

**Professional Education Services, LP**

# **Ethics and Professional Conduct for Arizona CPAs**

**#4025L**

**COURSE MATERIAL**



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# CHAPTER 1: THE AICPA CODE OF PROFESSIONAL CONDUCT

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## Chapter Objectives

### After completing this chapter, you should be able to:

- Recall the six guiding principles in the AICPA Code of Professional Conduct.
- Recognize the rules of the Code of Professional Conduct.

## Introduction

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

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

## Question and Answer



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

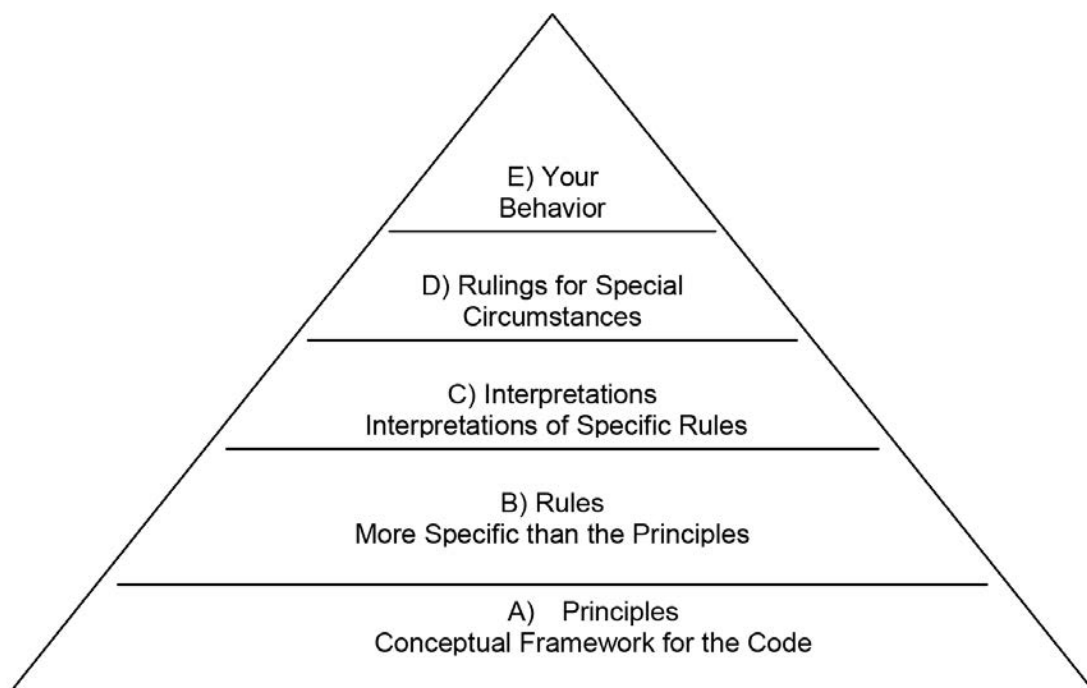
**A:** Most states pattern their rules after the AICPA. In addition, when courts look at professional negligence, they will look to national standards such as the AICPA Code of Professional Conduct.

## Observation



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

## I. AICPA ETHICS PYRAMID



The AICPA ethics pronouncements can be thought of as a pyramid.

### A) Principles

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

### B) Rules

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

### C) Interpretations

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

### D) Rulings

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

### E) Your Behavior

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

## II. PRINCIPLES

The Principles of the Code of Professional Conduct:

### 1. Responsibilities

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

### 2. The Public Interest

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

### 3. Integrity

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

### 4. Objectivity and Independence

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

### 5. Due Care

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

## 6. Scope and Nature of Services

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

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

## III. RULES

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

***Practice of public accounting*** - The practice of accounting consists of the performance for a client, by a member or a member's firm, while holding out as a CPA(s), of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council.

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

***Professional services*** - Professional services include all services performed by a member with very few exceptions.

## NEW CODIFIED CODE OF PROFESSIONAL CONDUCT EFFECTIVE 12/15/14

The AICPA has codified the Code of Professional Conduct to be more logical and user friendly. The code, rules, interpretations and rulings are essentially the same but have been grouped into functional areas based on the member's area of practice plus a preface that is applicable to all members. (Note: throughout the AICPA Code of Professional Conduct you will see the term "Member." This term relates to you, the CPA, whether or not you are a member of the AICPA). The three functional areas are:

Part 1: Members in Public Practice

Part 2: Members in Business

Part 3: Other Members (retired, unemployed, etc.)

The part number is followed by two sets of three digit numbers to identify the topic and, when applicable, the subtopic. For example, 1.100.001 relates to Part 1 (members in Public Practice); topic 100 Integrity and Objectivity; and subtopic 001 the Integrity and Objectivity rule.

By grouping all guidance for a particular type of member in one place, the CPA will save much time in researching a situation, as well as (hopefully) reach a more accurate conclusion. However, bear in mind that a member may be covered by more than one category. For example, one could work full time for an employer in industry and work part time during busy season preparing tax returns.



This chapter will focus on Part 1 of the Code of Professional Conduct: Members in Public Practice. Below is a listing of the topics covered in Part 1 followed by a discussion of each topic and selected corresponding interpretations, rulings, and other guidance by topic.

1.000 Conceptual Framework for Members in Public Practice

1.100 Integrity and Objectivity

1.200 Independence

1.300 General Standards

1.400 Acts Discreditable

1.500 Fees and Other Types of Remuneration

1.600 Advertising and Other Forms of Solicitation

1.700 Confidential Information

1.800 Form of Organization and Name

Throughout this course, we will attempt to use the actual AICPA code section references whenever possible. This will allow you to conduct further research on topics of interest to you. However, the source material is very voluminous and in many instances we have omitted entire sections of the code. In other instances we have greatly summarized the material – sometimes condensing several pages of material into a few bullet points or a single paragraph. We believe this approach is both appropriate and beneficial for the CPA seeking an overview or refresher course.

## **1.000.010 Conceptual Framework for Members in Public Practice**

### ***Introduction***

**.01** Members may encounter various relationships or circumstances that create threats to the member's compliance with the rules. The rules and interpretations seek to address many situations; however, they cannot address all relationships or circumstances that may arise. Thus, in the absence of an interpretation that addresses a particular relationship or circumstance, a member should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a threat to the member's compliance with the rules that is not at an acceptable level. When making that evaluation, the member should apply the conceptual framework approach as outlined in this interpretation.

**.02** The code specifies that in some circumstances no safeguards can reduce a threat to an acceptable level. For example, the code specifies that a member may not subordinate the member's professional judgment to others without violating the "Integrity and Objectivity Rule" [1.100.001]. A member may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in the code.

.03 The “Conceptual Framework for Independence” interpretation [1.210.010] of the “Independence Rule” [1.200.001] provides authoritative guidance that members should use when making decisions on independence matters that are not explicitly addressed by the “Independence Rule” and its interpretations.

## **1.100 Integrity and Objectivity**

### **1.100.001 Integrity and Objectivity Rule**

.01 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 1.100.001 is very broad on purpose. The Code of Professional Conduct could not possibly proscribe every action that is to be avoided. Thus, Rule 1.100.001 could cover a variety of misconduct.

### **Observation**



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

## **Interpretations Under the Integrity and Objectivity Rule**

### **1.100.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts**

.01 In the absence of an interpretation of the “Integrity and Objectivity Rule” [1.100.001] that addresses a particular relationship or circumstance, a member should apply the “Conceptual Framework for Members in Public Practice” [1.000.010].

.02 A member would be considered in violation of the “Integrity and Objectivity Rule” [1.100.001] if the member cannot demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

.03 A member should consider the guidance in “Ethical Conflicts” [1.000.020] when addressing ethical conflicts that may arise when the member encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both.

## **1.110 Conflicts of Interest**

### **1.110.010 Conflicts of Interest**

.01 In performing a professional service for a client, a conflict of interest may occur if a member or the

member's firm has a relationship with another person, entity, product, or service that, in the member's professional judgment, the client or other appropriate parties may view as impairing the member's objectivity. In such situations, adverse interest or self-interest threats may exist to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001].

Certain professional engagements, such as audits, reviews, and other attest services, require independence. Independence impairments under 1.200.001, 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.

## Question and Answer



**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 1.700.001: Confidential Client Information Rule.

### 1.120 Gifts and Entertainment

#### 1.120.010 Offering or Accepting Gifts or Entertainment

**.01** For purposes of this interpretation, a client includes the client, an individual in a key position with the client, or an individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

**.02** When a member offers to a client or accepts gifts or entertainment from a client, self-interest, familiarity, or undue influence threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist.

**.03** Threats to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards and the member would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

- a) The member offers to a client or accepts gifts or entertainment from a client that violate the member's or client's policies or applicable laws, rules, and regulations; and
- b) The member knows of the violation or demonstrates recklessness in not knowing.

**.04** A member should evaluate the significance of any threats to determine if they are at an acceptable level. Threats are at an acceptable level when gifts or entertainment are reasonable in the circumstances. The member should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:

- a) The nature of the gift or entertainment
- b) The occasion giving rise to the gift or entertainment
- c) The cost or value of the gift or entertainment

- d) The nature, frequency, and value of other gifts and entertainment offered or accepted
- e) Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f) Whether other clients also participated in the entertainment
- g) The individuals from the client and member's firm who participated in the entertainment

## **1.130 Preparing and Reporting Information**

### **1.130.010 Knowing Misrepresentations in the Preparation of Financial Statements or Records**

**.01** Threats to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards and the member would be considered to have knowingly misrepresented facts in violation of the "Integrity and Objectivity Rule," if the member

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

### **1.130.020 Subordination of Judgment**

**.01** The "Integrity and Objectivity Rule" [1.100.001] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services for a client, for an employer, or on a volunteer basis. This interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the member's organization.

**.02** Self-interest, familiarity, and undue influence threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist when a member and his or her supervisor or any other person within the member's organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.

**.03** A member should evaluate the significance of any threats to determine if they are at an acceptable level. Threats are at an acceptable level if the member concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If threats are not at an acceptable level, the member should apply the safeguards in paragraphs .05–.07 to eliminate or reduce the threat(s) to an acceptable level so that the member does not subordinate his or her judgment.

## Question and Answer



**Q:** Cindy Steffen is a CPA and the controller of Company X Inc. In preparing the financial statements for the quarter ended March 31, 2014, Steffen proposes to reduce obsolete inventory to net realizable value. The obsolete items represent a significant amount of total inventory. The CFO concurs with Steffen's position. However, he decides not to go against the CEO whose position is that reducing the inventory this quarter is a discretionary decision and the CEO would prefer to record any such reduction at year end, after Company X completes its anticipated public offering of stock later this year. What are the ethical obligations of Steffen's in this situation?

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

### 1.200 Independence

#### 1.200.001 Independence Rule

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

#### Interpretations Under the Independence Rule

#### 1.200.005 Application of the Conceptual Framework for Independence and Ethical Conflicts

.01 In the absence of an interpretation of the "Independence Rule" [1.200.001] that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation [1.210.010].

.02 A member would be considered in violation of the "Independence Rule" [1.200.001] if the member cannot demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

.03 A member should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the member encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both.

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

## **1.210 Conceptual Framework Approach**

### **1.210.010 Conceptual Framework for Independence**

#### ***Introduction***

**.01** It is impossible to enumerate all relationships or circumstances in which the appearance of independence might be questioned. Thus, in the absence of an independence interpretation that addresses a particular relationship or circumstance, a member should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a threat to either the member's or firm's independence, or both, that is not at an acceptable level. When making that evaluation, a member should apply the conceptual framework approach as outlined in this interpretation to analyze independence matters. A member may also wish to consider the conceptual framework approach described in this interpretation to gain a better understanding of the conclusions reached in other interpretations in ET section 1.200, "Independence."

**.02** The code specifies that in some circumstances no safeguards can reduce an independence threat to an acceptable level. For example, the code specifies that a covered member may not own even an immaterial direct financial interest in an attest client because there is no safeguard to reduce the self-interest threat to an acceptable level. A member may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in an independence interpretation.

## **1.230 Fees**

### **1.230.010 Unpaid Fees**

**.01** The existence of unpaid fees to a covered member for professional services previously rendered to an attest client may create self-interest, undue influence, or advocacy threats to the covered member's compliance with the "Independence Rule" [1.200.001].

**.02** Threats to the covered member's compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards if a covered member has unpaid fees from an attest client for any previously rendered professional service provided more than one year prior to the date of the current-year report. Accordingly, independence would be impaired. Unpaid fees include fees that are unbilled or a note receivable arising from such fees.

.03 This interpretation does not apply to fees outstanding from an attest client in bankruptcy.

## **1.240 Financial Interests**

### **1.240.010 Overview of Financial Interests**

.01 If a covered member had or was committed to acquire any direct financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member's compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

.02 If a covered member had or was committed to acquire any material indirect financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member's compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

.03 If a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than 5 percent of an attest client's outstanding equity securities or other ownership interests during the period of the professional engagement, the self-interest threat to compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

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

Independence would be considered to be impaired if:

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



- i. Was material to the close relative and of which the individual or partner has knowledge; and
- ii. Enabled the close relative to exercise significant influence over the client

## Question and Answer



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

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

### 1.300 General Standards

#### 1.300.001 General Standards Rule

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

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

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

Rule 1.300.001 requires that a firm have a certain level of expertise before an audit, tax, or consulting engagement is accepted. This does not suggest that an accounting firm must have complete knowledge in an area before the engagement is accepted -- a lack of competence is not apparent just because an accounting firm accepts a client knowing that additional research may be necessary to complete the job.

## Case Study: Competency, Auditing Standards and Other Professional Standards



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

**LIKELY DISCIPLINARY ACTION:** Violation of 1.300.001 – General Standards Rule.

### 1.310 Compliance With Standards

#### 1.310.001 Compliance With Standards Rule

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

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

## Observation



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

### 1.320 Accounting Principles

#### 1.320.001 Accounting Principles Rule

.01 A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data

taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

## Observation



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

1.320.001 also provides flexibility in the application of accounting principles.

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

### 1.400 Acts Discreditable

#### 1.400.001 Acts Discreditable Rule

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

**NOTE:** 1.400.001 is very broad. It is basic to ethical conduct, and only through its observance can the profession expect to win the confidence of the public. What constitutes a discreditable act is highly judgmental. There has been no attempt to be specific about what constitutes a discreditable act; however, the AICPA bylaws (Section 7.3) state that the following actions will lead to membership suspension or termination, without the need for a disciplinary hearing:

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

In addition, interpretations under the Acts Discreditable Rule identify the following discreditable acts:

- Discrimination or harassment in employment practices.
- Solicitation or disclosure of CPA examination questions or answers.
- Failure to file a tax return or pay a tax liability.
- Negligence in the preparation of financial statements or records.
- Negligence in the preparation of reports to governmental bodies, commissions, or other regulatory agencies.
- Failure to follow applicable standards in conducting governmental audits.
- Use of prohibited indemnification agreements.
- Disclosure or use of confidential information obtained from employment or volunteer activities.
- Using the CPA credential in violation of state law.
- Failure to comply with the request to return client records.
- Removing client files or proprietary information from a former employer.
- Use of confidential information from nonclient services.

#### **1.400.090 False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services**

.01 A member would be in violation of the “Acts Discreditable Rule” [1.400.001] if the member promotes or markets the member’s abilities to provide professional services or makes claims about the member’s experience or qualifications in a manner that is false, misleading, or deceptive.

#### **1.500 Fees and Other Types of Remuneration**

##### **1.510 Contingent Fees**

##### **1.510.001 Contingent Fees Rule**

.01 A member in public practice shall not

- a) Perform for a contingent fee any professional services for, or receive such a fee from a client for whom the member or the member’s firm performs,
  - i. an audit or review of a financial statement; or
  - ii. a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member’s compilation report does not disclose a lack of independence; or

- iii. an examination of prospective financial information; or
- b) Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

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

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

## Question and Answer



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

**A:** Yes. These are not prohibited transactions.

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

## Note



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

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

Fees are not considered to be contingent if they are determined (1) by courts or other public authorities or (2) by judicial proceedings or governmental agencies in the case of tax matters.

The period of prohibition includes the date covered by the financial statements and the period during which the attestation service (and compilation service, as described above) is performed. For example, if the CPA is auditing a client's financial statements for the year ended December 31, 2014, and the date

of the auditor's report is March 12, 2015, no services could be performed on a contingent fee basis by the auditor for the period from January 1, 2014, through March 12, 2015.

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

## **1.520 Commissions and Referral Fees**

### **1.520.001 Commissions and Referral Fees Rule**

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

- a) an audit or review of a financial statement; or
- b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
- c) an examination of prospective financial information.

**.02** This prohibition applies during the period in which the member is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in such listed services.

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

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

### **Note**



A CPA cannot receive a commission for recommending a client's product or services if the CPA audits or reviews that client's financial statements or examines that client's prospective financial information. In addition, no commissions can be received when the CPA compiles a client's financial statements if the CPA believes that a third party will rely on the statements, unless any lack of independence is disclosed in the compilation report.

## Observations



**#1** - When a CPA sells products that the CPA has title to directly to clients, this is not considered a commission. However, care should be exercised to ensure that the arrangement does not impair independence.

**#2** - As with contingent fees, the most important point for CPAs in public practice to remember is that although most Boards of Accountancy allow for commissions with varying requirements, some states continue to prohibit commissions altogether.

**#3** - The Commissions and Referral Fee 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 Professional 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.

**#4** - 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.

**#5** - The markup of a subcontractor's fees is not considered a commission.

**#6** - A member's spouse may receive a commission for referring a product to a client provided the spouse is not part of the member's firm. However, care must be taken to avoid any potential conflict of interest.

## 1.600 Advertising and Other Forms of Solicitation

### 1.600.001 Advertising and Other Forms of Solicitation Rule

.01 A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited.

Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that:

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

### Case Study: Public Communications and Advertising



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

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

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



## 1.700 Confidential Information

### 1.700.001 Confidential Client Information Rule

**.01** A member in public practice shall not disclose any confidential client information without the specific consent of the client.

**.02** This rule shall not be construed (1) to relieve a member of his or her professional obligations of the “Compliance With Standards Rule” [1.310.001] or the “Accounting Principles Rule” [1.320.001], (2) to affect in any way the member’s obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member’s compliance with applicable laws and government regulations, (3) to prohibit review of a member’s professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy. Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member’s confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members’ exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

### Question and Answer



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

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

## Practice Pointer: Your Laptop - Physical Security, Data Protection, and Tracking/Recovery

**Adapted from an article in the North Carolina State Board of CPA Examiners Newsletter.**

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

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

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

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

Industry experts estimate that one in eight laptops is at risk of theft. With such a daunting statistic, laptop users may feel resigned to being the victim of theft. However, one of the cheapest and most cost-effective solutions to deter the theft of a laptop is to attach a security cable (similar to the locks used on bicycles) to the laptop.

With cable locks, a steel clip provided by the manufacturer is installed in a security slot on the back or side of the laptop and a steel cable is threaded through the clip and wrapped around a heavy object such as a desk leg or support pole. The two ends of the cable are then secured with a locking device. If the laptop does not contain a security slot or if the desk does not provide a location for suitable anchorage, special adhesive pads containing an anchorage slot are available. Although cable locks are not infallible, they will at least make the thief work a little harder to get the laptop.

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

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

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

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

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

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

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

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

If you are running an operating system that supports proper logins, setting a password is not only a good idea, it is required. To successfully login to the computer, the user must provide a login name and password. If the information entered is incorrect, the operating system will refuse to allow the user to become an active user.

When creating a password, make sure you create a strong password. For a password to be considered strong, it must be eight or more characters (14 characters or longer is ideal); it must combine letters, numbers, and symbols; it must use a mix of uppercase letters and lowercase letters; and it should use words and phrases that are easy for you to remember, but difficult for others to guess. (**NOTE:** Avoid using your login name, your name, your birthday, anniversary, social security number, telephone number, etc., as part of your password.) Don't forget to change your passwords on a regular basis.

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

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

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

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

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

External drives, flash drives, and CDs are excellent choices for backing up your files.

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

Until recently, luck was the determining factor in recovering a lost or stolen machine, but new technology is providing users with the ability to track stolen or lost laptops.

With tracking programs, once a computer is reported lost or stolen, the tracking company will wait for the laptop to send a location signal (sent whenever the machine is connected to the Internet). When a signal is retrieved, the program will be instructed to broadcast as much information as it can about the current connection (originating phone number, IP address, service provider, etc.). When enough information has been collected, the tracking company will notify the appropriate law enforcement agency which may be able to recover the machine.

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

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

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

## Practice Pointer: The Ethics of Outsourcing Client Tax Returns

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

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

One prime concern is maintaining the confidentiality of client records. Pursuant to Rule 1.700.001, 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.

### 1.800 Form of Organization and Name

#### 1.800.001 Form of Organization and Name Rule

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

**.02** A member shall not practice public accounting under a firm name that is misleading.

**.03** Names of one or more past owners may be included in the firm name of a successor organization.

**.04** A firm may not designate itself as "Members of the American Institute of Certified Public Accountants" unless all its CPA owners are members of the AICPA.

## Question and Answer



**Q:** Three CPA firms wish to form an association – not a partnership – to be known as “Smith, Jones, Nash 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.

## Note



Over the past several decades, the character of the practice of accounting has broadened to include a variety of activities that are beyond the scope of accounting. These activities include, among others, environmental auditing, executive recruitment, and the design of sophisticated computer systems that are not part of the client’s accounting system. With the expansion of the types of services provided by accounting firms, there is an obvious need to recruit personnel who do not have an accounting/auditing background. For many accounting firms, these nontraditional professionals are increasingly important to their growth and development.

## Practice Pointer: Non-CPA Ownership of CPA Firms

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

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

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

## Observation



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

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## CHAPTER 1: TEST YOUR KNOWLEDGE

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

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1.	<p><b>Which of the following is found as the base of the AICPA Ethics Pyramid:</b></p> <ul style="list-style-type: none"><li>A. Your behavior</li><li>B. Principles</li><li>C. Rules</li><li>D. Interpretations</li></ul>
2.	<p><b>Which of the following is <u>not</u> one of the Principles of the AICPA Code of Professional Conduct:</b></p> <ul style="list-style-type: none"><li>A. Honesty</li><li>B. Integrity</li><li>C. Responsibilities</li><li>D. Due care</li></ul>
3.	<p><b>The AICPA codified the Code of Professional Conduct into three functional areas, including all of the following <u>except</u>:</b></p> <ul style="list-style-type: none"><li>A. Members in Public Practice</li><li>B. Members in Business</li><li>C. Member in Public Practice and Business</li><li>D. Other Members (retired, unemployed, etc.)</li></ul>

4.	<p><b>The General Standards Rule [1.300.001] provides guidance on professional competence. Which of the following is true regarding a CPA accepting an engagement under 1.300.001:</b></p> <ul style="list-style-type: none"> <li><b>A.</b> a CPA may generally accept any engagement in which the CPA can meet the expectations of the client</li> <li><b>B.</b> a CPA may accept an engagement only if, at the time of acceptance, the CPA possesses sufficient professional competence to complete the engagement</li> <li><b>C.</b> 1.300.001 generally prohibits CPAs from representing taxpayers before the Internal Revenue Service unless the CPA has also earned the Enrolled Agent designation</li> <li><b>D.</b> 1.300.001 allows a CPA to accept an engagement in which the CPA lacks professional competence provided the CPA can obtain the necessary competence prior to completing the engagement</li> </ul>
5.	<p><b>The Acts Discreditable Rule [1.400.001] is purposely very broad and very non-specific as to exactly when a violation occurs. Which of the following would most likely be a violation of 1.400.001 “Acts Discreditable”:</b></p> <ul style="list-style-type: none"> <li><b>A.</b> a CPA is convicted of a traffic offense and is fined \$400</li> <li><b>B.</b> a CPA cuts his professional services fee by 80% for a client who is near bankruptcy and prepays the estimated fee</li> <li><b>C.</b> a CPA files a false personal tax return but is not convicted of any crime due to the suppression of evidence that is inadmissible in court</li> <li><b>D.</b> a CPA mistakenly fails to sign his personal tax return but does sign it when requested by the tax authorities</li> </ul>

## CHAPTER 1: SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.	<p>A. Incorrect. The Code, interpretations, and rulings are meaningless unless they impact your behavior. Therefore, your behavior is at the top of the pyramid.</p> <p>B. <b>CORRECT.</b> The six principles of the Code of Professional Conduct provide the conceptual framework for the Code, and they are the cornerstone of ethical behavior.</p> <p>C. Incorrect. The rules of the Code of Professional Conduct are more specific than the principles.</p> <p>D. Incorrect. The interpretations are issued by the AICPA to better explain the Code. The Interpretations explain the Code but are not part of it.</p> <p><i>(See page 2 of the course material.)</i></p>
2.	<p>A. <b>CORRECT.</b> The other Principles are the public interest, objectivity and independence, and scope and nature of services.</p> <p>B. Incorrect. Members should perform all professional responsibilities with the highest sense of integrity to maintain and broaden public confidence.</p> <p>C. Incorrect. Members should exercise sensitive professional and moral judgments in all their activities.</p> <p>D. Incorrect. Members should observe the profession's technical and ethical standards, continually strive to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.</p> <p><i>(See pages 3 to 4 of the course material.)</i></p>
3.	<p>A. Incorrect. The groupings are based on the member's area of practice, including public practice. The term member relates to any CPA, whether or not he or she is a member of the AICPA.</p> <p>B. Incorrect. The groupings are based on the member's area of practice, including business. The term member relates to any CPA, whether or not he or she is a member of the AICPA.</p> <p>C. <b>CORRECT.</b> There is not a part that includes a combination of these groups.</p> <p>D. Incorrect. The groupings are based on the member's area of practice, including a grouping of other members that do not fall into the main two categories.</p> <p><i>(See page 4 of the course material.)</i></p>

4.	<p><b>A.</b> Incorrect. Meeting client expectations is important. However, 1.300.001 relates to professional competence, not client expectations.</p> <p><b>B.</b> Incorrect. The key period of time for determining professional competence is at the end of an engagement, not at the beginning of the engagement.</p> <p><b>C.</b> Incorrect. 1.300.001 is more general in nature and does not prohibit CPAs from performing tax services for clients.</p> <p><b>D.</b> <b>CORRECT.</b> A CPA that accepts an engagement while lacking professional competence could gain the required competence by taking a course on the topic or seeking the assistance of a colleague.</p> <p><i>(See page 13 of the course material.)</i></p>
5.	<p><b>A.</b> Incorrect. Although committing a crime punishable by imprisonment for more than one year is a violation of 1.400.001, a relatively minor traffic violation is not a violation.</p> <p><b>B.</b> Incorrect. Besides being a benevolent act, cutting one's fee may be a wise business move if billing the full fee in arrears resulted in no recovery due to bankruptcy.</p> <p><b>C.</b> <b>CORRECT.</b> Filing a false or fraudulent tax return is a violation of 1.400.001, even if a criminal conviction is not obtained.</p> <p><b>D.</b> Incorrect. An unintentional mistake is not generally a violation of 1.400.001, though a pattern of repeated material errors could potentially rise to that level.</p> <p><i>(See page 15 of the course material.)</i></p>

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## CHAPTER 2: ARIZONA ACCOUNTANCY STATUTES

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### Chapter Objective

**After completing this chapter, you should be able to:**

- Recall a registrant's responsibilities according to the Arizona Accountancy Statutes.

### 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 public 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 legislature.

In order to remain licensed, an Arizona 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. Material differences between state law and the AICPA exist and will be discussed in the next two chapters.

The law relating to CPAs can be divided into two parts. This chapter will discuss the law as passed by the legislature known as the Revised Statutes relating to Professions and Occupations (Title 32). The next chapter will cover the administrative code as promulgated by the Board of Accountancy as regulations.

### Where to Find the Law

The Arizona Revised Statutes can be found in the statutes relating to professions and occupations beginning at Section 701. The sections are grouped by topic and are called articles. Fortunately, the articles are in section number order for ease of use. Below is a listing of the articles and sections in the statutes.

The Statute and Board regulations are available on the Board's website at:  
[www.azaccountancy.gov/](http://www.azaccountancy.gov/)

For your convenience, the entire Statute table of contents by section number is reprinted below. You can use it to help research the answers to ethical and legal questions. For purposes of this course, selected Statutes have been reprinted in their entirety and discussed in detail. You are encouraged to research other parts of the Statutes as they relate to your practice.

**LAW**  
**CHAPTER 6, TITLE 32;**  
**STATUTES RELATING TO PROFESSIONS AND**  
**OCCUPATIONS; AMENDING LAWS RELATING TO**  
**CERTIFIED PUBLIC ACCOUNTANTS AND**  
**PUBLIC ACCOUNTANTS,**  
**AS ADOPTED BY THE FIFTY-FIRST LEGISLATURE,**  
**SECOND SPECIAL SESSION, 2014**

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### § 32-729. Fees

The board shall establish and collect:

1. A uniform fee from an applicant for each initial examination and reexamination application pursuant to section 32-723 to cover reasonable costs of reviewing the applicant's eligibility to take the examination and facilitating the applicant to take the examination until the applicant passes all sections.
2. A uniform fee from each applicant for a certificate to be issued pursuant to section 32-721.
3. A uniform registration fee of at least one hundred and not more than three hundred dollars from each applicant for registration as a certified public accountant or public accountant pursuant to section 32-730. The registration fee is due during the month of the anniversary of the registrant's birth. Registrants for less than two years shall be charged on a pro rata basis for the remainder of the registration period. The board shall establish and collect a late fee, if applicable, of not more than one hundred dollars.

4. A uniform registration fee of at least one hundred dollars and not more than three hundred dollars from each applicant for registration as a firm pursuant to section 32-730. The registration fee is due during the month of the anniversary of the effective date of the firm's formation. The board shall establish and collect a late fee, if applicable, of not more than one hundred dollars. The board shall not charge a fee for the registration of additional offices of the same firm or for the registration of a sole practitioner.
5. A uniform application fee in an amount to be determined by the board to reinstate a certificate pursuant to this chapter.
6. A uniform registration fee of fifty dollars for retired status registration as described in section 32-730.04. The board shall establish and collect a late fee, if applicable, and it is the intent of the legislature that the fee is not more than one hundred dollars.

### **§ 32-730. Biennial registration; continuing professional education**

A. Except as provided in subsection B of this section and in section 32-4301, the board shall require every certified public accountant, public accountant and firm to register once every two years with the board and pay a registration fee pursuant to section 32-729.

#### **Observation**



Both individuals and firms must register. A sole practitioner is considered a firm and must register as such.

B. The registration fee for certified public accountants and public accountants may be reduced or waived by the board for registrants with a disability to a degree precluding the continuance of their practice for six months or more prior to the due date of any renewal fee.

C. At the time of registration, every certified public accountant and public accountant, as a prerequisite to biennial registration, shall submit to the board satisfactory proof in a manner prescribed by the board that the registrant has completed the continuing education requirements established by the board. The board may grant a full or partial exemption from continuing professional education requirements or an extension of time to complete the continuing professional education requirements for registrants on a demonstration of good cause.

### **§ 32-730.01. Inactive status; reactivation; exception**

A. A registrant who is not actively engaged in the practice of accounting in this state for a fee or other compensation may request that the registrant's certificate be placed on inactive status by meeting the requirements for inactive status and completing the forms prescribed by the board. A registrant whose certificate is under a disciplinary order by the board, except for suspension for nonregistration pursuant to section 32-741.01, or against whom disciplinary proceedings have been initiated may not place or maintain a certificate on inactive status.



B. A registrant whose certificate is on inactive status:

1. Shall continue to register once every two years with the board and pay fifty percent of the registration fee and one hundred per cent of any applicable late fee pursuant to section 32-729.
2. Shall not engage in the practice of accounting in this state for a fee or other compensation while the registrant's certificate remains on inactive status.
3. In this state shall not assume or use the title or designation of "certified public accountant" or "public accountant" or the abbreviation "C.P.A.", "CPA", "P.A." or "PA" while the registrant's certificate remains on inactive status unless accompanied by the word "inactive".

C. A registrant may request that the registrant's certificate be reactivated if the certificate has been inactive for six years or less and if the registrant meets all of the following requirements:

1. Files an application for renewal on the form prescribed by the board and pays the registration fee pursuant to section 32-729.
2. Submits proof that the registrant has satisfied continuing professional education requirements as prescribed by the board.
3. Affirms that the registrant has not engaged in any conduct that would constitute grounds for revocation or suspension of a certificate pursuant to section 32-741.

D. A registrant may reactivate an inactive certificate pursuant to subsection C of this section only once.

E. A certificate expires if it has been inactive for more than six years.

F. Subsections D and E of this section do not apply if inactive status is approved by the board for good cause based on a registrant's disability.

#### **§ 32-730.02. Canceled status; reinstatement**

A. A registrant may cancel a certificate or registration by submitting a written request on a form prescribed by the board. A registrant whose certificate or registration is under a disciplinary order by the board, except for suspension for nonregistration pursuant to section 32-741.01, or against whom disciplinary proceedings have been initiated may not cancel the certificate or registration.

B. An individual whose certificate has been canceled shall not assume or use the title or designation of "certified public accountant" or "public accountant" or the abbreviation "C.P.A.", "CPA", "P.A." or "PA" while the certificate remains on canceled status unless the individual qualifies for limited reciprocity privilege pursuant to section 32-725.

C. An individual whose certificate has been canceled and who does not qualify for certification by reciprocity pursuant to section 32-721, subsection C may apply for reinstatement and the board may reinstate the certificate if the individual meets all of the following requirements:

1. Files an application for reinstatement on the form prescribed by the board and pays the reinstatement application fee pursuant to section 32-729.
2. Submits proof that the individual has satisfied continuing professional education requirements as prescribed by the board.
3. Affirms that the individual has not engaged in any conduct that would constitute grounds for revocation or suspension of a certificate pursuant to section 32-741.
4. On board approval of reinstatement, pays the registration fee pursuant to section 32-729.

D. A firm whose registration has been canceled may apply for reinstatement and the board may reinstate the firm's registration with a new effective date of the firm's formation if the firm meets both of the following requirements:

1. Files an application on a form prescribed by the board and pays the registration fee pursuant to section 32-729.
2. Meets the requirements of section 32-731.

#### **§ 32-730.03. Expired status; reinstatement**

A. A registrant's certificate or registration is expired if the registrant fails to reinstate the certificate within twelve months after it has been suspended pursuant to section 32-741.01 or 32-741.02 or fails to reinstate a certificate that has been on inactive status pursuant to section 32-730.01 for more than six years.

B. An individual whose certificate has expired shall not assume or use the title or designation of "certified public accountant" or "public accountant" or the abbreviation "C.P.A.", "CPA", "P.A." or "PA" while the certificate remains on expired status unless the individual qualifies for limited reciprocity privilege pursuant to section 32-725.

C. An individual whose certificate has expired may apply for reinstatement and the board may reinstate the certificate if the individual meets all of the following requirements:

1. Files an application for reinstatement on a form prescribed by the board and pays the reinstatement application fee pursuant to section 32-729.
2. Submits proof that the individual has satisfied continuing professional education requirements as prescribed by the board.
3. Affirms that the individual has not engaged in any conduct that would constitute grounds for revocation or suspension of a certificate pursuant to section 32-741.
4. On board approval of reinstatement, pays the registration fee pursuant to section 32-729.

D. A firm whose registration has been canceled may apply for reinstatement and the board may reinstate the firm's registration with a new effective date of the firm's formation if the firm meets both of the following requirements:

1. Files an application on a form prescribed by the board and pays the registration fee pursuant to section 32-729.
2. Meets the requirements of section 32-731.

#### **§ 32-730.04. Retired status; reactivation**

A. A registrant who is at least fifty-five years of age, who has been a certified public accountant or public accountant in one or more jurisdictions for at least twenty years and who is not actively engaged in the practice of accounting for a fee or other compensation may request that the registrant's certificate be placed on retired status by submitting a request on a form approved by the board. A registrant whose certificate is under a disciplinary order by the board, except for suspension for nonregistration pursuant to section 32-741.01 or against whom disciplinary proceedings have been initiated may not place or maintain a certificate on retired status.

B. A registrant whose certificate is on retired status:

1. Shall continue to register once every two years with the board and pay a registration fee and all of an applicable late fee as prescribed by section 32-729.
2. Shall not engage in the practice of accounting for a fee or other compensation while the registrant's certificate remains on retired status.
3. Shall not assume or use the title or designation of "certified public accountant" or "public accountant" or the abbreviation "C.P.A.", "CPA", "P.A." or "PA" unless accompanied by the word "retired" or the abbreviation "RET" while the registrant's certificate remains on retired status.

C. A registrant may request that the registrant's certificate be reactivated if the registrant meets all of the following requirements:

1. Files an application for renewal on the form prescribed by the board and pays the registration fee pursuant to section 32-729.
2. Submits proof that the registrant has satisfied continuing professional education requirements as prescribed by the board.
3. Affirms that the registrant has not engaged in any conduct that would constitute grounds for revocation or suspension of a certificate pursuant to section 32-741.

#### **§ 32-731. Certified public accountant or public accountant partnership; qualifications**

A. Except as provided in Section 32-725, subsection G, once every two years, a partnership engaged in this state in the practice of accounting by certified public accountants or public accountants shall pay the registration fee pursuant to Section 32-729 and register with the board as a partnership of certified public accountants and shall meet the following requirements:

1. At least one partner shall be a resident and a full-time practicing certified public accountant in good standing in this state.

2. At least fifty-one percent of the ownership of the partnership, in terms of direct and indirect financial interests and voting rights, must belong to holders in good standing of certificates or licenses to practice accounting as certified public accountants or public accountants in any jurisdiction. Only certified public accountants or public accountants whose qualifications are considered to be substantially equivalent, as provided by Section 32-721, subsections C and D, may be considered as meeting the requirement prescribed by this paragraph.

## Observation



CPA firms must be 51% or more owned by CPAs.

B. A partnership registered with the board pursuant to this section may include owners who are not certified pursuant to this chapter if all of the following apply:

1. The partnership designates a person who is certified pursuant to this chapter and who is responsible for the proper registration of the firm.
2. All noncertified partners actively participate in the management of the partnership or a directly affiliated entity that has been approved by the board. For the purposes of this paragraph:
  - (a) A partner actively participates if all of the following occur:
    - (i) The partner performs at least five hundred hours of professional services for the public accounting partnership during the calendar year.
    - (ii) The accounting services performed constitute the partner's principal occupation.
    - (iii) The partner's interest in the public accounting partnership reverts to the partnership if the partner stops performing services for the partnership.

## Practice Pointer



All non CPA partners must actively participate in the management of the CPA firm by meeting all three of the above tests.

(b) "Directly affiliated entity" means a firm where each owner of an equity interest in the entity actively participates in the business of providing services to the firm's clients.

3. Any partner who is ultimately responsible for supervising attest services in this state or the partner who signs any reports related to restricted financial services on behalf of the partnership in this state shall be certified pursuant to this chapter and shall meet the experience requirements for carrying out these functions adopted by the board in its rules.
4. The partnership complies with other requirements imposed by the board in its rules.

C. Application for registration pursuant to this section shall be made upon affidavit of a partner of the partnership who is a certified public accountant or public accountant in good standing in this state. The board in each case shall determine whether the applicant is eligible for registration. A partnership that is registered pursuant to this section may use the words “certified public accountants” or the abbreviation “C.P.A.s” or “CPAs” or the words “public accountants” or the abbreviation “P.A.s” or “PAs” in connection with its partnership name as provided for by the board in its rules. Partnerships registered pursuant to this chapter may provide attest services.

### Practice Pointer



A CPA partnership may use the plural title CPAs since it is composed of more than one CPA.

D. A partnership that applies for an initial registration or a renewal pursuant to this section shall list in its application all states in which the partnership has applied for or holds a registration, license or permit as a certified public accountant partnership and shall list any past denials, revocations or suspensions of registrations, licenses or permits by any other jurisdiction.

E. Except as provided in subsection F of this section, an applicant for registration or a partnership registered pursuant to this section shall notify the board in writing within one month of any of the following:

1. The termination of any partnership.
2. The admission of a partner to a partnership that is registered pursuant to this section if the partner is a certified public accountant or a public accountant.
3. The withdrawal of a partner from a partnership that is registered pursuant to this section if the partner is a certified public accountant or a public accountant.
4. A change of a partner's residence from this state to another jurisdiction or from another jurisdiction to this state if the partner is in a partnership that is registered pursuant to this section and the partner was a certified public accountant or a public accountant.
5. The death of a person who is a partner in a partnership that is registered pursuant to this section and who was a certified public accountant or a public accountant.

6. Any change by any jurisdiction in the certificate or license status of a certified public accountant or a public accountant owner of the partnership that prevents the certificate or license from being in good standing or that prevents the right of the certified public accountant or a public accountant to practice accounting as a certified public accountant or a public accountant in that jurisdiction.
7. Any change in the number or location of offices of the partnership in this state and any change in the identity of the individuals in charge of the partnership's offices in this state.

F. If a partnership fails to comply with subsection E of this section, the board may grant a reasonable period of time for the partnership to take corrective action.

G. Professional corporations composed of certified public accountants or public accountants shall meet the requirements of title 10, chapter 20 and any additional nonconflicting requirements contained in this section.

H. Limited liability companies, professional limited liability companies and limited liability partnerships composed of certified public accountants or public accountants shall meet the requirements of title 29, chapters 4 or 5 and any additional nonconflicting requirements contained in this section.

I. For the purposes of this section:

1. "Partner" includes any shareholder of a professional corporation and any member of a limited liability company or professional limited liability company.
2. "Partnership" includes a professional corporation, a limited liability company and a professional limited liability company.

### Practice Pointer: Form of Practice



In general, the requirements to practice public accountancy as a firm are the same regardless of which form of practice is chosen. Accordingly, the registration requirements are the same for partnerships, professional corporations, LLCs, PLLCs, LLPs and any other permitted entity.

### § 32-741. Revocation or suspension of certificate; disciplinary action; letter of concern

### Observation



The Board was created to protect the public. The Board has very broad powers to suspend or revoke a CPA's certificate for professional or criminal misconduct.

A. After notice and an opportunity for a hearing, the board may revoke or suspend any certificate granted under this chapter and may take disciplinary action concerning the holder of any certificate for any of the following causes:

1. Conviction of a felony under the laws of any state or of the United States if civil rights have not been restored pursuant to title 13, chapter 9 or other applicable recognized judicial or gubernatorial order.
2. Conviction of any crime that has a reasonable relationship to the practice of accounting by a certified public accountant or by a public accountant, including crimes involving accounting or tax violations, dishonesty, fraud, misrepresentation, embezzlement, theft, forgery, perjury or breach of fiduciary duty, regardless of whether civil rights have been restored.
3. Fraud or deceit in obtaining a certificate as a certified public accountant or in obtaining a certificate as a public accountant under this chapter.
4. Dishonesty, fraud or gross or continuing negligence in the practice of accounting.
5. Discipline to the holder of any certificate or other authority to practice or refusal to renew the certificate or other authority to practice as a certified public accountant by any other state or foreign country for any cause other than failure to pay license or registration fees.
6. Violation of any of the provisions of this chapter, of title 44, chapter 12, article 13 or of any fraud provisions of the federal securities laws.
7. Final judgment in a civil action if the court makes findings of accounting violations, dishonesty, fraud, misrepresentation or breach of fiduciary duty.
8. Final judgment or order in a civil action or administrative proceeding if the court or agency makes findings of violations of any fraud provisions of the laws of this state or federal securities laws.
9. Violation of any decision, order or rule issued or adopted by the board.
10. Suspension or revocation for cause of the right to practice before the federal securities exchange commission or any other governmental body or agency or the Public Company Accounting Oversight Board or its successor.
11. Offering or accepting commissions or contingency fees for services rendered for clients for whom the attest function is also offered or rendered in the performance of the practice of accounting unless:
  - (a) The fee is fixed by a court or another public authority.
  - (b) In a tax matter, the fee is determined based on the results of a judicial proceeding or the finding of a governmental agency.

## Note



Contingent fees and commissions will be discussed in the next chapter.

12. Failing to disclose to a client that the registrant has received or expects to receive a commission from a third party for any engagement, services or product sales involving services other than the attest function.
13. Making any false or misleading statement or verification in support of an application for a certificate, registration or permit filed by another person.
14. Making a false or misleading statement:
  - (a) To the board or its designated agent.
  - (b) On a form required by the board.
  - (c) In written correspondence to the board.
15. Failing to respond in writing or furnish information in a timely manner to the board or its designated agent, if the information is legally requested by the board and is in the registrant's possession or control.

B. Pursuant to title 41, chapter 6, article 10, the board may summarily suspend the certificate of any certified public accountant or public accountant pending proceedings for revocation or other disciplinary action on the receipt of either of the following:

1. A notice of conviction of any crime that has a reasonable relationship to the practice of accounting, including crimes involving accounting or tax violations, dishonesty, fraud, misrepresentation, embezzlement, theft, forgery, perjury or breach of fiduciary duty or of any felony.
2. A final judgment or order in a civil action or administrative proceeding in which the court or agency made findings of violations of any fraud provisions of the laws of this state or federal securities laws.

C. The board may take disciplinary action against a holder of a certificate pursuant to this chapter who is practicing accounting even if the person is not representing to the public that the person is a certified public accountant or a public accountant and even if the person is practicing accounting in a firm that is not registered by the board.

D. The board may issue a letter of concern if, in the opinion of the board, there is insufficient evidence to support disciplinary action against the registrant, but the board believes, as a result of information



ascertained during an investigation, that continuation of the activities that led to the investigation may result in future board action against the registrant. A registrant may file a response with the board within thirty days after receipt of a letter of concern. Letters of concern issued by the board and records kept by the board in connection with investigations leading to letters of concern are confidential and are not public records.

### **§ 32-742.01. Investigations**

A. The board on its own motion, or on receiving a complaint or other information suggesting violations of this chapter or board rules, may conduct or direct an authorized committee to conduct an initial analysis which shall be completed before the board may open an investigation file pursuant to subsection B to determine whether reasonable cause exists to believe that there is a violation of this chapter or board rules. The board or its authorized committee may designate one or more persons of appropriate competence to assist the board in its initial analysis.

B. After an initial analysis if the board finds reasonable cause to believe there is a violation of this chapter or board rules, the board may direct that an investigation file be opened to determine if there is reasonable cause to institute disciplinary proceedings under this chapter. An investigation is not a prerequisite to disciplinary proceedings under this chapter if reasonable cause can be determined without an investigation.

C. To assist in the investigation, the board or an authorized committee may designate one or more persons of appropriate competence to be investigators. When completing an investigation, the investigator shall file a report with the board or an authorized committee. Based on the investigator's report, the board or authorized committee may request further investigation, hold voluntary investigative interviews, make appropriate recommendations for dismissal, letters of concern, consent orders or other disciplinary actions.

D. If the board does not find reasonable cause to believe that there is a violation of this chapter or board rules, the board shall close the investigation file.

## **Observation**



The Board may initiate an investigation based on a complaint, other information received by the Board, or by its own motion.

### **§ 32-743. Hearings; judicial review**

A. The board may initiate proceedings under this chapter, for cause, either on its own motion or a verified complaint pursuant to title 41, chapter 6, article 10.

B. A written notice stating the nature of the charge or charges against the holder of a certificate and the time and place of the hearing before the board on the charges shall be served not less than twenty days

prior to the date of the hearing either personally or by mailing a copy of the notice, certified mail, to the address last known to the board.

C. If, after having been served with the notice of hearing, the person fails to appear at the hearing and defend, the board may proceed to hear evidence against the person and may enter such order as shall be justified by the evidence.

D. At all hearings, the attorney general of this state, one of the attorney general's assistants or a special assistant designated by the attorney general shall appear and represent the board.

E. The decision of the board shall be by majority vote. Any person aggrieved by the decision may file a motion for a rehearing pursuant to title 41, chapter 6, article 10.

F. Except as provided in section 41-1092.08, subsection H, the board's final decision is subject to judicial review pursuant to title 12, chapter 7, article 6.

### **§ 32-744. Ownership and custody of working papers and records**

A. All statements, records, schedules, working papers and memoranda prepared by a registrant or a partner, shareholder, officer, director, member, manager or employee of a registrant incidental to or in the course of rendering professional services to a client while a registrant are and shall remain the property of the registrant, except:

1. In the case of an express agreement between the registrant and the client to the contrary.
2. The reports submitted by the registrant to the client.
3. Records that are part of the client's records.

B. Without the consent of the client or the client's personal representative or assignee, no statement, record, schedule, working paper or memorandum may be sold, transferred or bequeathed to anyone other than surviving partners, stockholders or members or new partners, new stockholders, new members of the firm or any combined or merged firm or successor in interest to the firm.

C. On request with reasonable notice, a registrant shall timely furnish to a client or former client:

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

### **Example**



Depreciation calculations and carryforward schedules prepared by the CPA are generally considered to be prepared for the client. As such, they are part of the client's records, and copies must be made available to the client upon request.

2. Any accounting or other records belonging to, or obtained from or on behalf of, the client that the registrant removed from the client's premises or received for the client's account. The registrant may make and retain copies of these documents if they form the basis for work done by the registrant.

### Observation: Unpaid Fees



You may not hold a client's records hostage pending receipt of unpaid fees. However, a completed tax return may be withheld pending payment but not the client records which were used to prepare the return.

D. A registrant or firm shall maintain all records pertaining to any legal action initiated against the registrant or firm for a period of three years after the resolution of the action. On request, the registrant or firm shall timely furnish all records pertaining to the legal action to the board. For the purposes of this subsection, "legal action" means any civil or criminal lawsuit or state or federal administrative proceeding where the allegations against the registrant or firm are violations of accounting or auditing standards or that result from negligence, gross negligence or reckless conduct, dishonesty, fraud, misrepresentation, breach of fiduciary duty or the suspension or revocation of the right to practice before the federal securities and exchange commission, the internal revenue service or any other state, United States territory or federal agency.

E. Except as provided in subsection D, this section does not require a registrant to keep any work paper beyond the period prescribed by any other applicable statute.

### Client Records and Working Papers

#### **Applicable Statutes or Administrative Rules**

Arizona Accountancy Act Section 32-744

Regulation R4-1-455.02

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

Section 32-744 requires licensees to provide to a client or former client any records belonging to or obtained from or on behalf of the client, and a copy of the licensee's working papers, to the extent that the working papers include records that would ordinarily constitute part of the client's records and are not otherwise available to the client.

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

## Client Records and Working Papers (continued)

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

**Explanation:** If the CPA or PA received any records owned by the client, the records must be returned. Client records do not include the work product or working papers of the CPA/PA.

- A client's request for return of records that is made within a reasonable time and that occurs after the issuance of a tax return, financial statement, report or other document prepared by a licensee: the licensee shall furnish, within a reasonable time to the client or former client:
  - 1) A copy of a tax return, financial statement, report or other document issued by a licensee to or for such client or former client;
  - 2) Any accounting or other records belonging to or obtained from or on behalf of the client that the licensee removed from the client's premises or received for the client's account; and
  - 3) A copy of the licensee's working papers, to the extent that the working papers include records that would ordinarily constitute part of the client's records and are not otherwise available to the client.
  - 4) Working papers, for this rule, include but are not limited to all statements, records, schedules, general ledgers, journals, trial balances and depreciation schedules made by a licensee incident to or in the course of rendering services to a client or former client. Working papers are and shall remain the property of the licensee in the absence of an express agreement to the contrary between the licensee and the client.

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

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

## Client Records and Working Papers (continued)

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

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

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

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

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

If the client determined the account balances and provided schedules, copies of the schedules with the CPA/PA notes and conclusions are not required to be provided.

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

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

### § 32-745. Employment of persons by accountants

Nothing in this chapter shall be construed as preventing a person from being employed by a certified public accountant, a public accountant, a partnership of certified public accountants or a partnership of public accountants if such employed person does not sign reports or assume any responsibility for the conduct of his employer's professional practice.

## Observation



Obviously, CPAs must be able to hire non-CPA employees. However, employees must have adequate supervision and not be allowed to practice public accountancy.

### **§ 32-746. Fraudulent audit practices; classification**

A. A person commits fraudulent audit practices if such person knowingly prepares, issues or offers or files with any public agency an audit report or certificate on any financial statement which is materially false or misleading or fraudulent, or which purports to fairly present the financial position, results of operations or changes in financial position of the person or entity reported on but fails to do so.

B. Fraudulent audit practices is a class 5 felony. Fraudulent audit practices in connection with any securities offering or involving the filing of financial statements in connection with securities is a class 4 felony.

## Observation



The criminal penalties above are in addition to all administrative fines and sanctions the Board can issue.

### **§ 32-747. Unlawful use of designation or abbreviation; classification**

A. An individual who has received from the board a certificate to practice as a certified public accountant, or as a public accountant issued under the laws of the state, or who is a limited reciprocity privilege holder under section 32-725, shall be known as a “certified public accountant” or “public accountant”, in accordance with the certificate and may also use the abbreviation “C.P.A.”, “CPA”, “P.A.” or “PA”, in accordance with the certificate or the privilege unless the status of the certificate is canceled, expired, suspended, relinquished, or revoked. No other individual or firm shall assume or use any title, designation or abbreviation or any other title, designation, sign, card or device in this state tending to indicate that the individual or firm using it is authorized to practice public accounting or is a certified public accountant or a public accountant.

## Case Study: Holding Out as a Certified Public Accountant



Able is an Assistant Professor at an Arizona university. Able holds a CPA permit in Washington, but not in Arizona. Able's name followed by the CPA designation is published on the faculty profile.

**LIKELY BOARD ACTION:** Violation of Section 32-747. Unlawful use of designation or abbreviation.

B. No individual or firm shall when referring to accounting or accounting practices assume or use the title or designation "chartered accountant", "certified accountant", "enrolled accountant", "registered accountant", "licensed accountant", "certified tax accountant", "certified tax consultant" or any other title or designation likely or intended to be confused with "certified public accountant" or "public accountant" unless the individual or firm has received from the board a certificate to practice as a certified public accountant or as a public accountant issued under the laws of this state, the individual is a limited reciprocity privilege holder under section 32-725 or the partnership, corporation or other entity is permitted to practice accounting in this state pursuant to section 32-725, subsection G. No individual or firm shall assume or use any of the abbreviations "C.A.", "E.A.", "R.A.", "C.T.A.", "C.T.C.", "L.A." or similar abbreviations likely or intended to be confused with "C.P.A.", "CPA", "P.A." or "PA". An individual who is qualified as a certified public accountant in this state who also holds a comparable title under the laws of another country may use the title in conjunction with the title "certified public accountant", "C.P.A." or "CPA", and an individual enrolled to practice before the internal revenue service and recognized as an enrolled agent may use the abbreviation "E.A."

C. This section does not apply to or affect or limit the right to continuous use of a partnership name, or a modification of a partnership name, by successor firms formed by the remaining partner or partners or added partner or partners even though the individuals whose names are included in the partnership name are not partners, but the successor firm shall conform to all other provisions of this chapter. This section does not apply to or affect or limit the right to continuous use of a professional corporation's name as provided pursuant to this chapter or title 10, chapter 20 or a professional limited liability company's name pursuant to this chapter or title 29, chapter 4.

D. No corporation or professional limited liability company shall be permitted to practice public accounting in this state, provided that this subsection shall not apply to a professional corporation incorporated under the laws of this state or to a professional limited liability company, either of which is properly qualified to do business within this state and is otherwise qualified to practice accounting under this chapter.

E. If an individual violates this chapter, or represents himself to the public as having received a certificate or registration to practice after a certificate or registration has been revoked or suspended, the individual is guilty of a class 2 misdemeanor unless another classification is specifically prescribed in this chapter. Each day an offense is committed constitutes a separate offense.



## Observation



Restricted financial services include audits, reviews, and other attest engagements. If you perform any of these services, then you must be registered as a firm. This includes sole practitioners. The Board's website has a special form available for sole practitioners to register.

F. The displaying or uttering by an individual or firm of any card, sign, advertisement or other printed, engraved or written instrument or device bearing an individual's or firm's name and intended to be confused with the words "certified public accountant" or "public accountant" or an abbreviation of either shall be prima facie evidence in a prosecution, proceeding or hearing brought under this section that the individual or firm whose name is so displayed caused or procured the displaying or uttering of the card, sign, advertisement or other printed, engraved or written instrument or device.

### **§ 32-747.01. Attest services; requirements**

Except as provided in section 32-725, subsection G, an individual who holds a certificate issued by the board to practice as a certified public accountant or a public accountant may provide attest services only if the person provides attest services through a firm registered pursuant to this chapter.

### **§ 32-749. Confidential nature of information acquired by accountants; privilege; conditions for disclosure; public records; exceptions**

A. Certified public accountants and public accountants practicing in this state shall not be required to divulge, nor shall they voluntarily divulge, client records or information which they have received by reason of the confidential nature of their employment. Information derived from or as a result of such professional source shall be kept confidential as provided in this section, but this section shall not be construed as modifying, changing or affecting the criminal or bankruptcy laws of this state or the United States, nor shall it be construed to limit the authority of this state or any agency of this state to subpoena and use the information in connection with any investigation, public hearing or other proceeding.

B. The board shall not require a registrant to disclose taxpayer information protected from disclosure by section 42-2069 or section 43-381 except as provided by those sections.

C. This section and section 32-744 do not prohibit the disclosure of information for:

1. Compliance with ethical investigations or practice monitoring programs conducted by the board or private professional organizations pursuant to programs preapproved by the board. These programs include, but are not limited to, quality and peer reviews. The scope of quality and peer reviews may include subsequent, remedial or corrective actions. Disclosure of information under this paragraph shall not destroy its confidentiality and privilege nor relieve any registrant of the obligation of confidentiality. The registrants to whom the information is provided shall be bound by this section.



2. Access by the board or its duly authorized agents or employees during business hours to examine and copy any documents, reports, records or other physical evidence of any person being investigated by the board on its own motion or as the result of a complaint received, if the documents, reports, records or evidence relates to the competence or professional conduct of the registrant who is being investigated.

D. Records the board maintains in exercising its statutory duties are presumed to be public records pursuant to title 39, chapter 1, article 2 and are generally accessible for inspection and copying. Exceptions to the public records presumption include investigations of registrants. The board shall treat as confidential information the complaint, the investigation report, the testimony and documents submitted in support of the complaint or gathered in the investigation, including information obtained pursuant to section 32-721, and any correspondence related to the complaint or investigation. After the initial analysis under section 32-742.01, if the board opens an investigation file on a complaint, the details and records of the complaint and investigation shall remain confidential. However the fact that a complaint or investigation is pending and the nature of the complaint shall be public. The board shall not disclose this confidential information to any person except law enforcement authorities and, to the extent deemed necessary to conduct the investigation, the subject of the investigation, persons whose complaints are being investigated and witnesses questioned in the course of the investigation. Except for client records or information and any information from which the client or the client's property may be identified, the information made confidential under this subsection becomes public record if the board institutes civil enforcement or disciplinary proceedings or issues a consent order in lieu of disciplinary proceedings. If the board dismisses the matter with no disciplinary action, the board may disclose the information relating to the matter only with the consent of the registrant or entity under investigation.

## Question and Answer



**Question:** May a member in public practice disclose the name of a client for whom the member or the member's firm performed professional services?

**Answer:** It is permissible under AICPA Rule 1.700.001 for a member to disclose the name of a client, whether publicly or privately owned, without the client's specific consent unless the disclosure of the client's name constitutes the release of confidential information. For example, if a member's practice is limited to bankruptcy matters, the disclosure of a client's name would suggest that the client may be experiencing financial difficulties, which could be confidential client information.

### § 32-750. Injunction against unlawful act

When in the judgment of the board any person has engaged, or is about to engage, in any acts or practices which constitute, or will constitute, a violation of § 32-747, 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 does not have to wait until an unlicensed practitioner violates the law before acting. The Board may seek an injunction to prevent unlicensed practice.

### **§ 32-751. Actions to recover civil penalties**

The board may request the attorney general to bring an action in superior court to recover any administrative penalties imposed by the board pursuant to this chapter. An action to recover such penalties shall be brought in the county in which the board has its office, or in the county of residence or principal place of business of the person subject to the penalties.

## CHAPTER 2: TEST YOUR KNOWLEDGE

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

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1.	<p><b>A CPA in inactive status may continue to do which of the following:</b></p> <ul style="list-style-type: none"><li>A. engage in the practice of public accountancy for a fee</li><li>B. use the title, “CPA”</li><li>C. do volunteer accounting services where no fee or other compensation is required</li><li>D. all of the above; there are no restrictions on the services an inactive CPA may perform</li></ul>
2.	<p><b>A certificate that has been inactive expires after how many years:</b></p> <ul style="list-style-type: none"><li>A. 2</li><li>B. 4</li><li>C. 6</li><li>D. 10</li></ul>
3.	<p><b>All of the following are required to attain retired status of a registrant’s CPA license <u>except</u>:</b></p> <ul style="list-style-type: none"><li>A. the registrant must be at least 55 years old</li><li>B. the registrant must have been a certified public accountant or public accountant for at least 20 years</li><li>C. the registrant must not be actively engaged in the practice of accounting for a fee or other compensation</li><li>D. the registrant has not performed any attest services during the past year</li></ul>

4.	<p><b>Which of the following is correct regarding the ownership and custody of working papers and records according to the Arizona Accountancy Statutes:</b></p> <ul style="list-style-type: none"> <li><b>A.</b> all working papers prepared by a registrant must be provided to the client, whether or not the client has paid their fees</li> <li><b>B.</b> you may hold a client's records pending the receipt of unpaid fees</li> <li><b>C.</b> a completed tax return may be withheld pending payment of unpaid fees</li> <li><b>D.</b> depreciation calculations and carryforward schedules are generally considered the registrant's working papers that do not need to be made available to the client upon request</li> </ul>
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## CHAPTER 2: SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.	<p>A. Incorrect. A CPA may not engage in the practice of public accountancy for a fee while inactive.</p> <p>B. Incorrect. An inactive CPA may not use the CPA title.</p> <p>C. <b>CORRECT</b>. Volunteer accounting services are permitted.</p> <p>D. Incorrect. An inactive CPA may not practice public accountancy or use the CPA title.</p> <p><i>(See page 37 of the course material.)</i></p>
2.	<p>A. Incorrect. A certificate that has only been inactive for 2 years can still be reactivated.</p> <p>B. Incorrect. A certificate that has only been inactive for 4 years can still be reactivated.</p> <p>C. <b>CORRECT</b>. A certificate that has been inactive for more than 6 years expires; the CPA can no longer reactivate such license.</p> <p>D. Incorrect. A certificate that has been inactive for a period of less than ten years will be considered expired.</p> <p><i>(See page 37 of the course material.)</i></p>
3.	<p>A. Incorrect. There is an age requirement of at least 55 years old.</p> <p>B. Incorrect. In order to obtain retired status, the registrant must have been a CPA or PA in one or more jurisdictions for a minimum of 20 years.</p> <p>C. Incorrect. In order to obtain retired status, the registrant cannot be participating in the practice of accounting for compensation.</p> <p>D. <b>CORRECT</b>. The registrant cannot continue to practice accounting, but the registrant does not have to wait a year after providing services to request retired status.</p> <p><i>(See page 39 of the course material.)</i></p>

4.	<p>A. Incorrect. Generally the registrant's working papers are and shall remain the property of the registrant.</p> <p>B. Incorrect. Any accounting or other records belonging to, or obtained from or on behalf of, the client that the registrant removed from the client's premises or received from the client's account must be timely furnished to the client or former client on request.</p> <p>C. <b>CORRECT</b>. A completed tax return may be withheld pending payment but not the client records which were used to prepare the return.</p> <p>D. Incorrect. Depreciation calculations and carryforward schedules prepared by the CPA are generally considered to be prepared for the client. As such, they are part of the client's records, and copies must be made available to the client upon request.</p> <p><i>(See pages 46 to 47 of the course material.)</i></p>
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## CHAPTER 3: ARIZONA BOARD OF ACCOUNTANCY ADMINISTRATIVE CODE

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### Chapter Objective

**After completing this chapter, you should be able to:**

- Recognize the CPE requirements for Arizona registrants.

### INTRODUCTION

The legislature writes the law as discussed in the last chapter. The legislature 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 legislature passes. These regulations are called administrative law. Administrative law is more than mere interpretations but has the force and effect of law. Accordingly, for Arizona CPAs, these regulations have a higher priority than the AICPA Code of Professional Conduct. The regulations, known as the Administrative Code, are useful as they typically go into more detail than the legislative 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 regulations, are regularly published in the Board's newsletter and on its website. Following is the table of contents for the regulations.

The Administrative Code is divided into four articles:

Article 1 – General

Article 2 – CPA Examination

Article 3 – Certification and Registration

Article 4 – Regulation

**The entire regulations are available on the Board's website. We have reprinted the table of contents for Articles 3 and 4, followed by selected text of certain regulations.**

## **BOARD OF ACCOUNTANCY ADMINISTRATIVE CODE**

(Authority: A.R.S. § 32-701 et seq.)

### **ARTICLE 3. CERTIFICATION AND REGISTRATION**

R4-1-341	CPA Certificates; Reinstatement
R4-1-343	Education and Accounting Experience
R4-1-344	Denial of Certification
R4-1-345	Registration; Fees
R4-1-346	Notice of Change of Address

### **ARTICLE 4. REGULATION**

R4-1-453	Continuing Professional Education
R4-1-454	Peer Review
R4-1-455	Professional Conduct: Independence, Integrity, and Objectivity
R4-1-455.01	Professional Conduct: Competence and Technical Standards
R4-1-455.02	Professional Conduct: Confidentiality; Records Disposition
R4-1-455.03	Professional Conduct: Other Responsibilities and Practices
R4-1-455.04	Professional Conduct: Interpretations
R4-1-456	Reporting Practice Suspensions and Violations

#### **R4-1-345. Registration; Fees**

A. Initial registration: After the Board approves an applicant's request for certification or firm registration, the applicant shall file an application for initial registration in a format prescribed by the Board and pay a registration fee under subsection (C).

B. Renewal registration: A registrant shall file an application for renewal registration in a format prescribed by the Board no later than 5:00 p.m. on the last business day of the month. A renewal registration is deemed filed on the date and time received in the Board office. The Board shall record the date and time either by electronic date stamp in Arizona time or on physical receipt in the board's office. The Board shall not accept a postmark as evidence of timely filing. It is the sole responsibility of the registrant to complete the renewal registration requirements at the following times:

1. Individual registrant: An individual registrant shall renew registration at the following times:
  - a. A registrant born in an even-numbered year shall renew registration during the month of birth in each even-numbered year.
  - b. A registrant born in an odd-numbered year shall renew registration during the month of birth in each odd-numbered year.
2. Firm registrant: A firm shall renew registration at the following times:
  - a. A firm that initially registered with the Board in an even-numbered year shall renew registration during the board-approved month of the initial registration in each even-numbered year.



b. A firm that initially registered with the Board in an odd-numbered year shall renew registration during the board-approved month of the initial registration in each odd-numbered year.

C. Registration fees: The biennial registration fee is:

1. \$300 and, if applicable, a late fee of \$50 for each certified public accountant and, each public accountant. For a certified public accountant or public accountant, the registration fee shall be prorated by month for an initial registration period of less than two years.
2. \$300 and, if applicable, a late fee of \$50 for a firm. Under A.R.S. § 32-729, the Board shall not charge a fee for the registration of additional offices of the same firm or for the registration of a sole practitioner.

D. If a registrant's certificate is suspended for nonregistration under A.R.S. § 32-741.01 and remains in a suspended status for more than six months, the registrant must return their certificate to the Board.

### Observation



It is the certificate holder's responsibility to know when his/her registration expires and to renew in a timely manner. Failure to receive a renewal form is not an excuse, nor is slow delivery of mail an excuse. Be sure to mail your renewal early.

#### **R4-1-346. Notice of Change of Address**

A. Within 30 days of any business, mailing, or residential change of address, a registrant shall notify the Board of the new address by filling out a change of address form prescribed by the Board.

B. Within 30 days of the opening of any new or additional office, or the closing of any existing office, a registrant shall notify the Board in a letter signed by the registrant.

### Observation: 30-Day Notice Requirements



These simple notification requirements are two of the most often violated rules. Since all changes to a registrant's database require your signature, please submit all changes of address, etc. via mail or fax (602-364-0903).

#### **R4-1-453. Continuing Professional Education**

A. Measurement Standards. The Board shall use the following standards to measure the hours of credit given for CPE programs completed by an individual registrant.

1. A class hour shall consist of a minimum of 50 continuous minutes of instruction and a half class hour shall consist of a minimum of 25 continuous minutes of instruction. CPE credit shall be given in half-hour increments for periods of not less than one class hour. Credit shall not be allowed for repeat participation in any seminar or course during the registration period.
2. Courses taken at colleges and universities apply toward the CPE requirement as follows:
  - a. Each semester system credit hour is worth 15 CPE credit hours,
  - b. Each quarter system credit hour is worth 10 CPE credit hours, and
  - c. Each noncredit class hour is worth 1 CPE credit hour.
3. Each correspondence program hour is worth 1 CPE credit hour.
4. Acting as a lecturer or discussion leader in a CPE program, including college courses, may be counted as CPE credit. The Board shall determine the amount of credit on the basis of actual presentation hours, and shall allow CPE credit for preparation time that is less than or equal to the presentation hours. A registrant may only claim as much preparation time as is actually spent for a presentation. Total credit earned under this subsection for service as a lecturer or discussion leader, including preparation time may not exceed 40 credit hours of the renewal period's requirement. Credit is limited to only one presentation of any seminar or course with no credit for repeat teaching of that course.
5. Writing and publishing articles or books that contribute to the accounting profession may be counted for a maximum of 20 hours of CPE credit during each renewal period.
  - a. Credit may be earned for writing accounting material not used in conjunction with a seminar, if the material addresses an audience of certified public accountants, is at least 3,000 words in length, and is published by a recognized third-party publisher of accounting material or a sponsor.
  - b. For each 3,000 words of original material written, the author may earn two credit hours. Multiple authors may share credit for material written.
6. A registrant may earn a combined maximum of 40 hours of CPE credit under subsections (A)(4) and (5) above during each renewal period.
7. A registrant may earn a maximum of 20 hours of CPE during each renewal period by completing introductory computer-related courses. Computer-related courses may qualify as management advisory services pursuant to subsection (C).

B. Programs that Qualify. CPE credit may be given for a program that provides a formal course of learning at a professional level and contributes directly to the professional competence of participants.

1. The Board shall accept a CPE course as qualified if it:

- a. Is developed by persons knowledgeable and experienced in the subject matter,
  - b. Provides written outlines or full text,
  - c. Is administered by an instructor or organization knowledgeable in the program, and
  - d. Uses teaching methods consistent with the study program.
2. The Board shall accept a correspondence program which includes online or computer based programs if the sponsors maintain written records of each student's participation and records of the program outline for three years following the conclusion of the program.
  3. An ethics program taught or developed by an employer or co-worker of a registrant does not qualify for the ethics requirements of subsection (C)(4).

C. Hour Requirement. As a prerequisite to registration pursuant to A.R.S. § 32-730(C) or to reactivate from inactive status pursuant to A.R.S. § 32-730.01, a registrant shall complete the CPE requirements during the two-year period immediately before registration as specified under subsections (C)(1) through (C)(5). For registration periods of less than two years CPE may be prorated, with the exception of ethics.

1. A registrant whose last registration period was for two years shall complete 80 hours of CPE.
2. A registrant shall complete a minimum of 50 percent of the required hours in the subject areas of accounting, auditing, taxation, business law, or consulting services with a minimum of 16 hours in the subject areas of accounting, auditing, or taxation.
3. A registrant shall complete a minimum of 16 of the required hours:
  - a. In a classroom setting,
  - b. Through an interactive live webinar, or
  - c. By acting as a lecturer or discussion leader in a CPE program, including college courses.
4. A registrant shall complete four hours of CPE in the subject area of ethics. The four hours required by this subsection shall include a minimum of one hour of each of the following subjects:
  - a. Ethics related to the practice of accounting including the Code of Professional Conduct of the American Institute of Certified Public Accountants, and
  - b. Board statutes and administrative rules.

**Note:** This course meets the above ethics CPE requirement.

5. A registrant shall report total CPE hours completed for the registration period. Hours that exceed the number required for the current registration period may not be carried forward to a subsequent registration period. Any CPE hours completed to vacate a suspension for nonregistration or for noncompliance with CPE requirements may not be used to meet CPE requirements for the registration period.
6. As a prerequisite to reactivate from retired status or reinstate from cancelled, expired, relinquished or revoked status, an applicant shall complete up to 160 hours of CPE during the four-year period immediately before application to reactivate or reinstate. For periods of less than four years CPE may be prorated, with the exception of ethics.
  - a. An applicant shall complete a minimum of 50 percent of the required hours in the subject areas of accounting, auditing, taxation, business law, or consulting services with a minimum of 32 hours in the subject areas of accounting, auditing or taxation.
  - b. An applicant shall complete a minimum of 32 hours of the required hours:
    - i. In a classroom setting,
    - ii. Through an interactive live webinar, or
    - iii. By acting as a lecturer or discussion leader in a CPE program, including college courses.
  - c. An applicant shall complete eight hours of CPE in the subject area of ethics. The eight hours required by this subsection shall include a minimum of one hour of each of the following subjects. The following subjects shall be completed during the two-year period immediately preceding application for reactivation or reinstatement:
    - i. Ethics related to the practice of accounting including the Code of Professional Conduct of the American Institute of Certified Public Accountants; and
    - ii. Board statutes and administrative rules.

D. Reporting. An applicant for reinstatement, a registrant who is subject to an audit, or a registrant completing their registration must report the following details about their completed CPE:

1. Sponsoring organization;
2. Number of CPE credit hours;
3. Title of program or description of content; and
4. Dates attended.

E. In addition to the information required under subsection (D), an applicant for reinstatement from cancelled, expired, relinquished or revoked status, or a registrant subject to a CPE audit pursuant to subsection (G) shall provide evidence of completed CPE as required to be maintained by subsection (F).

F. CPE Record Retention: A registrant shall maintain for three years from the date their registration application was dated as received by the Board and provide the Board upon request the following documents: course outlines and certificates of completion that include registrant's name, course provider or sponsor, course title, credit hours, and date of completion.

G. CPE audits: The Board, at its discretion, may conduct audits of a registrant's CPE and require that the registrant provide the CPE records that the registrant is required to maintain under subsection (F) to verify compliance with CPE requirements.

H. The Board may grant a full or partial exemption from CPE requirements on demonstration of good cause for a disability for only one registration period.

#### **R4-1-455. Professional Conduct: Independence, Integrity, and Objectivity**

A. Independence: A certified public accountant, public accountant, or firm of which the certified public accountant or public accountant is a partner or shareholder shall not express an opinion on a financial statement of an enterprise unless the certified public accountant or public accountant and the firm are independent with respect to the enterprise. Independence is considered to be impaired if, for example:

1. During the period of their professional engagement, or at the time of expressing an opinion, the certified public accountant or public accountant or the firm:
  - a. Had or was committed to acquire any direct or material indirect financial interest in the enterprise;
  - b. Had any joint closely held business investment with the enterprise or any officer, director or principal stockholder of the enterprise that was material in relation to the certified public accountant, public accountant, or the firm's net worth; or
  - c. Had any loan to or from the enterprise or any officer, director or principal stockholder of the enterprise. This latter proscription does not apply to the following loans from a financial institution if the loans are made under normal lending procedures, terms and requirements:
    - i. Loans obtained by a certified public accountant or public accountant or the firm that are not material in relation to the net worth of the borrower;
    - ii. Home mortgages; and
    - iii. Other secured loans, except loans that would be unsecured if not guaranteed by a certified public accountant's or public accountant's firm.
2. During the period covered by the financial statement, during the period of the professional engagement, or when expressing an opinion, the certified public accountant, public accountant, or firm:
  - a. Was connected with the enterprise as a promoter, underwriter or voting trustee, director, or officer, or in any capacity equivalent to that of a member of management or of an employee; or

- b. Was a trustee of any trust or executor or administrator of any estate if the trust or estate had or was committed to acquire any direct or material indirect financial interest in the enterprise; or was a trustee for any pension or profit-sharing trust of the enterprise.
3. The above examples are not intended to be all-inclusive.

### Practice Pointer



See the Independence section in chapter 1 for a more detailed analysis.

B. Integrity and objectivity: A certified public accountant, public accountant, or firm shall not knowingly or recklessly misrepresent facts when engaged in the practice of public accounting, including the rendering of tax and management advisory services. In tax practices, a certified public accountant or public accountant may resolve doubt in favor of their client as long as there is reasonable support for the position.

### Observation



This regulation is similar to AICPA Rule 1.100.001.

### 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.

## Case Study: Integrity and Objectivity (continued)

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 R4-1-455 (B) Integrity and Objectivity.

1. Contingent fees: A contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of the service. For purposes of this Section, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.
  - a. A certified public accountant, public accountant, or firm engaged in the practice of public accounting shall not for a contingent fee for any client:
    - i. Perform an audit or review of a financial statement;
    - ii. Prepare a compilation of a financial statement when the certified public accountant, public accountant, or firm expects, or reasonably should expect, that a third party will use the financial statement and the certified public accountant's, public accountant's, or firm's compilation report does not disclose a lack of independence;
    - iii. Perform an examination of prospective financial information; or
    - iv. Prepare an original or amended tax return or a claim for a tax refund.
  - b. The prohibitions in subsection (B)(1)(a) apply during the period in which the certified public accountant, public accountant, or firm is engaged to perform any of the services listed in subsection (B)(1)(a) and the period covered by any historical financial statements involved in the listed services.

## Observation



This regulation is similar to AICPA Rule 1.510.001 you studied in an earlier chapter.

2. Commissions and referral fees:

- a. A commission is a fee calculated as a percentage of the total sale or service.
- b. A referral fee is a fee paid in exchange for producing a purchase of goods or services.
- c. Prohibited commissions: A certified public accountant, public accountant, or firm engaged in the practice of public accounting shall not for a commission recommend or refer to a client any product or service, recommend or refer any product or service to be supplied by a client, or receive a commission when the certified public accountant, public accountant, or firm also performs any of the following for that client:
  - i. An audit or review of a financial statement;
  - ii. A compilation of a financial statement when the certified public accountant, public accountant, or firm expects, or reasonably should expect, that a third party will use the financial statement and the certified public accountant, public accountant, or firm's compilation report does not disclose a lack of independence; or
  - iii. An examination of prospective financial information.
- d. The prohibitions in subsection (B)(2)(c) apply during the period in which the certified public accountant, public accountant, or firm is engaged to perform any of the services listed in subsection (B)(2)(c) and the period covered by any historical financial statements involved in the listed services.
- e. Disclosure of permitted commissions: A certified public accountant, public accountant, or firm engaged in the practice of public accounting that is not prohibited by this Section from performing services or receiving a commission and who is paid or expects to be paid a commission shall make a written disclosure in advance of accepting the engagement. The certified public accountant, public accountant, or firm shall ensure that the written disclosure is made to any person or entity to which the certified public accountant, public accountant, or firm recommends or refers a product or service to which the commission relates and shall include the dollar amount or percentage to be received.
- f. Disclosure of referral fees: Any certified public accountant, public accountant, or firm that accepts a referral fee for recommending or referring any product or service to any person or entity or that pays a referral fee to obtain a client shall disclose to the client, in writing, the acceptance or payment of the referral fee and its amount.



## Commissions, Contingent Fees & Referral Fees

R4-1-455 (B) (1) and (2) 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.

3. Incompatible occupations: A certified public accountant or public accountant who is engaged in the practice of public accounting shall not concurrently engage in any business or occupation that impairs the objectivity of the certified public accountant or public accountant in rendering professional services.

## Observation



The rules on commissions and referral fees are similar to AICPA Rule 1.520.001.

## R4-1-455.01. Professional Conduct: Competence and Technical Standards

A. Competence: A registrant shall not undertake any engagement to perform professional services that the registrant cannot reasonably expect to complete with due professional competence, including compliance, where applicable, with subsections (B) and (C).

### Observation



A registrant may undertake an engagement in which he or she currently lacks competence if he reasonably expects that such competence will be obtained prior to completing the engagement.

### Case Study: Competence



Brown prepared Client's 2014 tax returns and calculated that Client would receive a \$6,000 tax refund from Oregon, owe \$7,000 in taxes to Arizona, 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 Oregon, owe \$6,000 to Arizona, and owe \$5,500 to the IRS.

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

**LIKELY BOARD ACTION:** Violation of R4-1-455.01 (A). Competence.

### Case Study: Competence



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 R4-1-455.01 (A). Competence.

B. Auditing standards: A registrant shall not permit the registrant's name to be associated with a financial statement in a manner that implies that the registrant is acting with independence with respect to the financial statement unless the registrant has complied with applicable generally accepted auditing standards.

## Case Study: Competency and Auditing Standards



Able Accountants, CPAs (Firm) audited XYZ Company in 2012 and 2013. XYZ Company provided investment and money management services to clients, many of which were union pension trusts and health and welfare plans. XYZ Company managed a total portfolio of about one billion dollars.

A division of Firm prepared a valuation report of XYZ Company that valued XYZ Company at just under \$5 million dollars. XYZ Company's growth in fee income was fueled by a collateralized note program that was critical to Firm's valuation. The collateralized note program included loans made by XYZ Company to its affiliate ABC Company. By 2013, the collateralized note program with its affiliate ABC Company had accounted for 25% of the total assets managed by XYZ Company and 45% of the fees charged by XYZ Company.

ABC Company suffered losses during the years 2012 through 2014 and had a stockholders' deficit of \$109 million at the end of September 2014. ABC Company filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. The 2014 audit report for ABC Company was prepared by another firm. The audit report expressed substantial doubt about ABC Company's ability to continue as a going concern.

Firm audited XYZ Company during calendar years 2012 and 2013 and issued unqualified opinions for both years.

**LIKELY BOARD ACTION:** Violations of Generally Accepted Auditing Standards in both 2012 and 2013.

C. Accounting principles: A registrant shall not express an opinion that a financial statement is presented in conformity with generally accepted accounting principles if the financial statement contains any departure from an accounting principle that has a material effect on the financial statement taken as a whole, unless the registrant can demonstrate that by reason of unusual circumstances that the financial statement would otherwise be misleading. In this case, the registrant's report shall describe the departure from an accounting principle, the approximate effects of the departure, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

D. Accounting and review standards: A certified public accountant, public accountant, or firm shall not permit the certified public accountant, public accountant, or firm's name to be associated with an unaudited financial statement or other unaudited financial information of a non-public entity in a manner that implies the certified public accountant, public accountant, or firm is acting as an independent accountant unless the certified public accountant, public accountant, or firm has complied with all applicable standards for accounting and review services.

E. Forecasts and projections: A certified public accountant, public accountant, or firm shall not permit the certified public accountant's, public accountant's, or firm's name to be used in conjunction with any forecast of future transactions in a manner that may lead to the belief that the certified public accountant, public accountant, or firm vouches for the achievability of the forecast or projection.

F. In expressing an opinion on representations in a financial statement that the certified public accountant, public accountant, or firm has examined, a certified public accountant, public accountant, or firm violates A.R.S. § 32-741(A)(4) if the certified public accountant, public accountant, or firm:

1. Fails to disclose a known material fact that makes the financial statement misleading;
2. Fails to report a known material misstatement that appears in the financial statement;
3. Is materially negligent in the conduct of the examination or in making a report on the examination;
4. Fails to acquire sufficient information to warrant expression of an opinion, or the exceptions are sufficiently material to negate the expression of an opinion; or
5. Fails to direct attention to any material departure from a generally accepted accounting principle or disclose any material omission of generally accepted auditing procedure applicable under the circumstances.
6. The provisions of subsection (F) are not intended to be all-inclusive or to limit the application of A.R.S. § 32-741(A)(4).

G. Tax practice standards: A certified public accountant, public accountant, or firm shall exercise due diligence in the conduct of tax practices. The Board shall view the current standards in the American Institute of Certified Public Accountants Statements on Responsibilities in Tax Practice to presumptively represent due diligence.

## Case Study: Tax Practice Standards



Mr. and Mrs. Client donated an old house to the fire department for a training exercise during 2014. The fire department burned the donated house. Green, CPA prepared Client's 2014 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 2014. Client contacted Green CPA and asked if Green would represent Client during the audit. Green CPA told Client that they didn't need to be represented and instructed Client to represent themselves before the IRS.

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 R4-1-455.01 (G). Tax Practice Standards.

## Observation



The AICPA Statements on Standard for Tax Services is available on the AICPA website at [www.aicpa.org](http://www.aicpa.org).

H. Standards: The application of standards such as “generally accepted accounting principles,” “generally accepted auditing standards,” and “applicable standards for accounting and review services” by a certified public accountant, public accountant, or firm is to be made to the specific engagement or problem at hand by the exercise of professional judgment in the context of the literature of the accounting profession. The Board considers official statements of the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, and other specialized bodies dealing with accounting and auditing matters to be persuasive sources for interpretation of the standards. Persons who take positions that depart from the official statements shall be prepared to justify them.

## **R4-1-455.02. Professional Conduct: Confidentiality; Records Disposition**

A. Confidential client information: A certified public accountant, public accountant, or firm shall not disclose confidential information obtained in the course of a professional engagement except with the consent of the client. This rule shall not be construed to:

1. Relieve a certified public accountant, public accountant, or firm of the obligations under R4-1-455.01(B) and (C);
2. Affect the certified a public accountant's, public accountant's, or firm's compliance with a validly issued subpoena or summons enforceable by order of a court;
3. Prohibit review of a certified public accountant's, public accountant's, or firm's professional practices as a part of any peer or quality review conducted under Board decision or authority; or
4. Preclude a certified public accountant, public accountant, or firm from responding to any inquiry made by the Board under state statutes.

B. Records disposition responsibility: A certified public accountant, public accountant, or firm shall furnish to a client, or former client, upon request, within a reasonable time after original issuance:

1. A copy of any tax returns prepared for the client;
2. A copy of any reports, or other documents, that were previously issued to the client; and
3. Any accounting or other records belonging to the client that the certified public accountant, public accountant, or firm may have removed from the client's premises, or received for the client's account. The certified public accountant, public accountant, or firm may make a copy of the documents if the documents form the basis for work done by the certified public accountant, public accountant, or firm.

### **Case Study: Client Records and Working Papers Requested Records**

In 2013, 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 2015, Client "A" needed a copy of her depreciation schedule to complete 2013 and 2014 tax returns. Client "A" left telephone messages for Green. Green did not return Client's calls and did not provide Client with a copy of the requested depreciation schedule.

Green was required to retain client working papers and provide Client "A" with a copy of the depreciation schedule.

**LIKELY BOARD ACTION:** Violation of R4-1-455.02. Records Disposition.

### R4-1-455.03. Professional Conduct: Other Responsibilities and Practices

A. Discreditable acts: A certified public accountant, public accountant, or firm shall not commit an act that reflects adversely on the certified public accountant's, public accountant's, or firm's fitness to engage in the practice of public accounting, including:

1. Violating a provision of R4-1-455, R4-1-455.01, R4-1-455.02, R4-1-455.03, or R4-1-455.04;
2. Violating of a fiduciary duty or trust relationship with respect to any person; or
3. Violating a provision of A.R.S. Title 32, Chapter 6, Article 3, or this Chapter.

#### Case Study: Discreditable Acts



White, CPA prepared Smith's 2014 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 2013 tax return. Smith knew at the time that she paid for ETS that she would not use White's services again.

Smith's 2014 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 R4-1-455.03(A). Discreditable Acts.

B. Advertising practices: A certified public accountant, public accountant, or firm has violated A.R.S. § 32-741(A)(4) and engaged in dishonest or fraudulent conduct in the practice of public accounting in connection with the communication or advertising of public accounting services through any media, if the certified public accountant, public accountant, or firm willfully engages in any of the following:

1. Employs a device, scheme, or artifice to defraud;
2. Makes an untrue statement of material fact or fails to state any material fact necessary to make the statements made not misleading;
3. Engages in any advertising which would operate as a fraud or deceit;



4. Violates A.R.S. § 44-1522 and a court finds the violation willful;
5. Engages in fraudulent or misleading practices in the advertising of public accounting services which leads to a conviction pursuant to A.R.S. § 44-1481; or
6. Engages in fraudulent practice in the advertising of public accounting services which leads to a conviction for a violation of any other state or federal law.

## Observation



Although this regulation references Arizona law, it is similar to AICPA Rule 1.600.001 which you studied in a prior chapter.

## Case Study: Advertising Practices



“A” operated as a sole proprietor from 1984 through 2001. In March 2002, “A” registered “A LLC” with the Board. In August 2006, “B” and “C” merged with “A” to form “AB&C LLC.” The website for “AB&C LLC” described the firm as “established in 1984.”

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

**LIKELY BOARD ACTION:** Using the “established date” of 1984 is misleading and a violation of R4-1-455.03(B). Advertising Practices.

C. Solicitation practices: A certified public accountant, public accountant, or firm has violated A.R.S. § 32-741(A)(4) and engaged in dishonest or fraudulent conduct in the practice of public accounting in connection with the direct or indirect personal solicitation of public accounting services if the certified public accountant, public accountant, or firm willfully engages in any of the following:

1. Violates a provision of R4-1-455.03(B); or
2. Engages in direct or indirect personal solicitation through the use of coercion, duress, undue influence, compulsion, or intimidation practices.

## Observation



The firm must determine that all promotional efforts on the part of third parties does not violate this rule.



#### D. Form of practice and name

1. A certified public accountant or public accountant may practice public accounting, whether as an owner or employee, only in a firm as defined in A.R.S. § 32-701(14).

### Case Study: Firm Name



White registered his firm as “White CPA PC.” White did not use the registered name “White CPA PC” on letterhead, business cards or when answering the telephone. Instead, White used “Accounting Services” on letterhead, business cards and when answering the telephone. “White CPA PC” did not notify the Board of the assumed business name “Accounting Services.”

**POSSIBLE BOARD ACTION:** Violation of R4-1-455.03 (D). Form of Practice and Name.

2. A certified public accountant or public accountant shall not use a professional or firm name or designation that is misleading about the legal form of the firm, or about the persons who are partners, officers, members, managers, or shareholders of the firm, or about any other matter. A firm name or designation shall not include words such as “& Company”, “& Associates”, or “& Consultants” unless the terms refer to additional full-time CPAs that are not otherwise mentioned in the firm name.

### Example



Steve Nash is a sole practitioner with no employees. The following firm names would be prohibited:

- A. Steve Nash and Associates
- B. Steve Nash and Company CPAs
- C. World’s Best Accounting Firm, CPAs

## Are You Using the Firm Name As Registered with the Board?

A CPA shall not use a firm name that is misleading about the legal form of the firm.

This rule applies to stationery, envelopes, reports, business cards, brochures, banners, office signs, telephone directories, newspaper or magazine ads, websites, engagement letters, and business proposals, as well as any other advertisements or forms of solicitation.

For example, if your firm is registered with the Board as “Frederick W. Gumby, CPA,” you must always use “Frederick W. Gumby, CPA,” as the firm name – you may not delete any portion of the firm name or use an abbreviation for any portion of the firm name.

Therefore, referring to the firm as “Fred Gumby, CPA,” is a violation.

If your firm is registered with the Board as “Able, Baker, Charlie, Dog, and Easy, Company,” the firm must always use the firm’s full name – the firm cannot be referred to as “Able Baker Company” or just “Able.”

Suffixes such as “Professional Corporation,” “P.C.,” “PC,” “Limited Liability Partnership,” “LLP,” “L.L.P.,” “Professional Limited Liability Company,” “P.L.L.C.,” “PLLC,” “Company,” “Co.,” etc., which are part of the firm name as registered with the Board must be used each time the firm name is used.

In addition, if you register your firm name using all capital letters, e.g. SMITH AND JONES, you must always refer to the firm in all capital letters.

If your registered firm name includes “Certified Public Accountants,” “CPA,” or “CPAs,” this language must be included each time your firm name is referenced.

E. Acting through others: A certified public accountant or public accountant shall not knowingly permit others to carry out on behalf of the certified public accountant or public accountant, either with or without compensation, acts which, if carried out by the certified public accountant or public accountant, would violate a provision of R4-1-455, R4-1-455.01, R4-1-455.02, R4-1-455.03, or R4-1-455.04.

F. Communications: When requested, a certified public accountant or public accountant shall respond to communications from the Board within 30 days after the communication is mailed by registered or certified mail.

## 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 30 days. Brown did not respond within 30 days.

**LIKELY BOARD ACTION:** Violation of R4-1-455.03(F). Communications.

#### **R4-1-455.04. Professional Conduct: Interpretations**

The Board shall find interpretations of the Code of Professional Conduct adopted by the American Institute of Certified Public Accountants persuasive but not conclusive in the Board's interpretations of R4-1-455, R4-1-455.01, R4-1-455.02, or R4-1-455.03.

#### **R4-1-456. Reporting Practice Suspensions and Violations**

A. A registrant, individual, or firm shall report to the Board:

1. Any suspension or revocation of the right to practice accounting before the federal Securities and Exchange Commission, the Internal Revenue Service, or any other state or federal agency;
2. Any final judgment in a civil action or administrative proceeding in which the court or public agency makes findings of violations, by the registrant, of any fraud provisions of the laws of this state or of federal securities laws;
3. Any final judgment in a civil action where the court makes findings of accounting violations, dishonesty, fraud, misrepresentation, or breach of fiduciary duty by the registrant;
4. Any final judgment in a civil action involving negligence in the practice of public accounting by the registrant; and
5. All convictions of the registrant of any felony, or any crime involving accounting or tax violations, dishonesty, fraud, misrepresentation, embezzlement, theft, forgery, perjury or breach of fiduciary duty.

### **Observation**



Arizona requires all registrants to report certain practice violations to the Board. The AICPA has no such reporting requirements.

B. A registrant, individual, or firm required to report under subsection (A) shall make the report in the form of a written letter and ensure that the report is received by the Board within 30 days after the entry of any judgment or suspension or revocation of the registrant's right to practice before any agency. The registrant, individual, or firm shall ensure that the letter contains the following information:

1. Description of the registrant's activities that resulted in a suspension or revocation;
2. Final judgment or conviction;
3. Name of the state or federal agency that restricted the registrant's right to practice;
4. Effective date and length of any practice restriction;

5. Case file number of any court action, civil or criminal;
6. Name and location of the court rendering the final judgment or conviction; and
7. Entry date of the final judgment or conviction.

## Engagement Letters

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 3: TEST YOUR KNOWLEDGE

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

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1.	<p><b>Each registrant shall give notice to the Board within how many days of any business, mailing, or residential change of address:</b></p> <p>A. 10</p> <p>B. 14</p> <p>C. 30</p> <p>D. 90</p>
2.	<p><b>Steve Nash is a sole practitioner CPA with no employees. Which of the following firm names is permitted under Regulation R4-1-455.03:</b></p> <p>A. Steve Nash, CPA</p> <p>B. Steve Nash and Associates</p> <p>C. Steve Nash and Company CPAs</p> <p>D. World's Best Accounting Firm, CPAs</p>

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## CHAPTER 3: SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.	<p>A. Incorrect. Notice does not have to be made as quickly as 10 days.</p> <p>B. Incorrect. Notice does not have to be made as quickly as 14 days.</p> <p>C. <b>CORRECT</b>. Notice must be given within 30 days.</p> <p>D. Incorrect. Notice must be made sooner than within 90 days.</p> <p><i>(See page 61 of the course material.)</i></p>
2.	<p>A. <b>CORRECT</b>. Since there are no other CPAs at the firm, the CPA designation must be singular.</p> <p>B. Incorrect. The term “and Associates” implies that there is another person working with the CPA.</p> <p>C. Incorrect. The plural designation “CPAs” implies that there are two or more CPAs working for the firm.</p> <p>D. Incorrect. The plural designation “CPAs” implies that there are two or more CPAs working for the firm.</p> <p><i>(See page 77 of the course material.)</i></p>

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## CHAPTER 4: ETHICS FOR INDUSTRY CPAS

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### Chapter Objectives

**After completing this chapter, you should be able to:**

- Recognize AICPA guidance for Management Accountants.
- Identify ethical guidance promulgated by the Institute of Management Accountants (IMA).
- Recognize the similarities and differences of the guidance issued by the IMA and the AICPA.

### I. INTRODUCTION

Although many CPAs begin their careers in public practice, many soon migrate to positions in industry. Many will join the Institute of Management Accountants (IMA). Some of those who join the IMA will also get the Certified Management Accountant (CMA) designation. Many will retain their membership in the AICPA. Both the AICPA and IMA are voluntary member organizations – only members are required to follow their respective ethical guidelines. However, these guidelines were designed in furtherance of the CPA's role as trusted business advisers. Accordingly, these guidelines should be followed by members and non-members alike.

### II. NEW CODIFIED CODE OF PROFESSIONAL CONDUCT EFFECTIVE 12/15/14

The AICPA has codified the Code of Professional Conduct to be more logical and user friendly. The code, rules, interpretations and rulings are essentially the same, but they have been grouped into functional areas based on the member's area of practice plus a preface that is applicable to all members. (Note: Throughout the AICPA Code of Professional Conduct you will see the term "Member." This term relates to you, the CPA, whether or not you are a member of the AICPA.) The three functional areas are:

Part 1: Members in Public Practice

Part 2: Members in Business

Part 3: Other Members (retired, unemployed, etc.)

The part number is followed by two sets of three digit numbers to identify the topic and, when applicable, the subtopic. For example, 1.100.001 relates to Part 1 (Members in Public Practice); Topic 100 (Integrity and Objectivity); and Subtopic 001 (the Integrity and Objectivity rule).

By grouping all of the guidance for a particular type of member in one place, the CPA will save much time in researching a situation as well as (hopefully) reach a more accurate conclusion. However, bear in mind that a member may be covered by more than one category. For example, one could work full time for an employer in industry and work part time during busy season preparing tax returns.

This course will focus on Part 2 of the Code of Professional Conduct: Members in Business. Below is a listing of the topics covered in Part 2, followed by a discussion of each topic and selected corresponding interpretations, rulings, and other guidance by topic.

2.0 Conceptual Framework for Members in Business

2.100 Integrity and Objectivity

2.300 General Standards

2.400 Acts Discreditable

Throughout this course, we will attempt to use the actual AICPA code section references whenever possible. This will allow you to conduct further research on topics of interest to you. However, the source material is very voluminous, and in many instances, we have omitted entire sections of the Code. In other instances, we have greatly summarized the material – sometimes condensing several pages of material into a few bullet points or a single paragraph. We believe this approach is both appropriate and beneficial for the CPA seeking an overview or refresher course.

## **Part 2**

### ***Members in Business***

#### **2.000 Introduction**

.01 Part 2 of the Code of Professional Conduct (the code) applies to members in business. Accordingly, when the term member is used in part 2 of the code, the requirements apply only to members in business. When a member in business is also a member in public practice (for example, a member has a part-time tax practice), the member should also consult part 1 of the code, which applies to members in public practice.

#### **2.000.010 Conceptual Framework for Members in Business**

##### ***Introduction***

.01 Members may encounter various relationships or circumstances that create threats to the member's compliance with the rules. The rules and interpretations seek to address many situations; however, they cannot address all relationships or circumstances that may arise. Thus, in the absence of an interpretation that addresses a particular relationship or circumstance, a member should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a threat to the member's compliance with the rules that is not at an acceptable level. When making that evaluation, the member should apply the conceptual framework approach as outlined in this interpretation.

.02 The code specifies that in some circumstances, no safeguards can reduce a threat to an acceptable level. For example, the code specifies that a member may not subordinate the member's professional judgment to others without violating the "Integrity and Objectivity Rule" [2.100.001].

## ***Conceptual Framework Approach***

**.06** Under the conceptual framework approach, members should identify threats to compliance with the rules and evaluate the significance of those threats. Members should evaluate identified threats both individually and in the aggregate because threats can have a cumulative effect on a member's compliance with the rules.

### **2.000.020 Ethical Conflicts**

**.01** An ethical conflict arises when a member encounters one or both of the following:

- a) Obstacles to following an appropriate course of action due to internal or external pressures
- b) Conflicts in applying relevant professional and legal standards.

For example, a member suspects a fraud may have occurred, but reporting the suspected fraud would violate the member's responsibility to maintain the confidentiality of his or her employer's confidential information.

**.02** Once an ethical conflict is encountered, a member may be required to take steps to best achieve compliance with the rules and law. In weighing alternative courses of action, the member should consider factors such as the following:

- a) Relevant facts and circumstances, including applicable rules, laws, or regulations
- b) Ethical issues involved
- c) Established internal procedures

## **2.100 Integrity and Objectivity**

### **2.100.001 Integrity and Objectivity Rule**

**.01** 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.

## **2.110 Conflicts of Interest**

### **2.110.010 Conflicts of Interest**

**.01** In performing a professional service for an employer, a conflict of interest may occur if a member or the member's employer has a relationship with another person, entity, product, or service that, in the member's professional judgment, the employer or other appropriate parties may view as impairing the member's objectivity. In such situations, adverse interest or self-interest threats to the member's compliance with the "Integrity and Objectivity Rule" [2.100.001] may exist.

**.02** A member should evaluate the significance of the threats to determine if they are at an acceptable level. If, after evaluating the threats, the member determines that the threats are so significant that no safeguards could eliminate or reduce the threats to an acceptable level, therefore impairing the member's objectivity, the member should either not perform the professional service or terminate one or more of the relationships that are causing the conflict.

### **2.120.010 Offering or Accepting Gifts or Entertainment**

**.01** For purposes of this interpretation, a customer or vendor of the member's employer includes a representative of the customer or vendor.

**.02** When a member offers to, or accepts gifts or entertainment from, a customer or vendor of the member's employer, self-interest, familiarity, or undue influence threats to the member's compliance with the "Integrity and Objectivity Rule" [2.100.001] may exist.

**.03** Threats to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and the member would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

- a) The member offers to, or accepts gifts or entertainment from, a customer or vendor of the member's employer that violate applicable laws, rules, or regulations or the policies of the member's employer or the customer or vendor.
- b) The member knows of the violation or demonstrates recklessness in not knowing.

**.04** A member should evaluate the significance of any threats to determine if they are at an acceptable level. Threats are at an acceptable level when gifts or entertainment are reasonable in the circumstances. The member should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:

- a) The nature of the gift or entertainment
- b) The occasion giving rise to the gift or entertainment
- c) The cost or value of the gift or entertainment
- d) The nature, frequency, and value of other gifts and entertainment offered or accepted
- e) Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f) Whether other customers or vendors also participated in the entertainment
- g) The individuals from the customer or vendor and a member's employer who participated in the entertainment

## **2.130 Preparing and Reporting Information**

### **2.130.010 Knowing Misrepresentations in the Preparation of Financial Statements or Records**

**.01** Threats to compliance with the “Integrity and Objectivity Rule” [2.100.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and the member would be considered to have knowingly misrepresented facts in violation of the “Integrity and Objectivity Rule,” if the member

- a) makes, or permits or directs another to make, materially false and misleading entries in an entity’s financial statements or records;
- b) fails to correct an entity’s financial statements or records that are materially false and misleading when the member has the authority to record the entries; or
- c) signs, or permits or directs another to sign, a document containing materially false and misleading information.

### **2.130.020 Subordination of Judgment**

**.01** The “Integrity and Objectivity Rule” [2.100.001] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services for an employer or on a volunteer basis. This interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the member’s organization.

**.02** Self-interest, familiarity, and undue influence threats to the member’s compliance with the “Integrity and Objectivity Rule” [2.100.001] may exist when a member and his or her supervisor or any other person within the member’s organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.

**.03** A member should evaluate the significance of any threats to determine if they are at an acceptable level. Threats are at an acceptable level if the member concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If threats are not at an acceptable level, the member should apply the safeguards in paragraphs .05–.07 to eliminate or reduce the threat(s) to an acceptable level so that the member does not subordinate his or her judgment.

## Question and Answer



**Q:** Cindy Steffen is a CPA and the controller of Company X Inc. In preparing the financial statements for the quarter ended September 30, 200X, Steffen proposes to reduce obsolete inventory to net realizable value. The obsolete items represent a significant amount of total inventory. The CFO concurs with Steffen's position. However, he decides not to go against the CEO whose position is that reducing the inventory this quarter is a discretionary decision and the CEO would prefer to record any such reduction at year end, after Company X completes its anticipated public offering of stock later this year. What are the ethical obligations of Steffen's in this situation?

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

## Case Study: Unexplained Prosperity

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Henry Monterrey, a CPA employed as part-time controller by a small public accounting firm, prepared the financial statements and related tax returns during the first four years of operation for Thick-N-Chewy, Inc. This closely held company owns a chain of three candy stores located throughout the city. Aggregate annual revenues are 65 percent from delivery sales and 35 percent from in-store sales. Revenues increased by 12 percent in year two and 9 percent in year three. While preparing the annual statements and tax return for the current year, Monterrey noticed revenues were up 34 percent while costs of goods sold increased only 5 percent over the previous year. Taking note of this large increase, Monterrey began to investigate possible causes.

The CPA recalculated his original computations and found them to be correct. He then reviewed invoices for the goods purchased, thinking the cost of goods purchased could have decreased on a per-unit basis, thus explaining the disproportionate increase in revenues and cost of goods sold. He knew that he would need to check any changes in volume and price as well. Monterrey, believing he needed an answer to his question before he could publish the financial statements and sign the tax return, called a meeting to discuss the issue with the three brothers who worked as store managers and who were also majority shareholders.

After showing the brothers his unusual findings and inquiring about possible explanations, one of the brothers responded by saying that they had initiated cost saving measures to reduce the materials cost expense. The brother added that he did not appreciate being called into a meeting to answer unimportant questions about why they are making more money. On his way out, another brother said, "Rather than questioning our good business sense, you should be glad that we are making more money because you might now be able to get a larger bonus or a raise."

Sensing that he had received a less than truthful answer, Monterrey began talking with some of the long-time employees of the stores to determine if any changes had occurred during the past year that would account for the dramatic increase in revenues. Did volume go up substantially while costs were held fairly constant: Was there a major price increase with volume holding steady? The consistent answer was that they had been making candy the same way since the parlors opened and that there had been no significant change in price and only a modest increase in volume.

When he was back at his office, Monterrey was looking through the Thick-N-Chewy file when he came across a newspaper article indicating that two sales clerks had been arrested for selling a controlled substance in one of the stores. Although there was no suggestion in the article that store management had been involved in the drug sales, Monterrey realized that if the candy stores were laundering drug money, it could explain the large increase in revenues while price and volume remained steady.

What are the ethical issues?

What should Monterrey do?

### **Suggested Answer**

First, the CPA should assess the consequences of differing alternatives, some of which are:

Resign from the company

- Accountant's integrity preserved
- Successor accountant may pursue problem
- Owners' possible illegal activity not uncovered, at least at this time
- Drug peddling may continue
- Accountant's income decreases

Report suspicions to law enforcement officers

- Accountant violates obligation to client, (employer) exceeds approved limits of actions
- Owners' possible illegal activity may be uncovered
- Drug peddling may be stopped
- Candy stores may close, employees lose jobs

- Accountant may be sued by owner, censured by state Board
- Accountant's income decreases

Accept the owners' explanation, prepare the report

- Accountant's integrity compromised
- Illegal drug peddling, if real, continues
- Owners' reputation maintained
- Accountant's reputation may be harmed if drug activity subsequently discovered
- Accountant's income may increase

After assessing the possible consequences, the CPA should consider quitting his job. The CPA should talk candidly with a successor controller as to why he quit if the client permits the successor controller to speak candidly with the prior CPA.

**.09** If the member concludes that no safeguards can eliminate or reduce the threats to an acceptable level or if the member concludes that appropriate action was not taken, then he or she should consider the continuing relationship with the member's organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

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

**.01** The "Integrity and Objectivity Rule" [2.100.001] requires a member to maintain objectivity and integrity in the performance of a professional service. When dealing with an 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 the employer's external accountant requests written representation.

## **2.160 Educational Services**

### **2.160.010 Educational Services**

**.01** Members who perform educational services, such as teaching full or part time at a university, teaching a continuing professional education course, or engaging in research and scholarship, are performing professional services and, therefore, are subject to the "Integrity and Objectivity Rule" [2.100.001].

## **2.300 General Standards**

### **2.300.001 General Standards Rule**

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

- a) Professional Competence. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.



- b) Due Professional Care. Exercise due professional care in the performance of professional services.
- c) Planning and Supervision. Adequately plan and supervise the performance of professional services.
- d) Sufficient Relevant Data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

## **2.400 Acts Discreditable**

### **2.400.001 Acts Discreditable Rule**

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

#### **Interpretations Under the Acts Discreditable Rule**

Interpretations under the Acts Discreditable Rule identify the following discreditable acts:

- Discrimination or harassment in employment practices.
- Solicitation or disclosure of CPA examination questions or answers.
- Failure to file a tax return or pay a tax liability.
- Negligence in the preparation of financial statements or records.
- Negligence in the preparation of reports to governmental bodies, commissions, or other regulatory agencies.
- Use of prohibited indemnification agreements.
- Disclosure or use of confidential information obtained from employment or volunteer activities.
- False, misleading, or deceptive acts in promoting or marketing professional services.
- Using the CPA credential in violation of state law.

### **Observation**



While the AICPA guidance on using the CPA title is useful, the most important source of information on using the CPA title comes from your state Board of Accountancy. For example, both New York and California now severely restrict the use of the CPA title by inactive CPAs. Previously, many states allowed inactive CPAs to use the CPA title on business cards as long as it was clear that the CPA was not practicing public accounting. Most states have rules on who can use the CPA title and in what circumstances.

## Example



John was an experienced CPA when he went to work for XYZ Industries, Inc. (XYZ) as CFO. XYZ was rapidly growing and hoping to go public within a year. XYZ did not have a true CFO prior to hiring John, and the accounting department was in disarray. Eighteen months later, XYZ had a successful IPO after which John said, “I have been so busy with the IPO that I did not file my tax returns for the prior two years.”

John may not realize it, but he has a responsibility under this rule to timely file all tax returns and to pay all applicable taxes. More importantly, most state boards of accountancy have similar rules, and the states have the ability to discipline their licensees.

## Members in Business and Industry - Examples of Violations Adapted from the AICPA website

All members of the AICPA are required to follow the AICPA Code of Professional Conduct (Code). Members must be knowledgeable of their responsibilities under the Code. Below are a couple of fictitious examples of business and industry member violations prepared by the AICPA that show how the Rules and related interpretations could be applied. Some situations may result in more than one violation.

### Integrity and Objectivity Rule

Member Linda Chambers is a CPA and the Chief Financial Officer for Brookings Incorporated. At the request of the external auditors, Linda signed the client representation letter stating that, there has been no communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices. Earlier that month she had received an inquiry from the Securities and Exchange Commission (SEC) concerning the company’s revenue recognition policy.

As a member, Linda has a responsibility to the company’s external accountants. She is required to be candid in disclosing the communication received from the SEC. In addition, Linda may not sign documents containing materially false and misleading information. Linda could potentially be in violation of “Integrity and Objectivity Rule” (AICPA, *Professional Standards*, ET sec. 2.100.001) as supported by the “Knowing Misrepresentations in the Preparation of Financial Statements or Records” interpretation (AICPA, *Professional Standards*, ET sec. 2.130.010), and Obligations of a Member to His or Her Employer’s External Accountants” interpretation (AICPA, *Professional Standards*, ET sec. 2.130.030).

## Members in Business and Industry - Examples of Violations Adapted from the AICPA website (continued)

### General Standards Rule

The controller, member Dale Weinstein, CPA, of Brookings Incorporated recorded a material sale of merchandise on the last day of the first quarter. Dale never received notification of a sales invoice or received any shipping documentation to ascertain that the sales transaction had actually occurred. Although this was a departure from company policy, Dale recorded the transaction.

Dale did not exercise due professional care and had a responsibility to obtain sufficient relevant data that would provide him with a reasonable basis for his conclusion. Dale could potentially be in violation of the “General Standards Rule” (AICPA, *Professional Standards*, ET sec. 2.300.001) of the AICPA *Code of Professional Conduct*.

### Accounting Principles Rule

In a response to an SEC inquiry, member John Sterling, the CEO of Brookings Incorporated, writes: The Company’s financial statements are presented in conformity with generally accepted accounting principles, and I am not aware of any material misstatements. Earlier that morning, John had been present at a meeting with the company’s external accountants discussing a material error in those same financial statements.

John cannot express, in the written communication with the SEC that the financial statements are in accordance with generally accepted accounting principles and are free of material errors when he knows that his statement is false. As a member, John could be potentially in violation of the “Accounting Principles Rule” AICPA, *Professional Standards*, ET sec. 2.320.001) of the AICPA Code of Professional Conduct.

### Acts Discreditable Rule

I have been so busy with the company’s initial public offering that I have failed to file my personal income tax returns for the last two years, said member Susan Allen.

Susan may not realize it, but she has a responsibility to comply with applicable federal, state or local laws regarding the timely filing of her personal tax returns. She could now also be potentially in violation of the “Acts Discreditable Rule” as supported by the “Failure to File a Tax Return or Pay a Tax Liability” interpretation (AICPA, *Professional Standards*, ET sec. 2.400.030).

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### **III. IMA STATEMENT OF ETHICAL PROFESSIONAL PRACTICE<sup>1</sup>**

Members of IMA shall behave ethically. A commitment to ethical professional practice includes overarching principles that express our values, and standards that guide our conduct.

#### **PRINCIPLES**

IMA's overarching ethical principles include: Honesty, Fairness, Objectivity, and Responsibility. Members shall act in accordance with these principles and shall encourage others within their organizations to adhere to them.

#### **STANDARDS**

A member's failure to comply with the following standards may result in disciplinary action.

##### **I. COMPETENCE**

Each member has a responsibility to:

1. Maintain an appropriate level of professional expertise by continually developing knowledge and skills.
2. Perform professional duties in accordance with relevant laws, regulations, and technical standards.
3. Provide decision support information and recommendations that are accurate, clear, concise, and timely.
4. Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.

##### **II. CONFIDENTIALITY**

Each member has a responsibility to:

1. Keep information confidential except when disclosure is authorized or legally required.
2. Inform all relevant parties regarding appropriate use of confidential information, and monitor subordinates' activities to ensure compliance.
3. Refrain from using confidential information for unethical or illegal advantage.

##### **III. INTEGRITY**

Each member has a responsibility to:

1. Mitigate actual conflicts of interest, regularly communicate with business associates to avoid apparent conflicts of interest, and advise all parties of any potential conflicts.

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2. Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
3. Abstain from engaging in or supporting any activity that might discredit the profession.

#### **IV. CREDIBILITY**

Each member has a responsibility to:

1. Communicate information fairly and objectively.
2. Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.
3. Disclose delays or deficiencies in information, timeliness, processing, or internal controls in conformance with organization policy and/or applicable law.

#### **RESOLUTION OF ETHICAL CONFLICT**

In applying the Standards of Ethical Professional Practice, you may encounter problems identifying unethical behavior or resolving an ethical conflict. When faced with ethical issues, you should follow your organization's established policies on the resolution of such conflict. If these policies do not resolve the ethical conflict, you should consider the following courses of action:

1. Discuss the issue with your immediate supervisor except when it appears that the supervisor is involved. In that case, present the issue to the next level. If you cannot achieve a satisfactory resolution, submit the issue to the next management level. If your immediate superior is the chief executive officer or equivalent, the acceptable reviewing authority may be a group such as the audit committee, executive committee, board of directors, board of trustees, or owners. Contact with levels above the immediate superior should be initiated only with your superior's knowledge, assuming he or she is not involved. Communication of such problems to authorities or individuals not employed or engaged by the organization is not considered appropriate, unless you believe there is a clear violation of the law.
2. Clarify relevant ethical issues by initiating a confidential discussion with an IMA Ethics Counselor or other impartial advisor to obtain a better understanding of possible courses of action.
3. Consult your own attorney as to legal obligations and rights concerning the ethical conflict.

#### **Note**



The author believes that all CPAs in industry should adhere to both the AICPA and IMA guidelines regardless of membership.

## Case Study: Integrity and Objectivity



CPA, Director of Finance for a publicly owned company, made journal entries to adjust second and third quarter 200X financial statements according to a model developed and used by the company. When CPA made the adjustments to the second and third quarter financial statements, CPA did not report to senior management or to the external auditors that the adjustments could result in a misstatement of the financial statements. CPA reported the unsupported journal entries on the fourth quarter financial statements.

CPA made journal entries that were not in compliance with Generally Accepted Accounting Principles. CPA did not discharge the duty owed to the general public when CPA allowed incorrect second and third quarter financial statements to be issued.

## IV. FOREIGN CORRUPT PRACTICES ACT

Congress enacted the Foreign Corrupt Practices Act in 1977. This Act was passed because of disclosures by the Office of the Watergate Special Prosecutor and the Securities and Exchange Commission (SEC) of the use of U.S. corporate funds for domestic political contributions and for the bribery of foreign government officials. Some of these payments were clearly illegal and others questionable, while some payments appeared to have been made by avoiding internal control systems. To prevent these problems from occurring in the future, the Act requires a publicly traded company (it does not apply to privately held companies) to keep in reasonable detail “books, records and accounts” that accurately and fairly reflect its transactions and disposition of assets, and maintain an adequate system of internal controls. The control system must have the following attributes:

- Transactions must occur under the authorization of management
- Transactions must be properly recorded
- There must be reasonable controls over access to assets
- There must be periodic reconciliations of recorded to actual assets, with an investigation of any differences.

This Act is particularly applicable to multinational organizations, so the controllers of these organizations must be aware of it and its ramifications for enhanced control systems. To be in compliance with the Act, a controller should be particularly mindful of the adequacy of company control systems, as well as of subtle changes in financial results that may indicate the presence of control problems.

The penalties for violation of this act are fines of up to \$2,000,000 for any concern convicted of the violation. In addition, individuals involved in such illegal payoffs are subject personally to fines up to \$100,000 and prison for up to five years.

## V. COOK THE BOOKS & GO TO JAIL

In a sign of a widening crackdown, the Securities and Exchange Commission said it plans to work more closely with criminal prosecutors to attack corporate accounting fraud.

### Case Study: NextCard, Inc.



Mr. Wachtel served as the Controller of NextCard, Inc. from 1998 to 2003. The Securities and Exchange Commission (SEC) filed a civil suit in 2004.

The SEC's Complaint alleged that Mr. Wachtel and the other defendants, all former officers of NextCard, engaged in a fraudulent scheme which resulted in NextCard filing materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal year ended December 31, 2000, and in the company's quarterly reports on Form 10-Q for the first two quarters of fiscal year 2001. The Complaint alleged that Wachtel and the other defendants failed to disclose several changes in NextCard's accounting policies, including: (1) the reclassification of certain credit losses as fraud losses; and (2) changes in NextCard's policy for calculating its loan loss reserve. According to the Complaint, as a result of these undisclosed accounting policy changes, investors were misled and denied material information concerning the rising levels of losses on NextCard's credit card portfolio.

Mr. Wachtel consented to the entry of a Final Judgment, in which he, without admitting or denying the allegations of the Complaint, agreed to the imposition of a permanent injunction for violating sections of the Securities Act and the Exchange Act; his disgorgement of \$21,000, representing his sale of NextCard common stock, together with prejudgment interest in the amount of \$1,223; and payment of civil penalties in the amount of \$71,000. Mr. Wachtel was also prohibited for five years from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

The State Board of Accountancy then voted to revoke Mr. Wachtel's CPA license.

## VI. MANAGEMENT ACCOUNTANTS SHOULD HEED THE ABOVE WARNING

One of the most common schemes is the bill-and-hold sales transaction. While it's not necessarily a GAAP violation, it's often associated with financial frauds and calls for deeper investigation. The SEC says that all of the following conditions must be met for revenue recognition to be appropriate:

- The risks of ownership must have passed to the buyer.
- The customer must have a written commitment to purchase the goods.

- The buyer must request the bill-and-hold sales transaction and substantiate a business purpose for it.
- A fixed delivery date must exist.
- The seller must not retain any significant specific performance obligations.
- The goods must be complete and ready for shipment and not subject to being used to fill other orders.

To make matters even more difficult, the SEC points out that the following additional factors be considered:

- The extent to which the seller is modifying its normal terms for this transaction.
- The seller's history of employing bill and hold transactions.
- The extent to which the buyer will lose if the market value of the held goods subsequently declines.
- The extent to which the holding risk of the seller can be insured.
- The extent to which the seller's holding of the goods really creates a contingent sale that the buyer could reject.

## **VII. SARBANES-OXLEY CORPORATE RESPONSIBILITY ACT OF 2002**

Title III of the Sarbanes-Oxley Act deals with making corporations more responsible for the financial statements they issue. Some of the major changes affect audit committees and are designed to make them more independent. In particular, the Act vests the audit committee of an issuer with responsibility for the appointment, compensation, and oversight of any registered public accounting firm employed to perform audit services. It also requires committee members to be a member of the board of directors of the issuer, and to be otherwise independent.

Title IX of the Sarbanes-Oxley Act amends Federal criminal law to increase criminal penalties for: 1) conspiracy to commit offense or to defraud the United States, including its agencies; and 2) mail and wire fraud.

## **VIII. IMA ETHICS HOTLINE NOW OPEN TO ALL FINANCIAL PROFESSIONALS**

In response to the need for businesses to maintain the highest ethical standards, the Institute of Management Accountants provides financial professionals free, confidential guidance on ethical issues through the IMA Ethics Hotline.



Since Enron and other corporate accounting scandals, ethics programs and hotlines have become an unofficial requirement for businesses. Confidential hotlines, in particular, are gaining popularity to protect an employee from being labeled a “whistleblower.”

Financial professionals can call the hotline toll-free at 1-800-245-1383. The IMA does not record phone numbers. Confidentiality is maintained at all times.

## IX. FEDERAL SENTENCING GUIDELINES

Under the revised sentencing guidelines, there are five things you can do to change the culture of your company and reduce your firm’s potential exposure.

1. Create a formal, written ethics policy.
2. Require managers to monitor ethics compliance.
3. Screen potential employees carefully before hiring.
4. Develop incentives to promote compliance.
5. Encourage employees to speak up when they encounter problems.

Companies that embrace the five items above will receive lighter sentences in the event they are convicted of wrongdoing.

## X. STOCK OPTION BACKDATING

In the past, there was a flurry of controversy over stock option backdating. This controversy is the direct result of an ethical breakdown in corporate America. While it may take years to sort out the full impact of this dubious practice, here are a few of the possible impacts excerpted from articles written by the experts in employee ownership at the National Center for Employee Ownership ([www.NCEO.org](http://www.NCEO.org)):

1. **Shareholder Litigation:** Backdating will be a field day for securities lawyers for a number of reasons. If a company said it was issuing options at fair market value, but really didn’t, shareholders could sue because they never approved such a plan. Furthermore, IRS rules make shareholder approval a condition of tax-qualified incentive stock option plans.
2. **SEC Enforcement:** There are numerous violations that could be involved with backdating. If an executive got options timed just before the release of data that would affect the stock price, that’s potentially insider trading. If the options were granted in a way not in accordance with the plan, that could mean that proper disclosures from the executive to the SEC had not been made. If the two-day rule for reporting grants was effectively violated (because the grant date was pushed back more than two days over what the company actually claimed it was), then the securities laws are violated again.

3. **Corporate Taxes:** It's not entirely clear how the new rules on the taxation of deferred compensation will apply to backdated options issued before the effective date of the new deferred compensation rules under Internal Revenue Code Section 409A, which says that certain kinds of deferred compensation will be heavily taxed unless the recipient specified well in advance when the award would be paid. Options generally do not require such an advance election (you can exercise whenever you like once they are vested until they expire; that's why they are so appealing). Option grants at fair market value are not covered by Section 409A, but discounted options are. More clear is that if the options were incentive stock options, then the backdating would disqualify the option as an incentive option, and the executive would owe big-time back taxes on the exercised award, even if the stock had not yet been sold. If the exercise date is bogus, that means the company has underwithheld taxes on the exercise, and that means it owes the government, with penalties and interest. Failure to withhold payroll taxes on non-qualified options can result in the denial of the corporate tax deduction for the compensation element of the stock option award. This alone could result in hundreds of millions of dollars in unpaid corporate income taxes.
4. **Financial Statements and Restatements:** Rules for recording the impact of options expenses have changed, but under both the old rules and the new rules, pretending the awards were granted at a price they were not requires companies to go back and restate earnings.
5. **Excess Compensation:** Companies can take tax deductions for compensation to top executives over \$1 million only if it is performance-based. Backdated options are not, so there may well be tax penalties.
6. **The Alternative Minimum Tax:** Employees who have incentive stock options do not have to pay any tax when they exercise the option, only when they sell the stock (provided they hold the shares for one year after exercise and two years after grant). At sale, they only would pay capital gains taxes, but they may be subject to the alternative minimum tax (AMT) requiring them to count the spread on the option at exercise as a "preference" item. Many employees (especially executives) would have held on to the stock after exercise for at least a year and paid the AMT. But backdated options cannot be incentive options because incentive options must be issued at fair market value. So, that means they now owe regular tax on the exercise of the option from years ago.
7. **Changes to Option Programs:** This scandal could force companies to reduce or eliminate the granting of options. Why risk the hassle? Just cancel the plan.

## AICPA Ethics Guidance for CPAs in Business and Industry

Use these tips from the AICPA when you are confronted with an ethical dilemma:

- Do your best to resolve the issue within your own organization, whether that is your department in a larger organization or the company as a whole. Most issues are easily resolved.
- Be cognizant of your obligations to your employer's external accountant. You must be candid and must not knowingly misrepresent facts or fail to disclose material information to them.
- One of the most common ethics violations by CPAs in business and industry relates to Subordination of Judgment. This interpretation may be especially relevant if the CPA has a disagreement or dispute with their manager on the preparation of financial statements or the recording of transactions.
- Don't overlook an ethics policy or statement in place at your company. In a smaller company, you might need to rely on outside resources as ethics policies might not be fully developed or documented.
- Maintain professional skepticism. If you get an explanation for the situation, think about whether it makes sense. Continue to observe over time to see if the situation plays out as expected.
- Maintain documentation of the issue – your thoughts and decisions all along the way, and the parties with whom you discussed these issues – to review later as may be necessary.
- Even if you are successful in a particular situation, you might find that there are other implications that make it impossible to continue working at a company. In this situation, you should seek employment elsewhere.
- Depending on the severity of the issue, you may want to consult with people that you respect from outside the company. Also, consider whether you need to consult with an attorney.

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## CHAPTER 4: TEST YOUR KNOWLEDGE

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

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1.

**The AICPA codified the Code of Professional Conduct into three functional areas, including all of the following except:**

- A. Members in Public Practice
- B. Members in Business
- C. Member in Public Practice and Business
- D. Other Members (retired, unemployed, etc.)

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## CHAPTER 4: SOLUTION AND SUGGESTED RESPONSES

Below is the solution and suggested responses for the question on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

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| 1. | <p><b>A.</b> Incorrect. The groupings are based on the member's area of practice, including public practice. The term member relates to any CPA, whether or not he or she is a member of the AICPA.</p> <p><b>B.</b> Incorrect. The groupings are based on the member's area of practice, including business. The term member relates to any CPA, whether or not he or she is a member of the AICPA.</p> <p><b>C.</b> <b>CORRECT.</b> There is not a part that includes a combination of these groups.</p> <p><b>D.</b> Incorrect. The groupings are based on the member's area of practice, including a grouping of other members that do not fall into the main two categories.</p> <p><i>(See page 85 of the course material.)</i></p> |
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## GLOSSARY

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**Alternative Practice Structures (APS)** - 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).

**American Institute of Certified Public Accountants (AICPA)** - The national professional organization for all certified public accountants (CPAs).

**Client's records** - Any accounting or other records belonging to the client that were given to the member by, or on behalf of, the client.

**Close relative** - 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.

**Code of Professional Conduct (the Code)** - 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.

**Conflict 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.

**Consulting services** - Professional services that use the practitioner's technical skills, education, observations, experiences, and knowledge of the consulting process.

**Contingent fee** - 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.

**Direct financial interest** - A direct financial interest is created when a member invests in a client entity.

**Disqualifying services** - Term used to refer to the following services, which when performed for a client prohibit the member from accepting a contingent fee or commission: (a) An audit or a review of a financial statement; (b) An examination of prospective financial information; (c) A compilation of a financial statement expected to be used by third parties except when the compilation report discloses a lack of independence.

**Ethics Rulings** - Part of the Code of Professional Conduct. Rulings summarize the application of rules and interpretations to a particular set of factual circumstances.

**Firm** - 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.

**Former practitioner** - A proprietor, partner, shareholder or equivalent of a firm, who leaves by resignation, termination, retirement, or sale of all or part of the practice.

**Holding out as a CPA** - Includes any action initiated by a member, whether or not in public practice, that informs others of his or her status as a CPA.

**Independence in appearance** - If there are circumstances that a reasonable person might believe are likely to impair independence, the CPA is not independent in appearance. To be recognized as independent, the auditor must be free from any obligation to or interest in the client, its management, or its owners.

**Independence in fact** - 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.

**Indirect financial interest** - An indirect financial interest is created when a member invests in a nonclient entity that has a financial interest in a client.

**Integrity** - 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.

**Internal audit outsourcing** - 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.

**Interpretations of rules of conduct** - 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.

**Joint closely held business investment** - 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.

**Joint Ethics Enforcement Program (JEEP)** - The AICPA and most state societies cooperate in the Joint Ethics Enforcement Program (JEEP) in bringing enforcement actions against their members.

**Member** - 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.

**Multidisciplinary practices (MDP)** - Arrangements in which CPAs share fees with attorneys or other professionals.

**National Association of State Boards of Accountancy (NASBA)** - A voluntary organization composed of the state boards of accountancy. It promotes communication, coordination, and uniformity among state boards.

**Objectivity** - 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.

**Period of professional engagement** - 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.

**Practice of public accounting** - 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.

**Principles** - Positive statements of responsibility in the Code of Professional Conduct that provide the framework for the rules, which govern performance.

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

**Rules** - Broad but specific descriptions of conduct that would violate the responsibilities stated in the principles in the Code of Professional Conduct.

**Securities and Exchange Commission (SEC)** - A federal government regulatory agency with responsibility for administering the federal securities laws.

**State boards of accountancy** - State government regulatory organizations. Each state government issues a license to practice within the particular state under that state's accountancy statute.

**State societies of CPAs** - Voluntary organizations of CPAs within each individual state.

**Statements on Standards for Tax Services (SSTS)** - 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.

**Unpaid fees** - 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).

**Yellow Book** - Governmental Auditing Standards issued by the Government Accountability Office.

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