously prosecutes the unlawful use of the “PA” title.
   
   C: Correct. The Board does not enforce the provision related to the use of the “LA” title.
   
   D: Incorrect. The Board investigates 50-60 cases per year dealing with the unlawful use of the “CPA” title.
   
   (See Section 4701.14 in the course material.)

2. A: Incorrect. In order to use the title “CPA” a majority of its owners must be CPAs.
   
   B: Correct. In order to use the title “CPA” a majority of its owners must be CPAs.
   
   C: Incorrect. In order to use the title “CPA” a majority of its owners must be CPAs.
   
   D: Incorrect. In order to use the title “CPA” a majority of its owners must be CPAs.
   
   (See Section 4701.14(C) in the course material.)

3. A: Incorrect. When two statutes conflict, the most liberal statute applies.
   
   B: Incorrect. When two statutes conflict, the most liberal statute applies.
   
   C: Incorrect. When two statutes conflict, the most liberal statute applies.
   
   D: Correct. In an effort to promote freedom, Ohio has a long-standing tradition of using the most liberal interpretation.
   
   (See the Observation following Section 4701.14(I) in the course material.)

4. A: Correct. About half of all Board investigations involve unethical conduct.
   
   B: Incorrect. Less than 10% of Board investigations involve records retention.
   
   C: Incorrect. Less than 10% of Board investigations involve unlawful advertising.
   
   D: Incorrect. About half of the Board investigations involve unethical conduct.
   
   (See page 1-10 in the course material.)
Chapter 2: Professional Ethics Rules

Objectives:

After completing this chapter, you will be able to:

- Differentiate between the law as promulgated by the General Assembly and the administrative regulations issued by the Board of Accountancy.
- Identify the similarities and differences between the regulations and the AICPA Code of Professional Conduct.

INTRODUCTION

The General Assembly writes the law as discussed in the last chapter. The General Assembly created the Board of Accountancy to regulate and oversee the CPA profession. The Board of Accountancy issues regulations to this end. These regulations expound upon and clarify the laws the General Assembly passes. These regulations are called administrative law. Administrative law is more than mere interpretations but has the force and effect of law. Accordingly, for Ohio CPAs, these regulations have a higher priority than the AICPA Code of Professional Conduct. The regulations are useful as they typically go into more detail than the General Assembly law.

The Board has the authority to issue regulations after allowing for written and oral comment at public hearings. Notices of proposed regulations, including the actual text of the regulation, are regularly published on the Board’s website. Following is the table of contents for the regulations.

PROFESSIONAL ETHICS: TECHNICAL STANDARDS RULES

- 4701-7-04 Practice of Public Accounting and Regulated Services
- 4701-9-01 Integrity and Objectivity
- 4701-9-02 General Standards (Competence, due professional care, including planning and supervision, sufficient data for conclusions.)
- 4701-9-03 Generally Accepted Auditing Standards (Defines generally accepted auditing standards as those issued by the Public Company Accounting Oversight Board, the Government Accountability Office, and the American Institute of Certified Public Accountants, as applicable.)
- 4701-9-04 Generally Accepted Accounting Principles (Defines generally accepted accounting principles as those issued by the Financial Accounting Standards Board, the Governmental Accounting Standards Board, and the Federal Accounting Standards Advisory Board, as applicable.)
• **4701-9-05 Attestation Standards** (Defines attestation standards as those issued by the American Institute of Certified Public Accountants or the Government Accountability Office, as applicable.)

• **4701-9-06 Accounting and Review Services Standards** (Defines accounting and review standards as those issued by the American Institute of Certified Public Accountants.)

• **4701-9-08 Consulting Standards** (Defines consulting standards as those issued by the American Institute of Certified Public Accountants.)

• **4701-9-09 Tax Services Standards** (Defines tax services standards as those issued by the American Institute of Certified Public Accountants.)

• **4701-9-10 Quality Control Standards** (Defines quality control standards as those issued by the American Institute of Certified Public Accountants.)

**PROFESSIONAL ETHICS: BEHAVIORAL STANDARDS RULES**

• **4701-11-01 Independence** (Defines independence standards as those issued by the Securities and Exchange Commission, the Government Accountability Office, and the American Institute of Certified Public Accountants). Read the SEC rule on auditor independence.

• **4701-11-02 Confidential Client Information** (Outlines the instances in which confidential client information must be disclosed.)

• **4701-11-03 Contingent Fees** (Outlines the instances in which contingent fees are prohibited.)

• **4701-11-04 Commissions and Referral Fees** (Outlines the instances in which commissions and referral fees are prohibited.)

• **4701-11-05 Form of Practice and Name** (Acceptable names for public accounting firms.)

• **4701-11-06 Retention of Client Records** (Outlines the instances in which retention of client records is not permitted.)

• **4701-11-07 Board Communications** (Responsibility of licensees to be aware of official communications from the Board office.)

• **4701-11-09 Acts Discreditable** (Examples of actions that are subject to the disciplinary provisions of section 4701.16(A)(10) of the Revised Code.)

• **4701-11-10 Application of Ethics Rules to Non-CPA Owners** (Ethics rules apply to all owners of CPA firms.)
NOTE: Following each rule, you will find one or more of the following:

- Observations
- Practice Pointers
- AICPA Rules, Interpretations, and Rulings
- Case Studies

While not part of the official Board rule, these items will enhance your understanding of the rule and help you apply the rule to your practice situation.

**PROFESSIONAL ETHICS: PROFESSIONAL STANDARDS RULES**

**RULE 4701-7-04: PRACTICE OF PUBLIC ACCOUNTING AND REGULATED SERVICES**

(A) “Practice of public accounting” means one of the following:

1. The performance of or offering to perform any engagement that will result in the issuance of any report in accordance with the professional standards defined in rule 4701-9-03, 4701-9-04, 4701-9-05, or 4701-9-06 of the Administrative Code.

2. The performance of or offering to perform services other than those described in paragraph (A)(1) of this rule, such as consulting services, personal financial planning services, or the preparation of tax returns or the furnishing of advice on tax matters by a sole proprietorship, partnership, limited liability company, professional association, corporation or other business organization that advertises to the public as a “certified public accountant,” “CPA,” “public accountant,” or “PA.”

(B) A certified public accountant or public accountant who performs or offers to perform any services described in paragraph (A) of this rule must hold an Ohio permit and be affiliated with a registered firm.

OBSERVATION: The above rule applies to reports issued in accordance with:

- auditing standards,
- GAAP,
- attestation engagements,
- compilation and review standards, and
- government accounting and auditing standards.

Issuing any of the above reports is considered “practicing public accounting.” Note that providing consulting services and tax return preparation are not, in and of themselves, considered to be the practice of public accountancy. As detailed below, performing consulting and tax services rises to the level of “practicing public accounting” if the CPA advertises to the public as a CPA.

(2) The performance of or offering to perform services other than those described in paragraph (A)(1) of this rule, such as consulting services, personal financial planning services, or the preparation of tax returns or the furnishing of advice on tax matters by a sole proprietorship, partnership, limited liability company, professional association, corporation or other business organization that advertises to the public as a “certified public accountant,” “CPA,” “public accountant,” or “PA.”
PRACTICE POINTER: A permit holder may use his CPA title on his business card or letterhead without “practicing public accountancy.” However, having a yellow pages ad, an outdoor sign, or an Internet website is typically indicative of someone who is practicing public accountancy.

(C) “Regulated services” means the performance of or offering to perform any of the following services by a certified public accountant or public accountant who uses the designation “certified public accountant,” “CPA,” “public accountant,” or “PA” in association with those services and who is not affiliated with a registered firm:

(1) Consulting services in accordance with the professional standards defined in rule 4701-9-08 of the Administrative Code;

(2) Tax services in accordance with the professional standards defined in rule 4701-9-09 of the Administrative Code;

(3) Preparing financial reports, signing financial reports, preparing reports on internal controls, and signing reports on internal controls.

(D) A certified public accountant or public accountant who performs or offers to perform any services described in paragraph (C) of this rule must hold an Ohio permit.

CPA LICENSING FREQUENTLY ASKED QUESTIONS

1. Q: What type of license should I obtain?
   A: The law states that you need an Ohio permit if you are engaged in the practice of public accounting. Public accounting includes compilations, reviews, and audits, as well as tax work and consulting. If you are not engaged in the practice of public accounting, you may obtain the Ohio registration.

2. Q: I am not employed in public accounting, but I wish to use the CPA designation without the “Inactive” disclaimer. May I obtain the Ohio permit even though I am not practicing public accounting?
   A: Yes. However, you must complete the continuing education requirement applicable to Ohio permit holders. This requirement is 120 hours every three years.

3. Q: I do not have my own CPA firm, but I do some taxes and consulting for friends and neighbors. What license should I obtain?
   A: You should obtain the Ohio permit, because you are practicing public accounting and signing documents as a CPA. Even though you do not advertise to the public as a CPA firm, and as a result you do not need to register with the Board as a public accounting firm, you are still required to obtain the Ohio permit in order to use the CPA designation without the “Inactive” disclaimer.

4. Q: I now reside outside the USA. Must I obtain an Ohio CPA license?
   A: No. Section 4701.10 provides that an Ohio CPA who is a foreign resident is exempt from the licensing requirements.
5. Q: I no longer use the CPA designation, and I wish to retire my license. How may I do this?
   A: You should send the Board a letter stating this fact. The Board has two retirement categories: 1) retired-in good standing; and 2) retired-not in good standing. The latter category is for Ohio CPAs whose licenses expired prior to their requesting retired status.

6. Q: What are the differences among the “practicing” license, the “non-practicing” license, and the “inactive” license? I see these terms on your website, and I’m confused.
   A: The two types of licenses are, legally speaking, the Ohio permit and the Ohio registration. Since the Ohio permit is the authorization to practice public accounting, it is also known as the “permit to practice” or the “practicing license.” Continuing education is required in order to obtain or renew the Ohio permit. The Ohio registration was formerly known as the “non-practicing registration.” A CPA or PA who holds the Ohio registration must use the term “Inactive” after the CPA or PA designation, since continuing education is not required.

RULE 4701-9-01: INTEGRITY AND OBJECTIVITY

(A) An Ohio permit holder shall maintain integrity and objectivity, shall not knowingly misrepresent facts, shall be free of conflicts of interest and shall not subordinate to others any professional judgment.

(B) If an Ohio permit holder has a conflict of interest between the interest of a client or employer and another person, but the Ohio permit holder believes that professional services can be performed with objectivity, this rule shall not prohibit the performance of professional services by the Ohio permit holder if the conflict of interest is disclosed to, and consent is obtained from, such client or employer and the other person.

(C) Disagreements over the application of acceptable alternatives permitted by the professional standards defined in Chapter 4701-9 of the Administrative Code do not result in any subordination of professional judgment.

AICPA 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.

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

c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

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.

**Example**

Q: Cindy Steffen is a CPA and the controller of Company X, Inc. In preparing the financial statements for the quarter ended March 31, 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 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.

### 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.

**LIKELY BOARD ACTION:** Violation of Rule 4701-9-01 Integrity and Objectivity.
RULE 4701-9-02: GENERAL STANDARDS

(A) An Ohio permit holder shall only perform professional services that can reasonably be expected by the Ohio permit holder or the Ohio permit holder’s registered firm to be completed with professional competence.

OBSERVATION: A CPA may accept an engagement that he or she lacks competence, provided that the required competence can be obtained prior to the completion of the engagement. Taking CPE courses in the subject area is one method of attaining competence.

(B) An Ohio permit holder shall exercise due professional care in the practice of public accounting, including adequate planning and supervision of all professional activities for which the Ohio permit holder is responsible.

(C) An Ohio permit holder shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

(D) The provisions of this rule apply to a certified public accountant or public accountant who is engaged in the practice of public accounting or the performance of regulated services as defined by Rule 4701-7-04 of the Administrative Code.

RULE 4701-9-03: GENERALLY ACCEPTED AUDITING STANDARDS

(A) An Ohio permit holder shall be associated with audited financial statements only if the Ohio permit holder has complied with the applicable generally accepted auditing standards defined in paragraph (B), (C), and (D) of this rule, as applicable.

(B) Generally accepted auditing standards applicable to audits of public companies required to register with the "Securities and Exchange Commission" are defined as "Auditing and Related Professional Practice Standards" issued by the "Public Company Accounting Oversight Board" and published on that agency's website (www.pcaobus.org).

(C) Generally accepted auditing standards for federal agencies or entities receiving significant federal financial assistance are defined as "Government Auditing Standards" issued by the "Comptroller General of the United States" and published on the "Government Accountability Office" website (www.gao.gov).

(D) Generally accepted auditing standards for all entities except those specified in paragraph (B) or (C) of this rule are defined as "Statements on Auditing Standards" issued by the American Institute of Certified Public Accountants and published on that organization's website (www.aicpa.org).

(E) An Ohio permit holder may comply with one or more of the "International Standards on Auditing" issued by the "International Auditing and Assurance Standards Board" and published on the "International Federation of Accountants" website (www.ifac.org) in the following cases:
(1) The standards in paragraph (B) or (C) of this rule, as applicable to the specific audit engagement, do not prohibit the use of those standards.

(2) The parent company of the entity being audited is located in a foreign country and requires the use of those standards.

RULE 4701-9-04: GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

(A) An Ohio permit holder may not express an opinion or state affirmatively that financial statements or associated financial data of any entity are presented in conformity with generally accepted accounting principles, or express any negative assurance that such statements or data are in conformity with generally accepted accounting principles in all material respects, unless the financial statements and data are presented in conformity with generally accepted accounting principles applicable to both the entity under examination and to the particular engagement. Generally accepted accounting principles, including the pronouncements defined in paragraph (D), (E), or (F) of this rule, and the hierarchy of their application, are defined in the “FASB Accounting Standards Codification” published by the “Financial Accounting Standards Board” as of October 31, 2010.

(B) If the financial statements or associated data in paragraph (A) of this rule contain any departure from the pronouncements defined in paragraph (D), (E), or (F) of this rule, as applicable, that has a material effect on the financial statements and data, taken as a whole, then the Ohio permit holder cannot express an opinion on the financial statements and data unless the Ohio permit holder follows the procedure defined in paragraph (C) of this rule.

(C) If the Ohio permit holder can demonstrate that adherence to the pronouncements defined in paragraph (D), (E), or (F) of this rule, as applicable, would result in misleading financial statements or data due to unusual circumstances, the Ohio permit holder's report must describe the departure from the pronouncements, the approximate effects thereof if practicable, and the reasons why compliance with the pronouncements would result in misleading financial statements or data.

(D) The primary authoritative source of generally accepted accounting principles for non-governmental entities are defined as "FASB Accounting Standards Codification" published by the “Financial Accounting Standards Board” as of October 31, 2010.

(E) The primary authoritative source of generally accepted accounting principles for state and local government entities are defined as "Original Pronouncements: Governmental Accounting and Financial Reporting Standards" and "Codification of Governmental Accounting and Financial Reporting Standards" published by the "Governmental Accounting Standards Board" as of June 30, 2010.

(G) An Ohio permit holder may comply with one or more of the “International Financial Reporting Standards” issued by the “International Accounting Standards Board” and published on the “IFRS Foundation” website (www.ifrs.org).

**RULE 4701-9-05: ATTESTATION STANDARDS**

(A) The term "attest engagement" for the purposes of this rule, is defined as one in which an Ohio permit holder is engaged to issue or does issue an examination report, a review report, or an agreed-upon-procedures report on subject matter, or an assertion about the subject matter, that is the responsibility of another party.

(B) An Ohio permit holder shall not be associated with any attest engagement, defined in paragraph (A) of this rule, unless the Ohio permit holder has complied with the applicable standards for attestation engagements defined in paragraph (C) or (D) of this rule, as applicable.

(C) Attestation standards for government agencies or entities receiving significant federal financial assistance are defined in the "Government Auditing Standards" issued by the "Comptroller General of the United States" and published on the "Government Accountability Office" website (www.gao.gov).

(D) Attestation standards for all entities except those specified in paragraph (C) of this rule are defined as "Statements on Standards for Attestation Engagements" issued by the "American Institute of Certified Public Accountants", and published on that organization's website (www.aicpa.org).

(E) Examples of attest engagements include financial forecasts and projections, reports on pro forma financial information, reports on an entity's internal control over financial reporting, compliance attestations, "WebTrust" examinations, "SysTrust" examinations, and examinations or reviews of a management's discussion and analysis presentation prepared in accordance with the rules and regulations adopted by the "Securities and Exchange Commission." The above examples are not intended to be all-inclusive.

**RULE 4701-9-06: ACCOUNTING AND REVIEW SERVICES STANDARDS**

(A) An Ohio permit holder who is in the practice of public accounting shall be associated with unaudited financial statements only if the Ohio permit holder has complied with the applicable accounting and review services standards defined in paragraph (B) of this rule.

(B) Accounting and review services standards are defined as “Statements on Standards for Accounting and Review Services” issued by the “American Institute of Certified Public Accountants” and published on the organization’s website (www.aicpa.org).
RULE 4701-9-08: CONSULTING STANDARDS

(A) An Ohio permit holder shall be associated with a consulting engagement only if the Ohio permit holder has complied with the applicable standards for consulting services defined in paragraph (B) of this rule.

(B) Consulting services standards are defined as “Statements on Standards for Consulting Services” and “Statements on Standards for Valuation Services” issued by the “American Institute of Certified Public Accountants (AICPA),” and published on that organization’s website (www.aicpa.org).

Competence and Other Professional Standards

Able CPA provided professional services to Mrs. Frank during a divorce settlement. Able also prepared a business valuation of a dental practice owned by Mrs. Frank’s husband. The valuation was prepared for use in the divorce proceedings.

The business valuation of the dental practice was not prepared according to professional standards or similar pronouncements by a generally recognized authority. Instead, it was found that Able did not properly use industry statistics and had an overall lack of knowledge of standards. Able held out to Mrs. Frank that he could perform services that he was not competent to perform.

**LIKELY BOARD ACTION:** Violation of Rule 4701-9-02 General Standards; Violation of Rule 4701-9-08 Consulting Standards.

RULE 4701-9-09: TAX SERVICES STANDARDS

(A) An Ohio permit holder who prepares a tax return, signs a tax return, or recommends a tax return position for a client, employer, or other third-party recipient of tax services shall comply with the applicable standards for tax services defined in paragraph (B) of this rule.

(B) Tax services standards are defined as "Statements on Standards for Tax Services" issued by the "American Institute of Certified Public Accountants" and published on that organization’s website (www.aicpa.org).

Case Study

**Competence and Tax Services Standards**

Brown prepared Client’s tax returns and calculated that Client would receive a $6,000 tax refund from Arizona, owe $7,000 in taxes to Ohio, 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 Ohio, and owe $5,500 to the IRS.

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

**LIKELY BOARD ACTION:** Violation of Rule 4701-9-09 Tax Services Standards.
Competence – Preparation of Tax Return

Mr. and Mrs. Client donated an old house to the fire department for a training exercise during 2009. The fire department burned the donated house. Green, CPA prepared Client’s 2009 tax return and took a charitable contribution deduction for the appraised value of the donated house.

The IRS notified Client that it would audit their tax return for 2009. Client contacted Green CPA and asked if Green would represent Client during the IRS audit. Green CPA told Client that they didn’t need to be represented and instructed Client to represent themselves.

The IRS disallowed the charitable contribution of the donated house. When Client told Green CPA that the IRS disallowed the charitable contribution for the house, Green CPA did not question the findings of the IRS auditor, but instead prepared an amended state tax return for Client at no cost.

Green CPA took inconsistent positions when he prepared the original tax return and when he prepared the amended state tax return without verifying the validity of the tax deduction.

**LIKELY BOARD ACTION:** Violation of Rule 4701-9-09.

**RULE 4701-9-10: QUALITY CONTROL STANDARDS**

(A) A registered firm that performs accounting and auditing services in accordance with the professional standards defined in Chapter 4701-9 of the Administrative Code shall comply with the applicable standards for quality control defined in paragraph (B) of this rule.

(B) Quality control standards are defined as "Statements on Quality Control Standards" issued by the "American Institute of Certified Public Accountants (AICPA)," and published on that organization’s website (www.aicpa.org).

(C) An Ohio permit holder may comply with one or more of the “International Standards on Quality Control” issued by the “International Auditing and Assurance Standards Board” and published on the “International Federation of Accountants” website (www.ifac.org) if the standards in paragraph (B) of this rule, as applicable to the specific accounting or auditing engagement, permit the use of those standards.

**RULE 4701-11-01: INDEPENDENCE**

(A) An Ohio permit holder shall be independent in the performance of audits of public companies as required by applicable standards issued by the" Securities and Exchange Commission" and published on that agency's website (www.sec.gov).

(B) An Ohio permit holder shall be independent in the performance of other professional services for government agencies and entities receiving significant federal financial assistance as required by applicable standards issued by the “Comptroller General of the United States” and published on the “Government Accountability Office” website (www.gao.gov).
(C) An Ohio permit holder shall be independent in the performance of professional services, excluding those referenced in paragraph (A) or (B) of this rule, as required by the “Code of Professional Conduct” issued by the “American Institute of Certified Public Accountants” and published on that organization’s website (www.aicpa.org).

**OBSERVATION:** A CPA could spend countless hours reading the myriad independence rules and still be uncertain as to what is allowed or not allowed. Perhaps the best independence guidance is to remember what my college auditing professor called “the two faces of independence:"

- Independence in Fact – Meeting the letter of the law of all the various independence rules.
- Independence in Appearance – Regardless of the above, if a reasonable person with knowledge of the facts and circumstances surrounding the engagement would conclude that the CPA has a potential conflict of interest, then the CPA is not independent “in appearance.”

**RULE 4701-11-02: CONFIDENTIAL CLIENT INFORMATION**

(A) An Ohio permit holder shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client.

(B) This rule shall not be construed:

1. To relieve an Ohio permit holder of any obligation to comply with Chapter 4701-9 of the Administrative Code,

2. To affect in any way compliance with a validly issued subpoena or summons enforceable by order of a court,

3. To prohibit review of the professional practice of an Ohio permit holder as part of a peer review, or

4. To preclude an Ohio permit holder from responding to any inquiry made by the professional ethics committee or trial board of a professional accounting organization of which the Ohio permit holder is a member, by a duly constituted investigative or disciplinary body of a state CPA society, or under state statutes.

(C) Members of the accountancy board, a professional accounting organization ethics committee, or trial board described in paragraph (B)(4) of this rule, as well as professional practice reviewers, shall not disclose any confidential client information which comes to their attention in disciplinary proceedings or otherwise in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with an aforementioned duly constituted investigative or disciplinary body.
OBSERVATION: 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 4701-11-02 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. SAS-32 (Adequacy of Disclosure in Financial Statements) reinforces the position that if a client omits information that is required by GAAP, a qualified or adverse opinion must be expressed. On the other hand, SAS-32 does note that an auditor ordinarily should not make available information that is not required to be disclosed to comply with GAAP.

Rule 4701-11-02 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 4701-11-02 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 4701-11-02 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.

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 AICPA’s rules on Professional Ethics and Conduct.

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

**Example**

**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.

**RULE 4701-11-03: CONTINGENT FEES**

(A) An Ohio permit holder or registered firm shall not:

(1) Practice public accounting for a contingent fee for, or receive such a fee from, a client for whom any of the following professional engagements are performed:

(a) An audit or review of a financial statement.

(b) A compilation of a financial statement when the Ohio permit holder expects, or reasonably might expect, that a third party must use the financial statement and if the Ohio permit holder’s compilation report does not disclose a clear lack of independence.

(c) A report in accordance with the attestation standards defined in rule 4701-9-05 of the Administrative Code.

(d) An agreed-upon-procedures report on a financial statement.

(2) Prepare an original or amended tax return or claim for a tax refund for a contingent fee.

(B) The prohibitions outlined in paragraph (A)(1) of this rule apply during the period in which the Ohio permit holder or the Ohio permit holder's registered firm is engaged to perform any of the services described in paragraphs (A)(1)(a), (A)(1)(b), (A)(1)(c) of this rule, as well as during any period covered by any historical financial statements associated with those services.
EXAMPLE: Nash, CPA is hired December 1, 2010 to complete a review of XYZ, Inc.’s calendar year financial statements. Field work concludes in early February and the review report is issued March 1, 2011. The period of prohibition extends from January 1, 2010 through March 1, 2011.

What if Nash CPA had performed contingent fee services for XYZ, Inc. earlier in the year before accepting the review engagement? In such a case, Nash CPA could not accept the review engagement for 2010.

(C) A contingent fee is a fee established for the performance of any service pursuant to an agreement 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. However, an Ohio permit holder’s fees may vary depending, for example, on the complexity of the services rendered.

(D) 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.

AICPA RULE 302 – CONTINGENT FEES

The Ohio rule is very similar to AICPA Rule 302. The following discussion of Rule 302 may help.

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:

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

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. This is not a prohibited transaction.

RULE 4701-11-04: COMMISSIONS AND REFERRAL FEES

(A) An Ohio permit holder shall not, for a commission, recommend or refer to a client any product or service, nor shall the Ohio permit holder, for a commission, recommend or refer any product or service to be supplied by a client, nor shall the Ohio permit holder receive a commission when the Ohio permit holder or the Ohio permit holder's registered firm concurrently performs for that client any of the following professional services:

(1) An audit or review of a financial statement.

(2) A compilation of a financial statement when the Ohio permit holder expects, or reasonably might expect, that a third party may use the financial statement where the Ohio permit holder’s compilation report does not disclose a lack of independence.

(3) Any attestation engagement defined in rule 4701-9-05 of the Administrative Code.
(B) The prohibitions outlined in paragraph (A) of this rule apply during the period in which the Ohio permit holder is engaged to perform any of the services described in paragraph (A) of this rule as well as during any period covered by any historical financial statements involved with those services.

(C) An Ohio permit holder who is not prohibited by this rule from performing services for or receiving a commission from a client and who is paid or expects to be paid a commission by the client shall disclose that fact to any person or entity to whom the Ohio permit holder recommends or refers a product or service to which the commission relates.

(D) Any Ohio permit holder who accepts a referral fee for recommending or referring any services of an Ohio permit holder to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

PRACTICE POINTER: The required notice should be made in writing, either on a standard form or as part of the engagement letter.

(E) A commission is compensation for recommending or referring any product or service to be supplied by another person. A referral fee is compensation for recommending or referring any service of an Ohio permit holder to any person.

OBSERVATION: The rule on commissions and referral fees is similar to AICPA rules. 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.

Commissions, Contingent Fees & Referral Fees

Rules 4701-11-03 and 4701-11-04 describe the circumstances when licensees are prohibited from paying or receiving commissions, referral fees and 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 commissions, referral fees or 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.

RULE 4701-11-05: FORM OF PRACTICE AND NAME

(A) An Ohio permit holder may practice public accounting, whether as an owner or employee, only in the form of a sole proprietorship, a partnership, limited liability company, professional association, corporation, or other legal entity whose characteristics conform to the Revised Code and rules of the board.

(B) A public accounting firm shall not practice using any name that is misleading to the public with respect to either the size of the firm or the type of services provided.

(C) Names of one or more retired or deceased partners, shareholders, or members may be included in the registered firm name of a successor public accounting firm.

(D) A public accounting firm that uses a fictitious name must register that name with the board.

OBSERVATION: Firm names have been ruled in Ohio to be equivalent to trade names. The “misleading” sentence in rule 4701-11-05(B) thus refers only to a name that a reasonable person would find misleading on its face.

Some general observations: 1) “Company,” “Co.,” “and Associates,” etc. are not restricted, since everyone uses them and they have been rendered meaningless over the years; 2) A CPA firm with a given number of names in the firm’s name (e.g., Smith, Jones, and Green) should have at least that many CPAs employed by the firm. The CPAs employed by the firm need not have the same names as the names in the firm title if the non-employee names are past owners, and a CPA does not have to be a firm owner to be included in a CPA firm name.

All 50 states and the District of Columbia allow either Limited Liability Partnerships (LLPs) or Limited Liability Corporations (LLCs) or both. More and more accounting firms are changing their style of ownership to one of these two forms.
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.

OBSERVATION: In general, fictitious names are permitted since they would not be inherently misleading (e.g., Columbus Accounting Service).

Association Without Partnership

Sometimes two or more CPAs or CPA firms may cooperate informally in limited activities short of a partnership. They may benefit by helping one another on particular projects or in sharing office space, secretaries, or computer or other services. Usually such informal associations are entirely ethical, if they avoid certain pitfalls.

First, the associates should avoid loose, general oral understandings; instead, they should express in writing the specific conditions of any cooperative arrangement. This makes it a matter of record. For example, each person should receive specific compensation for all time spent on professional services for the other.
Second, the associates should give the public no grounds to believe they are partners. A client needs to know who is accountable for professional services rendered, since, unlike a partner, an associate has no unlimited responsibility for the acts of another. Thus, two CPAs who shared an office and staff asked if a joint letterhead would be proper, if the letterhead showed them as individual CPAs. The Committee on Professional Ethics ruled:

In these circumstances, the public would assume that a partnership existed. If any reports were to be issued under the joint heading, Rule 505 would be violated.

Members should not use a letterhead showing the names of two accountants when a partnership does not exist.

FIRM NAMES – FAQ
Now and then a firm may wish to work with another firm in a limited way as “Associates.” Yet confusion is almost an inevitable result. The AICPA Ethics Division Executive Committee recommends that the association be either dissolved or upgraded into a partnership. For example, they said:

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.

Q: I am a 51% owner of a CPA firm, and the other shareholder of the firm is not a CPA. May I use the names of the two owners in the firm name with the CPA designation?

A: The use of both names in the firm name with the designation “CPA” is a violation of rule 4701-11-05, because to imply that both owners are CPAs is misleading.

RULE 4701-11-06: RETENTION OF CLIENT RECORDS

(A) If a client makes a written request for records from a registered firm or Ohio permit holder, the registered firm or Ohio permit holder shall comply with the request within thirty days after receipt of the request. The thirty-day deadline may be extended by the board if the registered firm or Ohio permit holder requests an extension of time in accordance with paragraph (I) of this rule.

(B) A client's records are any accounting or other records belonging to the client that were provided to the registered firm or Ohio permit holder by or on behalf of the client, as well as records defined in paragraph (E) of this rule as client records.

(C) The workpapers of the Ohio permit holder include, but are not limited to, the following:
(1) The registered firm's or Ohio permit holder's notes or memos regarding the engagement;

(2) Records kept by the registered firm or Ohio permit holder of procedures applied, tests performed, information obtained, and pertinent conclusions reached in the engagement;

(3) Analyses and schedules prepared by the client at the registered firm's or Ohio permit holder's request, and;

(4) Audit programs, audit analyses and memoranda, letters of confirmation and representation, abstracts of company documents, and schedules or commentaries either prepared or obtained by the registered firm or Ohio permit holder.

(D) Workpapers may also be in the form of data stored on discs, tapes, films, or any media other than paper. Workpapers are considered to be the registered firm's or Ohio permit holder's property. In the event of a dispute between the registered firm or Ohio permit holder and the client concerning records, the board will determine whether or not a document may be classified either as registered firm's or Ohio permit holder's workpaper, or as a client record.

(E) Workpapers may contain information that is not reflected in the client's books and records, with the result that the client's financial information is incomplete. These records are defined as client records, and may include but are not limited to:

(1) Adjusting, closing, combining or consolidating journal entries;

(2) Depreciation and amortization schedules, including tax carryforward information; and

(3) Information normally contained in books of original entry, as well as general ledgers and subsidiary ledgers.

(F) If the registered firm or Ohio permit holder has converted client information onto computer files for use with the registered firm's or Ohio permit holder's software, and the registered firm or Ohio permit holder has not been paid for professional services rendered, then the registered firm or Ohio permit holder is under no obligation to provide the client with electronic files or a copy of any software. If the client has paid the registered firm or Ohio permit holder for professional services rendered, then the registered firm or Ohio permit holder must provide a copy of all relevant electronic data files to the client.

(G) If the registered firm or Ohio permit holder has provided the information described in paragraph (B) or (E) of this rule to the client, then the registered firm or Ohio permit holder need not comply with further client requests for the same information.

(H) The registered firm or Ohio permit holder may demand that agreed-upon fees be paid prior to providing any information described in paragraph (E) of this rule if there is an engagement letter or other documented understanding prepared prior to the engagement and communicated to the client that states the specific fee payment arrangements for providing such information.
(I) In the event of a dispute between the client and a registered firm or Ohio permit holder over the return of records described in paragraph (E) of this rule, the registered firm or Ohio permit holder may request an extension of the deadline specified in paragraph (A) of this rule in order to mediate the dispute. This request must be filed within thirty days of the date the records retention complaint is filed with the board. The mediation must be conducted before a mediator mutually agreed upon and selected by the parties, and must be completed within sixty days of the date the complaint is filed with the board. The mediator may be the executive director of the board or a designee if the parties agree. If either party is dissatisfied with the recommendations of the mediator, that party may request a hearing before the board.

AICPA RULE 501 – ACTS DISCREDITABLE

Interpretation 501-1 (Response to Requests by Clients and Former Clients for Records)

When a client of 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:

- **Client provided records** in the member’s custody or control should be returned to the client.
- **Client records prepared by the member** should be provided to the client, except that client records prepared by the member may be withheld if the preparation of such records is not complete or there are fees due the member for the engagement to prepare those records.
- **Supporting records** relating to a completed and issued work product should be provided to the client, except that such supporting records may be withheld if there are fees due to the member for the specific work product.

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

Member’s working papers are the member’s property and need not be provided to the client under provisions of this interpretation; however, such requirements may be imposed by state and federal statutes and regulations, and contractual agreements.

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

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1 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.
• 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;\(^2\) 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.

**OBSERVATION:** The Ohio regulation on retention of client records is much more detailed than AICPA Rule 501. Ohio spells out several situations which could arise along with the required licensee action. Ohio also specifies a 30-day time period for a licensee to comply with a client request for the return of records. The AICPA rule specifies no such time period.

**PROFESSIONAL ETHICS – FAQ**

**Retention of Client Records**

**Q:** I am a CPA and my client owes me for a past due bill. May I withhold the client’s records until I am paid?

**A:** Rule 4701-11-06 states that you must return client records 30 days after the client makes a written request for the records. This time period may be used by you to collect past due fees. However, if the client still does not pay after the 30-day period expires, you must return the client records and enforce collection by other means.

**Q:** AICPA ethics Interpretation 501-1 (ET section 501.02) seems to permit me to hold on to records until I get paid by the client. Why is the Board’s rule different?

**A:** The AICPA ethics interpretation has no deadline for return of client records. The Board’s opinion is that a rule without a deadline is not enforceable; consequently, the Board’s rule balances the interests of the client with those of the CPA.

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\(^2\) 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.
**Case Study**

**Client records and working papers**
**Requested records**

In 2008, 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 2009, Client “A” needed a copy of her depreciation schedule to complete her 2008 tax return. 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 Rule 4701-11-06 Retention of Client Records.

**RULE 4701-11-07: BOARD COMMUNICATIONS**

(A) All official communications from the board are mailed to a person’s last address of record as maintained by the board. If the mail is not returned to the board, the person will be considered by the board to have received such official communications, to be aware of the contents of such official communications, and to be responsible for any actions required of them by such official communications. If a person notifies the board in writing of a failure to receive the official communication, the board will resend the official communication to the person. The board will not extend any deadlines nor abate any penalties unless it feels appropriate circumstances exist.

(B) Any change in a person’s name or address must be made to the board in writing.

**NOTE:** The Board’s website has a convenient on-line address change form available.

(C) Official communications which require a response, unless otherwise specifically designated by the board, shall require a response within fifteen business days. A business day is defined as any day, Monday through Friday, excluding state holidays, that the board office is open.

(D) The board will not be responsible for any delays in communications or in the filing of any other documents or fees submitted by or on behalf of a person which are caused by any third party, whether it be an individual or an organization.

(E) For purposes of this rule, “person” shall have the same meaning as in division (T) of section 4701.01 of the Revised Code.
Case Study

Failure to Respond to a Board Communication

A complaint was filed against Brown. The Board notified Brown of the complaint and requested that Brown respond within 15 business days. Brown did not respond within 15 business days.

LIKELY BOARD ACTION: Violation of Rule 4701-11-07 Board Communications.

RULE 4701-11-09: ACTS DISCREDITABLE

(A) Section 4701.03 of the Revised Code provides that the board may promulgate rules consistent with the goal of maintaining a high standard of integrity and dignity in the accounting profession.

(B) This rule applies to acts by a person holding an Ohio permit, Ohio registration, CPA certificate, PA registration, or firm registration, by a person holding a foreign certificate whose activities are regulated by the board, or by an owner of a public accounting firm equity interest who does not hold an Ohio permit, Ohio registration, CPA certificate, PA registration, foreign certificate, or firm registration.

(C) The following acts by a person defined in paragraph (B) of this rule are determined by the board as conduct discreditable to the accounting profession as stated in division (A)(10) of section 4701.16 of the Revised Code:

(1) Using deceptive representations in connection with the performance of services;

(2) Representing that services are of a particular standard when they are not;

(3) Promoting one’s professional services or registered firm in any manner which is inconsistent with upholding a high standard of integrity and dignity in the accounting profession, including, but not limited to:

(a) Misrepresenting facts or failing to disclose relevant facts.

(b) Creating false or unjustified expectation of favorable results.

(c) Implying abilities not supported by valid educational background, professional attainments, or licensing recognition.

(d) Implying the ability to influence improperly any court, tribunal, or other public body or official.

(4) Engaging in any deceptive trade practice prohibited by law.

(5) Committing fraud or deceit in the act of verifying a CPA candidate’s experience in accordance with paragraph (C) of rule 4701-7-05 of the Administrative Code, or making any false statement with respect to such verification.
(6) Holding out to the public that an accounting credential issued in a foreign country is in good standing if that credential has been suspended or revoked under the laws of the foreign country.

(7) Being convicted of a felony or any crime involving dishonesty or fraud under the laws of a foreign country.

(8) Failing to follow specialized professional engagement requirements of governmental bodies, commissions, or other regulatory agencies.

(9) Assuming responsibility for, associating with, or preparing materially false or misleading financial statements, associated financial data, or accounting entries.

(10) Failing to file a tax return or failing to remit taxes collected on behalf of others in a timely manner.

(D) The acts by a certified public accountant or public accountant outlined in the provisions of paragraph (C) of this rule are not intended to limit the scope of division (A)(10) of section 4701.16 of the Revised Code with respect to investigations concerning alleged discreditable conduct.

**AICPA 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
AICPA RULE 502

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.

HOW TO APPLY AICPA RULES 501, 502, 503 AND 505

Designation as Expert

Since 1981, a person has been able to call himself an expert or specialist in a given area provided that such self-designation was not false, deceptive or misleading.

The CPA who spends 20 hours completing one German tax return for a U.S. client that has a subsidiary in Germany would probably have a hard time justifying advertising expertise or specialization in international income taxes or even German income taxes. Another CPA who has spent the last 30 years dealing solely with international income taxes will have no problem calling himself an expert or specialist in that area. Where, between these two extremes, one will be deemed to qualify as an expert or specialist has not yet been determined and may well never be determined.

Testimonials and Endorsements

Starting in 1986, testimonials and endorsements were permitted in advertising and solicitation. The only guidelines issued on who may give such testimonials and endorsements and what statements they may contain are they cannot be false, misleading, or deceptive.

Would it be ethical for Nash and Co., a hypothetical public accounting firm, to use in their advertising and solicitation materials testimonial letters from the presidents of some of their clients if such letters contained statements such as:
1. Nash and Co. is the best accounting firm in this city.
2. Nash and Co.’s work was far superior and their billing rates lower than our previous accountants, Howard and Co.
3. During the last 15 years we have used, at various time, the other three accounting firms in this city. None of the three measured up to Nash and Co. in quality of work done, timeliness or fees charged.
4. If you want the best service at the lowest price, I would use Nash and Co.
5. Nash and Co. is a better firm than any other public accounting firm in this area.

Although using such material might be crude to many CPAs, it would appear that using them would not be a violation of the Code of Professional Conduct. The statements are not those of Nash and Co., but rather statements (i.e., opinions) of their clients. Further, they do not contain any statement that is known to be false. This would be protected speech under the First Amendment.

What if one of the statements had been – “Nash and Co.’s billing rates are lower than any other public accounting firm in this area?” If Nash and Co.’s partners know this to be untrue, then it would be a violation of the Code of Professional Conduct to use that testimonial in either an advertisement or a solicitation.

What if the testimonials were written by the brother-in-law or some other close relative of the managing partner of Nash and Co.? Would that have to be disclosed? Would it be misleading or deceptive (and thus a violation of the Code of Professional Conduct) not to disclose it? Probably so.

The author believes that testimonials should not be used unless each testimonial is linked to a specific client. For example, “Nash and Co. provided excellent service – B. Smith, XYZ Manufacturing, Fresno, CA.” You should obtain permission from the client prior to publication.

**Acts Discreditable to the Profession**

Because of professional standing, a CPA places limits on his or her conduct which may differ from those observed by people in other areas of work. The non-professional may conduct business as he sees fit, within the framework of the law and general moral guidelines. If the non-professional stumbles past these moral guidelines, he may suffer some inconvenience, embarrassment, or discomfort. The non-professional’s responsibility, however, is primarily to himself, bound as he is by his own behavioral and occupational standards. As CPAs practice, they must bear in mind that their every professional act reflects upon their fellow practitioners as well as on themselves. Rule 501 states that: “A member shall not commit an act discreditable to the profession.”

What are “acts discreditable to the profession?” Independence rates high among the standards of professional conduct. If a CPA gave an unqualified opinion, knowing he lacked independence, he would be committing a discreditable act. The CPA may be taken to task under Rule 501 if he breaks any of the rules of ethical conduct, or if he does anything of an illegal or immoral nature that discredits the profession. The reputation of every CPA may be affected by what every other practitioner does.

An act may result in sanctions, even if the act is not illegal.
Case Study

Public Communications and Advertising by Firm


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

POSSIBLE BOARD ACTION: Using the “established date” of 1984 is misleading and a violation of Rule 4701-11-09 Acts Discreditable.

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Case Study

Professional Misconduct

White, CPA prepared Smith’s 2009 tax return. White offered client “Extended Tax Service” (ETS) for a fee. White explained to Smith that ETS is a guarantee to represent Smith at no additional cost if a taxing authority selected Smith’s tax return for audit.

White required that clients who purchased ETS must be continuing clients to receive the benefits of ETS. White published the terms of ETS once a year in his December newsletter.

The continuing client requirement was not printed on Smith’s invoice. White did not give Smith a verbal explanation of the continuing client requirement. Smith did not read White’s December newsletter.

Smith paid White for ETS when she picked up her 2009 tax return. Smith knew at the time that she paid for ETS that she would not use White’s services again.

Smith’s 2009 tax return was selected for audit. White refused to represent Smith, because Smith was not a continuing client.

White was obligated under the terms stated on Smith’s invoice to provide ETS.

POSSIBLE BOARD ACTION: Violation of Rule 4701-11-09 Acts Discreditable.
Case Study

Holding Out as a Certified Public Accountant
Professional Misconduct – State Tax Defaults

Murphy neglected to file tax returns or pay state income tax liabilities for tax years 2006 through 2010. Department of Revenue notified the Board of Accountancy. The Board suspended Murphy’s CPA permit until such time that Murphy filed tax returns and paid outstanding taxes.

During the time that Murphy's permit to practice was suspended, Murphy held himself out as a CPA when he signed 75 individual income tax returns, displayed his CPA wall certificate, and used business cards that included the CPA designation.

LIKELY BOARD ACTION:
First Action: Violation of Rule 4701-11-09 Acts Discreditable.
Second Action: Violation of Rule 4701-7-04 Use of Title or Designation “Certified Public Accountant” or “CPA.”

RULE 4701-11-10: APPLICATION OF ETHICS RULES TO NON-CPA OWNERS

(A) Pursuant to division (D)(8) of section 4701-04 of the Revised Code, a person who holds an equity interest in a public accounting firm, but does not hold an Ohio permit or a foreign certificate, shall be subject to either the “Code of Professional Conduct” issued by the “American Institute of Certified Public Accountants” and published on that organization’s website (www.aicpa.org), or a comparable code of conduct applicable to the person's profession.

(B) The person described in paragraph (A) of this rule shall also be subject to the provisions of Chapter 4701-9 and Chapter 4701-11 of the Administrative Code as though the person held an Ohio permit or a foreign certificate.

Practice Pointer - CPE Due Date Extended to December 31st.

In 2004, the Board changed the continuing education reporting deadline in Rule 4701-15-02 from October 31 to December 31.

The December 31st CPE deadline is now the same as the CPE reporting deadline.
The Board receives frequent inquiries regarding fees charged by licensees. 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.
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. The term “practice of public accountancy” means the performance of or offering to perform any engagement that will result in the issuance of an attest report in accordance with professional standards. This rule applies to reports issued in accordance with which of the following:
   a) auditing standards
   b) GAAP
   c) compilation and review standards
   d) all 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 AICPA 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

3. Nash CPA is hired November 1, 2010 to complete a review of XYZ, Inc.’s calendar year financial statements. Field work concludes February 28th and the review report is issued March 31, 2011. Nash CPA also wants to do an engagement for XYZ, Inc. on a contingent fee basis. What is the period of exclusion in which Nash CPA may not do a contingent fee engagement for XYZ, Inc.:
   a) November 1, 2010 through February 28, 2011
   b) November 1, 2010 through March 31, 2011
   c) January 1, 2010 through February 28, 2011
   d) January 1, 2010 through March 31, 2011
CHAPTER 2 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Auditing standards is just one of the types of reports specified.
   B: Incorrect. GAAP is just one of the types of reports specified.
   C: Incorrect. Compilation and review standards is just one of the types of reports specified.
   D: Correct. The rule applies to all attest engagements.
   (See Rule 4701-7-04 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 exclusion period begins on January 1, 2010, the beginning of the client’s fiscal year.
   B: Incorrect. The exclusion period begins on January 1, 2010, the beginning of the client’s fiscal year.
   C: Incorrect. The exclusion period ends when the engagement ends.
   D: Correct. The exclusion period encompasses the entire period covered in the financial statements and the entire period the CPA is engaged to review the financial statements.
   (See Rule 4701-11-03 in the course material.)
Chapter 3: Ethics and the Tax Professional

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

- Discuss the Internal Revenue Service Requirements as outlined in Circular 230.
- Describe the applicable AICPA guidance on tax practice.
- Apply the AICPA standards and the IRS rules to common ethical dilemmas faced by CPAs in tax practice.

Introduction

The tax preparation and tax consulting industry has historically enjoyed less government regulation than the practice of accountancy. In 1995, the IRS proposed studying the concept of tax preparer registration in order to combat rising fraud in the earned income credit program. This proposal was dropped because of widespread industry opposition. Instead, the IRS increased the scrutiny applied to firms applying to file tax returns electronically. In 2010, the IRS issued regulations requiring the registration of tax preparers. Effective January 1, 2011, all paid tax return preparers are required to have a Preparer Tax Identification Number (PTIN).

The tax practice field has had less ethical guidance because of the unique relationship between the CPA and client. In an attest engagement, the CPA is ultimately responsible to the users of the client financial statements as well as to the client. In a tax engagement, the CPA is an “advocate of the taxpayer.” The courts have held that there is nothing illegal or sinister in a taxpayer arranging one’s affairs so as to pay the lowest tax legally available.

Nevertheless, CPAs in tax practice do have two sets of ethical and legal guidance which governs their tax practice. Circular 230 governs practice before the Internal Revenue Service. The AICPA has issued statements on standards for tax services. We will examine both of these items, pointing out the differences wherever relevant.

Circular 230

Circular 230 is published by the Treasury Department. It prescribes regulations governing the practice of attorneys, CPAs, EAs, Enrolled Actuaries, appraisers, and others before the Internal Revenue Service. Circular 230 has been amended several times recently, and more changes are proposed. The IRS is currently revising Circular 230 to extend its application to cover unenrolled tax return preparers. This course reprints and discusses most, but not all, of Circular 230.

Explanations of Provisions

Tax advisors play an increasingly important role in the federal tax system, which is founded on principles of voluntary compliance. The tax system is best served when the public has confidence in the honesty and integrity of the professionals providing tax advice. To restore, promote, and maintain the public’s confidence in those individuals and firms, Circular 230 sets forth regulations and best practices applicable to all tax advisors. Circular 230 regulations are limited to practice before the IRS and do not alter or supplant other ethical standards applicable to practitioners.
What is not considered “practice before the IRS”

Section 10.7 of Circular 230 provides a long list of exceptions and exclusions to Circular 230. The following persons and situations are not considered “practicing before the IRS” and therefore are generally exempt from the rules we will discuss later in this course.

A. Representing oneself – individuals may always appear on their own behalf before the IRS.
B. Participating in rulemaking – individuals may participate in rule making.
C. Limited practice – in a number of circumstances an individual who is not a practitioner can represent a taxpayer on a limited basis:
   i. An individual may represent a member of his or her immediate family.
   ii. A regular full-time employee of an individual employer may represent the employer.
   iii. A general partner or regular full-time employee of a partnership may represent the partnership.
   iv. A bona fide officer or a regular full-time employee of a corporation may represent the corporation.
   v. A trustee, receiver, guardian, personal representative, administrator, executor, or regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate.
   vi. An individual may represent any individual or entity before personnel of the Internal Revenue Service who are outside of the United States.
   vii. An individual who prepares and signs a taxpayer’s return as the preparer, or who prepares a return but is not required (by the instructions to the return or regulations) to sign the return, may represent the taxpayer before officers and employees of the Examination Division of the Internal Revenue Service with respect to the tax liability of the taxpayer for the taxable year or period covered by that return.

D. Preparing tax returns and furnishing information. Perhaps the most important exception applies to preparing tax returns. Any individual may prepare a tax return, appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Service or any of its officers or employees. This is not considered practicing before the IRS. As noted previously, although simply preparing tax returns is not currently considered to be “practicing before the IRS,” Circular 230 is being revised so that all tax return preparers will be subject to the rules in Circular 230. As of January 1, 2011, all return preparers must be registered, and the proposed revisions to Circular 230 will extend limited IRS practice rights to registered preparers. Soon, preparing tax returns will be considered practice before the IRS.

It should be noted that signing a tax return does entail certain responsibilities as discussed later. However, preparing a tax return does not rise to the level of practicing before the IRS.

**Observation:** None of the items above in A-D are considered to be practicing before the IRS.
A CPA who is practicing before the IRS and does not fall into one of the exception categories above is subject to subpart B of Circular 230 – Duties and Restrictions relating to practice before the IRS. It is reproduced below and should be read in its entirety.

CIRCULAR 230: SUBPART B -- DUTIES AND RESTRICTIONS RELATING TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

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SUBPART C -- SANCTIONS FOR VIOLATION OF THE REGULATIONS

10.50 Sanctions
10.51 Incompetence and disreputable conduct
10.52 Violation of regulations
10.53 Receipt of information concerning practitioner

SECTION 10.20 Information to be furnished.

(a) To the Internal Revenue Service.

(1) A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.
(2) Where the requested records or information are not in the possession of, or subject to the control of, the practitioner or the practitioner's client, the practitioner must promptly notify the requesting Internal Revenue Service officer or employee and the practitioner must provide any information that the practitioner has regarding the identity of any person who the practitioner believes may have possession or control of the requested records or information. The practitioner must make reasonable inquiry of his or her client regarding the identity of any person who may have possession or control of the requested records or information, but the practitioner is not required to make inquiry of any other person or independently verify any information provided by the practitioner's client regarding the identity of such persons.

**OBSERVATION:** The paragraph above should be read in light of the recently enacted accountant-client privilege.

**OBSERVATION:** Section 10.20 requires a practitioner to respond promptly to a proper and lawful request for records and information, unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.

(b) To the Director of the Office of Professional Responsibility.

When a proper and lawful request is made by the Director of the Office of Professional Responsibility, a practitioner must provide the Director of the Office of Professional Responsibility with any information the practitioner has concerning an inquiry by the Director of the Office of Professional Responsibility into an alleged violation of the regulations in this part by any person, and to testify regarding this information in any proceeding instituted under this part, unless the practitioner believes in good faith and on reasonable grounds that the information is privileged.

**OBSERVATION:** Sometimes referred to as “snitch laws” these provisions require the cooperation of those practicing before the IRS. Failure to cooperate could result in the loss of the right to practice before the IRS.

(c) Interference with a proper and lawful request for records or information.

A practitioner may not interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service, its officers or employees, or the Director of the Office of Professional Responsibility, or his or her employees, to obtain any record or information unless the practitioner believes in good faith and on reasonable grounds that the record or information is privileged.

SECTION 10.21 Knowledge of client’s omission.

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.
SECTION 10.22 Diligence as to accuracy.

(a) In general.

A practitioner must exercise due diligence:

(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

(2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and

(3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

(b) Reliance on others.

Except as provided in §§10.34, 10.35, and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

(c) Effective/applicability date. This section is applicable on September 26, 2007.

SECTION 10.23 Prompt disposition of pending matters.

A practitioner may not unreasonably delay the prompt disposition of any matter before the Internal Revenue Service.

EXAMPLE

Nash, CPA is representing a client under audit by the IRS. Nash believes all the factual matters of the audit could be resolved in 6-8 weeks. Nash learns that the auditor assigned to the audit is planning to retire in six months. Nash believes that if he could delay the audit by raising unreasonable objections until after the IRS agent retires, he could possibly get a better result from the new agent. Purposely delaying the conclusion of the audit until after the IRS agent retires would be a violation of Section 10.23.

OBSERVATION: The following two sections seek to ensure that all persons will be treated equally by the IRS and that none will receive preferential treatment.
SECTION 10.24 Assistance from disbarred or suspended persons and former Internal Revenue Service employees.

A practitioner may not, knowingly and directly or indirectly:

(a) Accept assistance from or assist any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter or matters constituting practice before the Internal Revenue Service.

(b) Accept assistance from any former government employee where the provisions of §10.25 or any federal law would be violated.

SECTION 10.25 Practice by former government employees, their partners and their associates.

(a) Definitions.

For purposes of this section:

(1) Assist means to act in such a way as to advise, furnish information to, or otherwise aid another person, directly or indirectly.

(2) Government employee is an officer or employee of the United States or any agency of the United States, including a special government employee as defined in 18 U.S.C. 202(a), or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

(3) Member of a firm is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practitioners who represent nongovernmental parties.

(4) Particular matter involving specific parties is defined at 5 CFR 2637.201(c), or superseding post-employment regulations issued by the U.S. Office of Government Ethics.

(5) Rule includes Treasury regulations, whether issued or under preparation for issuance as notices of proposed rulemaking or as Treasury decisions, revenue rulings, and revenue procedures published in the Internal Revenue Bulletin (see 26 CFR 601.601(d)(2)(ii)(b)).

(b) General rules

(1) No former Government employee may, subsequent to Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate 18 U.S.C. 207 or any other laws of the United States.
(2) No former Government employee who personally and substantially participated in a particular matter involving specific parties may, subsequent to Government employment, represent or knowingly assist, in that particular matter, any person who is or was a specific party to that particular matter.

(3) A former Government employee who within a period of one year prior to the termination of Government employment had official responsibility for a particular matter involving specific parties may not, within two years after Government employment is ended, represent in that particular matter any person who is or was a specific party to that particular matter.

(4) No former Government employee may, within one year after Government employment is ended, communicate with or appear before, with the intent to influence, any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule the development of which the former Government employee participated in, or for which, within a period of one year prior to the termination of Government employment, the former government employee had official responsibility. This paragraph (b)(4) does not, however, preclude any former employee from appearing on one’s own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a particular matter involving specific parties involving the application or interpretation of a rule with respect to that particular matter, provided that the representation is otherwise consistent with the other provisions of this section and the former employee does not utilize or disclose any confidential information acquired by the former employee in the development of the rule.

(c) Firm representation.

(1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any particular matter with respect to which the restrictions of paragraph (b)(2) of this section apply to the former Government employee, in that particular matter, unless the firm isolates the former Government employee in such a way to ensure that the former Government employee cannot assist in the representation.

(2) When isolation of a former Government employee is required under paragraph (c)(1) of this section, a statement affirming the fact of such isolation must be executed under oath by the former Government employee and by another member of the firm acting on behalf of the firm. The statement must clearly identify the firm, the former Government employee, and the particular matter(s) requiring isolation. The statement must be retained by the firm and, upon request, provided to the Director of the Office of Professional Responsibility.

(d) Pending representation. The provisions of this regulation will govern practice by former Government employees, their partners and associates with respect to representation in particular matters involving specific parties where actual representation commenced before the effective date of this regulation.

(e) Effective/applicability date. This section is applicable on September 26, 2007.

**OBSERVATION:** This section reflects changes to federal statutes governing post-employment restrictions applicable to former government employees.
OBSERVATION: The section above may impose obligations on the firms of former government employees that exceed the obligations of other practitioners.

SECTION 10.26 Notaries.

A practitioner may not take acknowledgments, administer oaths, certify papers, or perform any official act as a notary public with respect to any matter administered by the Internal Revenue Service and for which he or she is employed as counsel, attorney, or agent, or in which he or she may be in any way interested.

OBSERVATION: Obviously, a notary may not be a party to the transaction, benefit from the transaction, or have a conflict of interest.

SECTION 10.27 Fees.

(a) In general.

A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

OBSERVATION: A practitioner may charge different rates depending upon the complexity of the issue.

(b) Contingent fees.

(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to—

(i) An original tax return; or

(ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return.

OBSERVATION: Contrary to AICPA standards, a contingent fee may not be charged on an original return even when the practitioner reasonably anticipates that the return position will be substantively reviewed by the IRS prior to filing of the return.

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.
(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

(c) Definitions. For purposes of this section—

(1) Contingent fee is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) Matter before the Internal Revenue Service includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.

(d) Effective/applicability date. This section is applicable for fee arrangements entered into after March 26, 2008.

SECTION 10.28 Return of client’s records.

(a) In general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his or her federal tax obligations. The practitioner may retain copies of the records returned to a client. The existence of a dispute over fees generally does not relieve the practitioner of his or her responsibility under this section. Nevertheless, if applicable state law allows or permits the retention of a client's records by a practitioner in the case of a dispute over fees for services rendered, the practitioner need only return those records that must be attached to the taxpayer's return. The practitioner, however, must provide the client with reasonable access to review and copy any additional records of the client retained by the practitioner under state law that are necessary for the client to comply with his or her federal tax obligations.

OBSERVATION: The records that must be returned are limited to those records necessary for the client to comply with his or her federal tax obligations. This rule does not apply to other records the practitioner may have.

(b) For purposes of this section – Records of the client include all documents or written or electronic materials provided to the practitioner, or obtained by the practitioner in the course of the practitioner's representation of the client, that preexisted the retention of
the practitioner by the client. The term also includes materials that were prepared by the
client or a third party (not including an employee or agent of the practitioner) at any time
and provided to the practitioner with respect to the subject matter of the representation.
The term also includes any return, claim for refund, schedule, affidavit, appraisal or any
other document prepared by the practitioner, or his or her employee or agent, that was
presented to the client with respect to a prior representation if such document is
necessary for the taxpayer to comply with his or her current federal tax obligations. The
term does not include any return, claim for refund, schedule, affidavit, appraisal or any
other document prepared by the practitioner or the practitioner's firm, employees or
agents if the practitioner is withholding such document pending the client's performance
of its contractual obligation to pay fees with respect to such document.

**OBSERVATION:** A practitioner may withhold the client’s current year completed tax
return pending payment of fees.

**AICPA AND STATE LAW COMPARISON:** This section is more restrictive than AICPA
rules. However, most state accountancy laws require the immediate return of all client
records while the IRS rule pertains only to tax related records.

**SECTION 10.29**   Conflicting interests.

(a) Except as provided by paragraph (b) of this section, a practitioner shall not
represent a client before the Internal Revenue Service if the representation involves a
conflict of interest. A conflict of interest exists if:

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be
materially limited by the practitioner's responsibilities to another client, a former client or
a third person or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this
section, the practitioner may represent a client if:

(1) The practitioner reasonably believes that the practitioner will be able to
provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law;

(3) Each affected client waives the conflict of interest and gives informed
consent, confirmed in writing by each affected client, at the time the existence of the
conflict of interest is known by the practitioner. The confirmation may be made within a
reasonable period after the informed consent, but in no event later than 30 days.

(c) Copies of the written consents must be retained by the practitioner for at least 36
months from the date of the conclusion of the representation of the affected clients and
the written consents must be provided to any officer or employee of the Internal
Revenue Service on request.
(d) Effective/applicability date. This section is applicable on September 26, 2007.

**Practice Pointer:** Consents must be in writing and must be retained for at least 36 months after the conclusion of the engagement.

**SECTION 10.30 Solicitation.**

(a) Advertising and solicitation restrictions.

(1) A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim. Enrolled agents or enrolled retirement plan agents, in describing their professional designation, may not utilize the term of art "certified" or imply an employer/employee relationship with the Internal Revenue Service. Examples of acceptable descriptions for enrolled agents are "enrolled to represent taxpayers before the Internal Revenue Service," "enrolled to practice before the Internal Revenue Service," and "admitted to practice before the Internal Revenue Service." Similarly, examples of acceptable descriptions for enrolled retirement plan agents are "enrolled to represent taxpayers before the Internal Revenue Service as a retirement plan agent" and "enrolled to practice before the Internal Revenue Service as a retirement plan agent."

**OBSERVATION:** Most Boards of Accountancy have similar laws banning false and misleading statements.

(2) A practitioner may not make, directly or indirectly, an uninvited written or oral solicitation of employment in matters related to the Internal Revenue Service if the solicitation violates federal or state law or other applicable rule, e.g., attorneys are precluded from making a solicitation that is prohibited by conduct rules applicable to all attorneys in their State(s) of licensure. Any lawful solicitation made by or on behalf of a practitioner eligible to practice before the Internal Revenue Service must, nevertheless, clearly identify the solicitation as such and, if applicable, identify the source of the information used in choosing the recipient.

(b) Fee information.

(1)(i) A practitioner may publish the availability of a written schedule of fees and disseminate the following fee information:

(A) Fixed fees for specific routine services.

(B) Hourly rates.

(C) Range of fees for particular services.

(D) Fee charged for an initial consultation.

(ii) Any statement of fee information concerning matters in which costs may be incurred must include a statement disclosing whether clients will be responsible for such costs.
Practice Pointer: When practitioners send their clients annual income tax organizers, it is appropriate to include an engagement letter. The engagement letter should specify the responsibilities of both the practitioner and client as well as the responsibility for fees and costs.

(2) A practitioner may charge no more than the rate(s) published under paragraph (b)(1) of this section for at least 30 calendar days after the last date on which the schedule of fees was published.

(c) Communication of fee information.

Fee information may be communicated in professional lists, telephone directories, print media, mailings, electronic mail, facsimile, hand delivered flyers, radio, television, and any other method. The method chosen, however, must not cause the communication to become untruthful, deceptive, or otherwise in violation of this part. A practitioner may not persist in attempting to contact a prospective client if the prospective client has made it known to the practitioner that he or she does not desire to be solicited. In the case of radio and television broadcasting, the broadcast must be recorded and the practitioner must retain a recording of the actual transmission. In the case of direct mail and e-commerce communications, the practitioner must retain a copy of the actual communication, along with a list or other description of persons to whom the communication was mailed or otherwise distributed. The copy must be retained by the practitioner for a period of at least 36 months from the date of the last transmission or use.

Practice Pointer: Practitioners must keep a copy of all mailers for at least 36 months.

(d) Improper associations.

A practitioner may not, in matters related to the Internal Revenue Service, assist, or accept assistance from, any person or entity who, to the knowledge of the practitioner, obtains clients or otherwise practices in a manner forbidden under this section.

(e) Effective/applicability date. This section is applicable on September 26, 2007.

SECTION 10.31 Negotiation of taxpayer checks.

A practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the government in respect of a federal tax liability.

Practice Pointer: By completing Form 2848 “Power of Attorney and Declaration of Representative,” a taxpayer may authorize their representative to receive refund checks. However, even the power of attorney specifically forbids the representative from endorsing refund checks.
SECTION 10.32 Practice of law.

Nothing in the regulations in this part may be construed as authorizing persons not members of the bar to practice law.

SECTION 10.33 Best practices for tax advisors.

(a) Best practices. Tax advisors should provide clients with the highest quality representation concerning federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. In addition to compliance with the standards of practice provided elsewhere in this part, best practices include the following:

1. Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client’s expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

2. Establishing the facts, determining which facts are relevant, and evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts.

3. Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.

4. Acting fairly and with integrity in practice before the Internal Revenue Service.

(b) Procedures to ensure best practices for tax advisors. Tax advisors with responsibility for overseeing a firm’s practice of providing advice concerning federal tax issues or of preparing or assisting in the preparation of submissions to the Internal Revenue Service should take reasonable steps to ensure that the firm’s procedures for all members, associates, and employees are consistent with the best practices set forth in paragraph (a) of this section.

(c) Applicability date. This section is effective after June 20, 2005.

SECTION 10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) [Reserved].

(b) Documents, affidavits and other papers

1. A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.
(2) A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service

(i) The purpose of which is to delay or impede the administration of the federal tax laws;
(ii) That is frivolous; or
(iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.

(c) Advising clients on potential penalties.

(1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to

(i) A position taken on a tax return if—

(A) The practitioner advised the client with respect to the position; or
(B) The practitioner prepared or signed the tax return; and

(ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.

(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) Relying on information furnished by clients. A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) [Reserved].

(f) Effective/applicability date. Section 10.34 is applicable to tax returns, documents, affidavits and other papers filed on or after September 26, 2007.
Tax Return Standards

As you can see from the sections above titled “reserved,” the IRS intends to update this section to implement the tax return preparer penalty provisions of the Small Business and Work Opportunity Tax Act of 2007 “The Act.” IRS Notice 2008-13 provides some guidance as follows:

The Act amended several provisions of the Code to extend the application of the income tax return preparer penalties to all tax return preparers, alter the standards of conduct that must be met to avoid imposition of the section 6694(a) penalty for preparing a return which reflects an understatement of liability, and increase applicable penalties under section 6694(a) and (b). The amendments made by the Act to section 6694 were effective for tax returns and claims for refund prepared after May 25, 2007 but were subsequently retroactively repealed by The Emergency Economic Stabilization Act of 2008.

As amended by the Act, section 7701(a)(36) now defines tax return preparer as any person that prepares for compensation a tax return or claim for refund, or a substantial portion of a tax return or claim for refund, and is no longer limited to persons who prepare income tax returns.

Section 301.7701-15 of the current Procedure and Administration Regulations defines the term income tax preparer to include any person who prepares for compensation all or a substantial portion of a tax return or claim for refund under Subtitle A of the Code. Operation of the current regulations brings into the preparer penalty regime a wide range of activities performed by persons who do not sign the tax return or claim for refund, who may have no knowledge of how their work is ultimately reported on the tax return or claim for refund, or who may have no knowledge of the size or complexity of the schedule, entry, or other portion of a tax return or claim for refund relative to the entire tax return.

The Act also amended section 6694(a) by raising the standards of conduct for tax return preparers. For undisclosed positions, the Act replaced the realistic possibility standard with a requirement that there be a reasonable belief that the tax treatment of the position would more likely than not be sustained on its merits. For disclosed positions, the Act replaced the nonfrivolous standard with the requirement that there be a reasonable basis for the tax treatment of the position.

SECTION 10.35 Requirements for covered opinions.

(a) A practitioner who provides a covered opinion shall comply with the standards of practice in this section.

(b) Definitions.

For purposes of this subpart –

(1) A practitioner includes any individual described in Sec. 10.2(a)(5).
(2) Covered opinion –

(i) In general

A covered opinion is written advice (including electronic communications) by a practitioner concerning one or more federal tax issues arising from:

(A) A transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the Internal Revenue Service has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction under 26 CFR 1.6011-4(b)(2);

(B) Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code; or

(C) Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code if the written advice –

(1) Is a reliance opinion;
(2) Is a marketed opinion;
(3) Is subject to conditions of confidentiality; or
(4) Is subject to contractual protection.

(ii) Excluded advice

A covered opinion does not include –

(A) Written advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of this section;

(B) Written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(ii)(B) of this section (concerning the principal purpose of avoidance or evasion) that –

(1) Concerns the qualification of a qualified plan;
(2) Is a state or local bond opinion; or
(3) Is included in documents required to be filed with the Securities and Exchange Commission;

(C) Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the Internal Revenue Service reflecting the tax benefits of the transaction. The preceding sentence does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits not reported on previously filed return) filed after the date on which the advice is provided to the taxpayer;
(D) Written advice provided to an employer by a practitioner in that practitioner’s capacity as an employee of that employer solely for purposes of determining the tax liability of the employer; or

(E) Written advice that does not resolve a federal tax issue in the taxpayer’s favor, unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue. If written advice concerns more than one federal tax issue, the advice must comply with the requirements of paragraph (c) of this section with respect to any federal tax issue not described in the preceding sentence.

(3) A federal tax issue is a question concerning the federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property for federal tax purposes. For purposes of this subpart, a federal tax issue is significant if the Internal Revenue Service has a reasonable basis for a successful challenge and its resolution could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstances, on the overall federal tax treatment of the transaction(s) or matter(s) addressed in the opinion.

(4) Reliance opinion

Written advice is a reliance opinion if the advice concludes at a confidence level of at least more likely than not (a greater than 50 percent likelihood) that one or more significant federal tax issues would be resolved in the taxpayer’s favor.

For purposes of this section, written advice, other than advice described in paragraph (b)(2)(1)(A) of this section (concerning listed transactions) or paragraph (b)(2)(1)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a reliance opinion if the practitioner prominently discloses in the written advice that it was not intended or written by the practitioner to be used, and that it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(5) Marketed opinion

(i) Written advice is a marketed opinion if the practitioner knows or has reason to know that the written advice will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner’s firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayer(s).

(ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a marketed opinion if the practitioner prominently discloses in the written advice that –

(A) The advice was not intended or written by the practitioner to be used, and that it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;
(B) The advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the written advice; and

(C) The taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.

(6) Conditions of confidentiality

Written advice is subject to conditions of confidentiality if the practitioner imposes on one or more recipients of the written advice a limitation on disclosure of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that practitioner’s tax strategies, regardless of whether the limitation on disclosure is legally binding. A claim that a transaction is proprietary or exclusive is not a limitation on disclosure if the practitioner confirms to all recipients of the written advice that there is no limitation on disclosure of the tax treatment or tax structure of the transaction that is the subject of the written advice.

(7) Contractual protection

Written advice is subject to contractual protection if the taxpayer has the right to a full or partial refund of fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner’s firm) if all or a part of the intended tax consequences from the matters addressed in the written advice are not sustained, or if the fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner’s firm) are contingent on the taxpayer’s realization of tax benefits from the transaction. All the facts and circumstances relating to the matters addressed in the written advice will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to a transaction have not designated as fees or any agreement to provide services without reasonable compensation.

(8) Prominently disclosed

An item is prominently disclosed if it is readily apparent to a reader of the written advice. Whether an item is readily apparent will depend on the facts and circumstances surrounding the written advice including, but not limited to, the sophistication of the taxpayer and the length of the written advice. At a minimum, to be prominently disclosed, an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface of any discussion of the facts or law in the written advice.

(9) State or local bond opinion

A state or local bond opinion is written advice with respect to a federal tax issue included in any materials delivered to a purchaser of a state or local bond in connection with the issuance of the bond in a public or private offering, including an official statement (if one is prepared), that concerns only the excludability of interest on a state or local bond from gross income under section 103 of the Internal Revenue Code, the application of section 55 of the Internal Revenue Code to a state or local bond, the status of a state or local bond as a qualified tax-exempt obligation under section 265(b)(3) of the Internal
Revenue Code, the status of a state or local bond as a qualified zone academy bond under section 1397E of the Internal Revenue Code, or any combination of the above.

(10) The principal purpose

For purposes of this section, the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion under this paragraph (b)(10).

(c) Requirements for covered opinions.

A practitioner providing a covered opinion must comply with each of the following requirements.

(1) Factual matters

(i) The practitioner must use reasonable efforts to identify and ascertain the facts, which may relate to future events if a transaction is prospective or proposed, and determine which facts are relevant. The opinion must identify and consider all facts that the practitioner determines to be relevant.

(ii) The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events). An unreasonable factual assumption includes a factual assumption that the practitioner knows or should know is incorrect or incomplete. For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits. A factual assumption includes reliance on a projection, financial forecast or appraisal. It is unreasonable for a practitioner to rely on a projection, financial forecast or appraisal if the practitioner knows or should know that the projection, financial forecast or appraisal is incorrect or incomplete or was prepared by a person lacking the skills or qualifications necessary to prepare such projection, financial forecast or appraisal. The opinion must identify in a separate section all factual assumptions relied upon by the practitioner.

(iii) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings of the taxpayer or any other person. An unreasonable factual representation includes a factual representation that the practitioner knows or should know is incorrect or incomplete. For example, a practitioner may not rely on a taxpayer’s factual representation that a transaction has a business purpose if the representation fails to include a specific description of the business purpose or the practitioner knows or should know that the representation is incorrect or incomplete. The opinion must identify in a separate section all factual representations, statements or findings of the taxpayer relied upon by the practitioner.
(2) Relate law to facts

(i) The opinion must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(ii) The practitioner must not assume the favorable resolution of any significant federal tax issue except as provided in paragraphs (c)(3)(v) and (d) of this section, or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

(iii) The opinion must not contain internally inconsistent legal analyses or conclusions.

(3) Evaluation of significant federal tax issues

(i) In general

The opinion must consider all significant federal tax issues except as provided in paragraphs (c)(3)(v) and (d) of this section.

(ii) Conclusion as to each significant federal tax issue

The opinion must provide the practitioner’s conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant federal tax issue considered in the opinion. If the practitioner is unable to reach a conclusion with respect to one or more of those issues, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues. The opinion must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more issues. If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant federal tax issues considered, the opinion must include the appropriate disclosure(s) required under paragraph (e) of this section.

(iii) Evaluation based on chances of success on the merits

In evaluating the significant federal tax issues addressed in the opinion, the practitioner must not take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

(iv) Marketed opinions

In the case of a marketed opinion, the opinion must provide the practitioner’s conclusion that the taxpayer will prevail on the merits at a confidence level of at least more likely than not with respect to each significant federal tax issue. If the practitioner is unable to reach a more likely than not conclusion with respect to each significant federal tax issue, the practitioner must not provide the marketed opinion, but may provide written advice that satisfies the requirements in paragraph (b)(5)(ii) of this section.
(v) Limited scope opinions

(A) The practitioner may provide an opinion that considers less than all of the significant federal tax issues if –

(1) The practitioner and the taxpayer agree that the scope of the opinion and the taxpayer’s potential reliance on the opinion for purposes of avoiding penalties that may be imposed on the taxpayer are limited to the federal tax issue(s) addressed in the opinion;

(2) The opinion is not advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions), paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) or paragraph (b)(5) of this section (a marketed opinion); and

(3) The opinion includes the appropriate disclosure(s) required under paragraph (e) of this section.

(B) A practitioner may make reasonable assumptions regarding the favorable resolution of a federal tax issue (an assumed issue) for purposes of providing an opinion on less than all of the significant federal tax issues as provided in this paragraph (c)(3)(v). The opinion must identify in a separate section all issues for which the practitioner assumed a favorable resolution.

(4) Overall conclusion

(i) The opinion must provide the practitioner’s overall conclusion as to the likelihood that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach an overall conclusion and describe the reasons for the practitioner’s inability to reach a conclusion.

(ii) In the case of a marketed opinion, the opinion must provide the practitioner’s overall conclusion that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment at a confidence level of at least more likely than not.

(d) Competence to provide opinion; reliance on opinions of others.

(1) The practitioner must be knowledgeable in all of the aspects of federal tax law relevant to the opinion being rendered, except that the practitioner may rely on the opinion of another practitioner with respect to one or more significant federal tax issues, unless the practitioner knows or should know that such opinion of the other practitioner should not be relied on. If a practitioner relies on the opinion of another practitioner, the relying practitioner must identify the other opinion and set forth the conclusions reached in the other opinion.

(2) The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, and the overall conclusion, if any, satisfy the requirements of this section.
(e) Required disclosures.

A covered opinion must contain all of the following disclosures that apply -

(1) Relationship between promoter and practitioner. An opinion must prominently disclose the existence of -

(i) Any compensation arrangement, such as a referral fee or a fee-sharing arrangement, between the practitioner (or the practitioner’s firm or any person who is a member of, associated with, or employed by the practitioner’s firm) and any person (other than the client for whom the opinion is prepared) with respect to promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion; or

(ii) Any referral agreement between the practitioner (or the practitioner’s firm or any person who is a member of, associated with, or employed by the practitioner’s firm) and a person (other than the client for whom the opinion is prepared) engaged in the promoting, marketing, or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion.

(2) Marketed opinions

A marketed opinion must prominently disclose that -

(i) The opinion was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in the opinion; and

(ii) The taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.

(3) Limited scope opinions

A limited scope opinion must prominently disclose that -

(i) The opinion is limited to the one or more federal tax issues addressed in the opinion;

(ii) Additional issues may exist that could affect the federal tax treatment of the transaction or matter that is the subject of the opinion and the opinion does not consider or provide a conclusion with respect to any additional issues; and

(iii) With respect to any significant federal tax issues outside the limited scope of the opinion, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(4) Opinions that fail to reach a more likely than not conclusion

An opinion that does not reach a conclusion at a confidence level of at least more likely than not with respect to a significant federal tax issue must prominently disclose that -
(i) The opinion does not reach a conclusion at a confidence level of at least more likely than not that with respect to one or more material federal tax issues addressed by the opinion; and

(ii) With respect to those significant federal tax issues, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(5) Advice regarding required disclosures

In the case of any disclosure required under this section, the practitioner may not provide advice to any person that is contrary to or inconsistent with the required disclosure.

(f) Effect of opinion that meets these standards

(1) In general

An opinion that meets the requirements of this section satisfies the practitioner’s responsibilities under this section, but the persuasiveness of the opinion with regard to the tax issues in question and the taxpayer’s good faith reliance on the opinion will be separately determined under applicable provisions of the law and regulations.

(2) Standards for other written advice

A practitioner who provides written advice that is not a covered opinion for purposes of this section is subject to the requirements of Sec. 10.37.

(g) Effective date.

This section applies to written advice that is rendered after June 20, 2005.

SECTION 10.36 Procedures to ensure compliance.

(a) Requirements for covered opinions.

Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm’s practice of providing advice concerning federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with Sec. 10.35. Any such practitioner will be subject to discipline for failing to comply with the requirements of this paragraph if –

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with Sec. 10.35, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with Sec. 10.35; or

(2) The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with the firm, that does not comply with Sec. 10.35 and
the practitioner, through willfulness, recklessness, or gross incompetence, fails to take prompt action to correct the noncompliance.

(b) Effective date.

This section is applicable after June 20, 2005.

SECTION 10.37 Requirements for other written advice.

(a) Requirements.

A practitioner must not give written advice (including electronic communications) concerning one or more federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events), unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, does not consider all relevant facts that the practitioner knows or should know, or, in evaluating a federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised. All facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client will be considered in determining whether a practitioner has failed to comply with this section. In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the determination of whether a practitioner has failed to comply with this section will be made on the basis of a heightened standard of care because of the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.

(b) Effective date.

This section applies to written advice that is rendered after June 20, 2005.

SECTION 10.38 Establishment of Advisory Committees.

(a) Advisory committees.

To promote and maintain the public's confidence in tax advisors, the Director of the Office of Professional Responsibility is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the Internal Revenue Service. Under procedures prescribed by the Director, an advisory committee may review and make recommendations regarding professional standards or best practices for tax advisors, or more particularly, whether a practitioner may have violated Sec. 10.35 or 10.36.

(b) Effective date.

This section applies after December 20, 2004.
SUBPART C -- SANCTIONS FOR VIOLATION OF THE REGULATIONS

SECTION 10.50 Sanctions.

(a) Authority to censure, suspend, or disbar.

The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may censure, suspend or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable (within the meaning of Sec. 10.51), fails to comply with any regulation in this part (under the prohibited conduct standards of Sec. 10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

OBSERVATION: The new regulations add “censure” as a possible sanction.

(b) Authority to disqualify.

The Secretary of the Treasury, or delegate, after due notice and opportunity for hearing, may disqualify any appraiser for a violation of these rules as applicable to appraisers.

(1) If any appraiser is disqualified pursuant to this subpart C, the appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Director of the Office of Professional Responsibility pursuant to §10.81, regardless of whether the evidence or testimony would pertain to an appraisal made prior to or after the effective date of disqualification.

(2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the taxpayer's reliance in good faith on such appraisal.

(c) Authority to impose monetary penalty

(1) In general.

(i) The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may impose a monetary penalty on any practitioner who engages in conduct subject to sanction under paragraph (a) of this section.

(ii) If the practitioner described in paragraph (c)(1)(i) of this section was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to the penalty, the Secretary of the Treasury, or delegate, may impose a monetary penalty on the employer, firm, or entity if it knew, or reasonably should have known, of such conduct.

(2) Amount of penalty. The amount of the penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty.
(3) Coordination with other sanctions. Subject to paragraph (c)(2) of this section

(i) Any monetary penalty imposed on a practitioner under this paragraph (c) may be in addition to or in lieu of any suspension, disbarment or censure and may be in addition to a penalty imposed on an employer, firm or other entity under paragraph (c)(1)(ii) of this section.

(ii) Any monetary penalty imposed on an employer, firm or other entity may be in addition to or in lieu of penalties imposed under paragraph (c)(1)(i) of this section.

(d) Sanctions to be imposed. The sanctions imposed by this section shall take into account all relevant facts and circumstances.

(e) Effective/applicability date. This section is applicable to conduct occurring on or after September 26, 2007, except paragraph (c) which applies to prohibited conduct that occurs after October 22, 2004.

SECTION 10.51 Incompetence and disreputable conduct.

(a) Incompetence and disreputable conduct. Incompetence and disreputable conduct for which a practitioner may be sanctioned under §10.50 includes, but is not limited to--

(1) Conviction of any criminal offense under the Federal tax laws.

(2) Conviction of any criminal offense involving dishonesty or breach of trust.

(3) Conviction of any felony under Federal or State law for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(4) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term “information.”

(5) Solicitation of employment as prohibited under §10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or any officer or employee thereof.

(6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.
(7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

(8) Misappropriation of, or failure properly or promptly to remit, funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(9) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage, or by the bestowing of any gift, favor or thing of value.

(10) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant or actuary by any duly constituted authority of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia, any Federal court of record or any Federal agency, body or board.

(11) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment or ineligibility of such other person.

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations or statements, knowing them to be false or circulating or publishing malicious or libelous matter.

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph (a)(13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

(14) Willfully failing to sign a tax return prepared by the practitioner when the practitioner’s signature is required by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.
(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under §10.60.

(b) Effective/applicability date. This section is applicable to conduct occurring on or after September 26, 2007.

### Case Study
#### Disreputable Conduct

While employed by CPA firm, CPA prepared 17 income tax returns for clients who were not clients of the CPA firm. CPA used the employer’s tax return preparation software and computer equipment to prepare these tax returns. CPA did not remove the employer’s name from the paid preparer section of the tax returns prior to issuing these tax returns to clients. CPA billed the clients using invoices with CPA’s name only and kept the fees received for these services.

CPA believed that these clients knew the CPA firm was not responsible for the tax returns even though the employer’s name was displayed in the paid preparer section of the tax return.
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. Which of the following is considered practicing before the IRS:
   a) preparing one’s own tax return
   b) preparing, at no charge, a tax return for a friend
   c) preparing simple tax returns for $100 each
   d) none of the above

2. Bob Jones, Inc. is a new small business client that has asked you to prepare its current year tax return. Upon interviewing the client, you determine that the client has not filed several prior year tax returns. According to Circular 230 what should you do:
   a) notify the IRS of this failure
   b) advise the client promptly of the fact of non-compliance and notify the IRS if the client refuses to file
   c) advise the client promptly of the fact of non-compliance
   d) ignore the fact of non-filing provided the current year return is filed timely

3. Circular 230 Section 10.22 requires a practitioner to be diligent as to accuracy in most situations. In which of the following is diligence as to accuracy not required:
   a) preparing tax returns
   b) year-end tax planning
   c) preparing letters to the IRS regarding a taxpayer under audit
   d) preparing amended tax returns

4. Under Circular 230 Section 10.27, a practitioner is prohibited from charging certain fees. Which of the following fees is prohibited:
   a) fees in excess of $300 per hour
   b) contingent fees
   c) an unconscionable fee
   d) fees based on the number of forms and schedules contained in a tax return
5. Which of the following is true regarding when a contingent fee is permitted by the IRS:
   a) contingent fees are permitted as long as AICPA standards are followed
   b) contingent fees are allowed on original tax returns
   c) contingent fees are allowed when representing a client under audit
   d) contingent fees are never allowed

6. Under Circular 230 Section 10.28, a practitioner must return certain client records under various circumstances. Which of the following is true under section 10.28 regarding returning client records:
   a) a practitioner may withhold the client’s current year completed tax return pending payment of fees
   b) a practitioner may withhold all client records pending payment of fees
   c) a practitioner must return all client records upon request
   d) federal law gives a practitioner the right to place a lien on client records

7. Circular 230 Section 10.30 imposes numerous restrictions on solicitation and advertising. Which of the following is true:
   a) hourly fee information must be included in all ads
   b) although ads may include a fee schedule, rates can be changed at any time
   c) a copy of all direct mail advertisements must be retained for at least 36 months
   d) when accepting a new client, the practitioner must give the client a good faith estimate of the cost of the services contemplated

8. Circular 230 Section 10.51 outlines items that may constitute incompetence or disreputable conduct. Which of the following would not be considered disreputable conduct:
   a) using abusive language with an IRS auditor in order to get the auditor to delete an item from the audit report
   b) having one’s CPA license revoked for cause
   c) being subject to a preparer penalty for negligence in the preparation of a state tax return by that state’s tax authority
   d) conviction of a crime relating to the filing of a state tax return
CHAPTER 5 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. A taxpayer may always prepare his or her own tax return.

   B: Incorrect. Simply preparing tax returns is not practicing before the IRS.

   C: Incorrect. Although the paid preparer must sign the tax return as preparer, simply preparing tax returns is not practicing before the IRS.

   D: Correct. Practice usually entails representing clients during an examination.

   (See page 3-2 of the course material.)

2. A: Incorrect. Practitioners have no obligation to notify the IRS.

   B: Incorrect. Practitioners are prohibited from notifying the IRS even if the client refuses to take corrective action.

   C: Correct. A practitioner must notify the client of the non-compliance.

   D: Incorrect. A practitioner may not ignore the non-compliance.

   (See Section 10.21 of Circular 230 in the course material.)

3. A: Incorrect. Although a practitioner must exercise due diligence when preparing tax returns, tax planning alone does not entail filing anything with the IRS and is not covered under Section 10.22.

   B: Correct. Since nothing is being filed with the IRS, due diligence is not expressly required. Section 10.22 relates to items provided to the IRS.

   C: Incorrect. Although a practitioner must exercise due diligence when preparing letters to the IRS, tax planning alone does not entail filing anything with the IRS. Section 10.22 relates to items provided to the IRS.

   D: Incorrect. Although a practitioner must exercise due diligence when preparing any federal tax return, tax planning alone does not entail filing anything with the IRS. Section 10.22 relates to items provided to the IRS.

   (See Section 10.22 of Circular 230 in the course material.)
4. A: Incorrect. There is no limit on the hourly rate charged as long as the fee is not unconscionably high.

B: Incorrect. There are significant restrictions on contingent fees, but they are not prohibited in all circumstances.

C: **Correct.** Although subject to interpretation, an unconscionably high fee is prohibited.

D: Incorrect. Generally, the more schedules required in a tax return, the more time and effort required by the practitioner. Accordingly, charging a greater fee for a more detailed return is not prohibited.

(See Section 10.27 of Circular 230 in the course material.)

5. A: Incorrect. The AICPA and IRS have vastly different rules relating to contingent fees. CPAs will generally be bound by more than one set of rules and must adhere to the strictest rule that applies to any given situation

B: Incorrect. Contingent fees for preparing original tax returns are never permitted by the IRS.

C: **Correct.** When representing a client under audit, there is little incentive for the practitioner to misstate income and play the “audit lottery.”

D: Incorrect. The IRS prohibits contingent fees on original tax returns and most amended tax returns while permitting contingent fee arrangements in many other situations.

(See Section 10.27 of Circular 230 in the course material.)

6. **A: Correct.** A completed tax return is the practitioner’s work product and is not a client record.

B: Incorrect. All client records necessary to calculate a client’s federal tax liability must be returned promptly upon request. Section 10.28 does not expressly require the return of other client records allowing practitioners to consider remedies under state law.

C: Incorrect. All client records necessary to calculate a client’s federal tax liability must be returned promptly upon request. Some states permit the practitioner to withhold records that are not required to compute federal tax liability.

D: Incorrect. All client records necessary to calculate a client’s federal tax liability must be returned promptly upon request. Some states permit the practitioner to withhold records that are not required to compute federal tax liability. Federal law does not afford that option.

(See Section 10.28 of Circular 230 in the course material.)
7. A: Incorrect. Ads may include a schedule of fees, but publishing the fee schedule is not mandatory.

B: Incorrect. Rates may not be increased for at least 30 days after the last date the fee schedule was published.

C: Correct. In addition, a list or description of the intended recipients must also be retained for 36 months. This also applies to e-mail solicitations.

D: Incorrect. Although sound business practices suggest the use of an engagement letter that includes fee information, Circular 230 does not require giving the client a fee estimate.

(See Section 10.30 of Circular 230 in the course material.)

8. A: Incorrect. Using abusive language with an IRS agent is unprofessional and may subject you to disciplinary action.

B: Incorrect. Having one’s CPA license revoked is considered disreputable conduct.

C: Correct. Section 10.51 is primarily concerned with the preparation of federal tax forms. Being assessed of a preparer penalty is not a crime, and is not considered disreputable conduct.

D: Incorrect. Section 10.51 is primarily concerned with the preparation of federal tax forms. However, conviction of a state tax crime would be disreputable.

(See Section 10.51 of Circular 230 in 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 |
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<tr>
<th>Term</th>
<th>Definition</th>
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<td>Consulting services</td>
<td>Professional services that use the practitioner’s technical skills, education, observations, experiences, and knowledge of the consulting process.</td>
</tr>
<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></td>
<td>a. An audit or a review of a financial statement.</td>
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<tr>
<td></td>
<td>b. An examination of prospective financial information.</td>
</tr>
<tr>
<td></td>
<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>
</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.</td>
</tr>
<tr>
<td></td>
<td>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>Glossary Term</td>
<td>Definition</td>
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<td>--------------------------------------------------</td>
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<tr>
<td>Internal audit outsourcing</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>Interpretations of rules of conduct</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>Joint closely held business investment</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>Joint Ethics Enforcement Program (JEEP)</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>Member</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>Multidisciplinary practices (MDP)</td>
<td>Arrangements in which CPAs share fees with attorneys or other professionals.</td>
</tr>
<tr>
<td>National Association of State Boards of Accountancy (NASBA)</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>Objectivity</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>Period of professional engagement</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>
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<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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