Ethics and Professional Conduct for Florida CPAs

Course #4805E/QAS4805E
Course Material
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**Glossary**

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

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

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

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

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

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

**OBSERVATION:** In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board (PCAOB), and the U.S. Securities and Exchange Commission (SEC) if the member’s report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member’s report will be filed with the DOL, the AICPA SEC Practice Section (SECPs) if the member’s firm is a member of the SECPs, 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.
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.

PRINCIPLES

The Principles of the Code of Professional Conduct:

I. Responsibilities

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

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

III. Integrity

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

IV. Objectivity and Independence

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

V. Due Care

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

VI. Scope and Nature of Services

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

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

**RULES**

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

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

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

**Professional services** - Professional services include all services performed by a member while holding out as a CPA.
Below is a listing of the applicable rules followed by a discussion of each rule:

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

Rule 101 - Independence

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

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

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

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

Rule 102 - Integrity and Objectivity

In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.
Rule 102 is very broad on purpose. The Code of Professional Conduct could not possibly proscribe every action that is to be avoided. Thus, Rule 102 could cover a variety of misconduct.

Rule 201 - General Standards

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

A. **Professional Competence.** Undertake only those professional services that the member or the member’s firm can reasonably expect to be completed with professional competence.

B. **Due Professional Care.** Exercise due professional care in the performance of professional services.

C. **Planning and Supervision.** Adequately plan and supervise the performance of professional services.

D. **Sufficient Relevant Data.** Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

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

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

Rule 202 - Compliance with Standards

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

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

**OBSERVATION:** The Code of Professional Conduct does not refer to Audit and Accounting Guides that may be issued by a committee or task force established by the AICPA. Although each Audit Guide contains a preamble that states that a Guide does not have the authority of a pronouncement by the ASB, it does note that a member may be called upon to justify departures from the Guide if the member’s work is challenged.
Rule 203 - Accounting Principles

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

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

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

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

Rule 301 - Confidential Client Information

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

This rule shall not be construed (1) to relieve a member of his or her professional obligations under Rules 202 and 203, (2) to affect in any way the member’s obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member’s compliance with the applicable laws and government regulations, (3) to prohibit review of a member’s professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member’s confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members’ exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.
NOTE: An auditor should have access to a variety of information held by the client if the engagement is to be successful. The client will grant the auditor access to sensitive files and reports only if it can expect the auditor to hold the information in confidence. The purpose of Rule 301 is to encourage a free flow of information from the client to the CPA; however, the rule makes it clear that the principle of confidentiality is not absolute. The confidentiality concept does not allow the client to omit information that is required by generally accepted accounting principles. SAS-32 (Adequacy of Disclosure in Financial Statements) reinforces this position by stating that if a client omits information that is required by GAAP, a qualified or adverse opinion must be expressed. On the other hand, SAS-32 does note that an auditor ordinarily should not make available information that is not required to be disclosed to comply with GAAP.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In addition, the IRS and most states impose criminal and civil penalties for the unauthorized disclosure of tax return data.
Rule 302 - Contingent Fees

A member in public practice shall not:

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

2. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

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

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

A member’s fees may vary depending on the complexity of services rendered.

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

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

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

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

The period of prohibition includes the date covered by the financial statements and the period during which the attestation service (and compilation service, as described above) is performed. For example, if the CPA is auditing a client’s financial statements for the year ended December 31, 2001, and the date of the auditor’s report is March 12, 2002, no services could be performed on a contingent fee basis by the auditor for the period from January 1, 2001, through March 12, 2002.

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

**Rule 501 - Acts Discreditable**

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

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

- If a member commits a crime punishable by imprisonment for more than one year.
- If a member willfully fails to file an income tax return that he or she, as an individual taxpayer, is required by law to file.
- If a member files a false or fraudulent income tax return on his or her behalf, or on a client’s behalf.
- If a member willfully aids in the preparation and presentation of a false and fraudulent income tax return of a client.
- If a member’s certificate as a certified public accountant, or license or permit to practice as such, is revoked by a governmental authority as a disciplinary measure.
Rule 502 - Advertising and Other Forms of Solicitation

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

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

Rule 503 - Commissions and Referral Fees

A. Prohibited Commissions

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

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

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

B. Disclosure of Permitted Commissions

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

C. Referral Fees

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

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

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

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

The rule also does not prohibit the payment of bonuses to employees even though practice development efforts on the part of the employee are a factor in determining the amount of the bonus.

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

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

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

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

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

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

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

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

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

- Fifty-one percent of the ownership (as measured by financial interest and voting rights) must be held by CPAs.
- A non-CPA owner must be actively engaged in providing services to clients of the firm, and that participation must be the principal occupation of the non-CPA.
- 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 who becomes an owner after the adoption of the AICPA resolution must have a baccalaureate degree (after 2010, the individual must have completed 150 semester hours of education).
- 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.
- A non-CPA owner must observe the AICPA Code of Professional Conduct.
- A non-CPA owner must complete the same number of CPE units as CPAs.

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

**OBSERVATION:** Each state is responsible for determining what forms of ownership may be used to practice public accounting; however, the AICPA notes that a practitioner can practice only in a business organization form that conforms to resolutions of the AICPA Council.
CHAPTER 1 – REVIEW QUESTIONS

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

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

1. Why does this ethics course examine the AICPA Code of Professional Conduct when membership in the AICPA is voluntary:
   - a) although membership in the AICPA is voluntary, federal law requires that all CPAs adhere to the AICPA Code of Professional Conduct
   - b) most state boards of accountancy pattern their laws and regulations after the AICPA Code or refer to it
   - c) membership in the AICPA is not voluntary; membership is required for all CPAs and firms doing attest work
   - d) most state CPA societies pattern their code of conduct after the AICPA Code, and most states require their licensees belong to their state CPA Society

2. The fundamental theme of the six principles of the Code of Professional Conduct is:
   - a) to be committed to honorable behavior
   - b) to sacrifice personal advantage
   - c) to be committed to honorable behavior, even at the sacrifice of personal advantage
   - d) to make the most money possible in the shortest possible time without violating any laws or standards of decency

3. Which of the following is true regarding Rule 102 – Integrity and Objectivity:
   - a) Rule 102 is very broad on purpose
   - b) Rule 102 provides a “safe harbor” against allegations of possible violations provided a CPA is following the orders of one’s boss or another superior
   - c) Rule 102 provides a very long list of prohibited actions, but the list does not include every possible instance of possible violations
   - d) Rule 102 only applies to CPAs doing attest engagements
4. AICPA Rule 201 requires that a CPA be competent. Nash, CPA seeks to provide services to a new client in an industry that he has not previously served. Which of the following is true regarding Nash, CPA providing services to this client:

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

5. The AICPA prohibits non-CPAs from owning any part of a CPA firm.

a) true
b) false
CHAPTER 1 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Membership in the AICPA is voluntary. Federal law does not explicitly state that CPAs must follow the AICPA Code of Professional Conduct.

   **B: Correct.** Most state boards of accountancy pattern their regulations on the AICPA Code of Professional Conduct and then address specific instances where their regulations differ.

   C: Incorrect. Membership in the AICPA and state CPA societies is voluntary.

   D: Incorrect. Most state CPA societies pattern their code of conduct after the AICPA Code, but state CPA society membership is voluntary.

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

2. A: Incorrect. Being committed to honorable behavior is only a part of the fundamental theme.

   B: Incorrect. Personal sacrifice is only a part of the fundamental theme.

   **C: Correct.** Both honorable behavior and personal sacrifice together comprise the fundamental theme.

   D: Incorrect. Making money is not part of the fundamental theme.

   (See the discussion of the Six Principles in the course material.)

3. **A: Correct.** The AICPA Code of Professional Conduct could not possibly list every possible violation.

   B: Incorrect. Rule 102 specifies that a CPA must not subordinate his or her judgment to others. There is no “safe harbor.”

   C: Incorrect. The AICPA Code of Professional Conduct could not possibly list every possible violation and therefore does not even begin to list possible violations.

   D: Incorrect. Rule 102 applies to all CPAs. CPAs in industry must not subordinate their judgment to others.

   (See Rule 102 in the course material.)
4. A: Incorrect. A CPA should undertake only those engagements that the firm reasonably expects can be completed competently. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate.

B: Incorrect. Rule 201 clearly applies to all CPAs.

C: Correct. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate.

D: Incorrect. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate. Nash, CPA is ultimately responsible to ensure that competence is attained.

(See Rule 201 in the course material.)

5. A: True is incorrect. Certain non-CPA ownership has been allowed for several years.

B: False is correct. Non-CPAs may own up to 49% of a CPA firm if specified conditions are met.

(See Rule 505 in the course material.)
CHAPTER 2: UNDERSTANDING THE CODE OF PROFESSIONAL CONDUCT

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

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

Introduction

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

Independence, Integrity, Objectivity

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

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

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

AICPA Interpretations of Rules 101 and 102

RULE 101 - INDEPENDENCE

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

A. During the period of a professional engagement a covered member:
1. Had or was committed to acquire any direct or material indirect financial interest in the client.

2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client, and
   
i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or
   
ii) The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
   
iii) The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.

3. Had a joint closely held investment that was material to the covered member.

4. Except as specifically permitted in Interpretation 101-5, had any loan to or from the client, or any officer or director of the client, or any individual owning 10 percent or more of the client’s outstanding equity securities or other ownership interests.

B. During the period of the professional engagement, a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than five percent of a client's outstanding equity securities or other ownership interests.

C. During the period covered by the financial statements or during the period of the professional engagement, a partner or professional employee of the firm was simultaneously associated with the client as a(n):
   
   1. Director, officer, or employee, or in any capacity equivalent to that of a member of management;
   
   2. Promoter, underwriter, or voting trustee; or
   
   3. Trustee for any pension or profit-sharing trust of the client.

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

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

1. Participated on the attest engagement team or was an individual in a position to influence the attest engagement for the client when the attest engagement covers any period that includes his or her former employment or association with that client; or
2. Was otherwise a covered member with respect to the client unless the individual first dissociates from the client by:

   a. Terminating any relationships with the client described in Interpretation 101-1C;
   b. Disposing of any direct or material indirect financial interest in the client;
   c. Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under Interpretation 101-5;
   d. Ceasing to participate\(^1\) in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and
   e. Liquidating or transferring all vested benefits in the client’s defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty\(^2\) significant to the benefits is imposed upon liquidation or transfer.

Application of the Independence Rules to a Covered Member’s Immediate Family

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

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

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

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

**OBSERVATION:** At this point, you may believe the independence rules are very complex. You may wish to skim the independence rules, paying particular attention to the observations presented throughout the chapter.

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

\(^2\) A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.
Application of the Independence Rules to Close Relatives

Independence would be considered to be impaired if:

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

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

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

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

Grandfathered Employment Relationships

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

Other Considerations

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. In the absence of an independence interpretation or ruling under Rule 101 that addresses a particular circumstance, a member should evaluate whether that circumstance would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member’s and the firm’s independence. When making that evaluation, members should refer to the risk-
based approach described in the Conceptual Framework for AICPA Independence Standards. If the threats to independence are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented.³

**Interpretation 101-6 (The Effect of Actual or Threatened Litigation on Independence)**  
In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

**Litigation Between Client and Member**

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

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

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.
2. The commencement of litigation by the covered member against the present management alleging management fraud or deceit would be considered to impair independence.
3. An expressed intention by the present management to commence litigation against the covered member alleging deficiencies in audit work for the client would be considered to impair independence if the auditor concludes that it is probable that such a claim will be filed.

³ A failure to prepare the required documentation would be considered a violation of Rule 202, Compliance With Standards, of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee.]
4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered member's firm\(^4\) or to the client company\(^5\) would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

**Litigation by Security Holders**

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

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered member in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered member’s firm\(^6\) or to the client.

2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.

3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

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\(^4\) Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment.

\(^5\) Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment.

\(^6\) Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment.
**Other Third-Party Litigation**

Another type of third-party litigation against the covered member may be commenced by a lending institution, other creditor, security holder, or insurance company who alleges reliance on financial statements of the client with which the covered member is associated as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may commence litigation (under subrogation rights) against the covered member in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered member and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered member alleges, in his defense, fraud, or deceit by the present management.

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered member (“the plaintiff client”), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered member’s firm\(^7\) or to the plaintiff client.

**Effects of Impairment of Independence**

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

**Termination of Impairment**

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

**RULE 102 – INTEGRITY AND OBJECTIVITY**

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

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\(^7\) Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment.
Interpretation 102-1 (Knowing Misrepresentations in the Preparation of Financial Statements or Records) A member shall be considered to have knowingly misrepresented facts in violation of Rule 102 when he or she knowingly:

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

Interpretation 102-2 (Conflicts of Interest) A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider Rule 301, Confidential Client Information.

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

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

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

- A member has provided tax or personal financial planning (PFP) services for a married couple who are undergoing a divorce, and the member has been asked to provide the services for both parties during the divorce proceedings.

- In connection with a PFP engagement, a member plans to suggest that the client invest in a business in which he or she has a financial interest.

- A member provides tax or PFP services for several members of a family who may have opposing interests.

- A member has a significant financial interest, is a member of management, or is in a position of influence in a company that is a major competitor of a client for which the member performs management consulting services.

- A member serves on a city's board of tax appeals, which considers matters involving several of the member's tax clients.
A member has been approached to provide services in connection with the purchase of real estate from a client of the member's firm.

A member refers a PFP or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement to do so.

A member recommends or refers a client to a service bureau in which the member or partner(s) in the member's firm hold material financial interest(s).

The above examples are not intended to be all-inclusive.

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

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

Interpretation 102-3 (Obligations of a Member to His or Her Employer's External Accountant) Under Rule 102, a member must maintain objectivity and integrity in the performance of a professional service. In dealing with his or her employer's external accountant, a member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which his or her employer's external accountant requests written representation.

Interpretation 102-4 (Subordination of Judgment by a Member) Rule 102 prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment:

1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature or omission of disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. If, after appropriate research or consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.

2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should...
consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed.

3. If, after discussing his or her concerns with the appropriate person(s) in the organization, the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member also should consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In this connection, the member may wish to consult with his or her legal counsel.

4. The member should at all times be cognizant of his or her obligations under Interpretation 102-3.

**OBSERVATION:** In an audit engagement, guidance established by SAS-22 (Planning and Supervision) with respect to the subordination of judgment should be observed.

Q: Cindy Steffen is a CPA and the controller of Company X Inc. In preparing the financial statements for the quarter ended March 31, 2005, Steffen proposes to reduce obsolete inventory to net realizable value. The obsolete items represent a significant amount of total inventory. The CFO concurs with Steffen's position. However, he decides not to go against the CEO whose position is that reducing the inventory this quarter is a discretionary decision and the CEO would prefer to record any such reduction at year end, after Company X completes its anticipated public offering of stock later this year. What are the ethical obligations of Steffen’s in this situation?

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

**Interpretation 102-5 (Applicability of Rule 102 to Members Performing Educational Services)** Educational services (for example, teaching full- or part-time at a university, teaching a continuing professional education course, or engaging in research and scholarship) are professional services as defined in ET section 92.11 and are therefore subject to Rule 102. Rule 102 provides that the member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

**Interpretation 102-6 (Professional Services Involving Client Advocacy)** A member or a member's firm may be requested by a client—
1. To perform tax or consulting services engagements that involve acting as an advocate for the client.
2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.

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

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

**AICPA Interpretations of Rules 201 and 203**

**RULE 201 – GENERAL STANDARDS**

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

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

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

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

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**Case Study**

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

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

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

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**RULE 203 – ACCOUNTING PRINCIPLES**

**Interpretation 203-1 (Departures from Established Accounting Principles)** Rule 203 was adopted to require compliance with accounting principles promulgated by the body designated by Council to establish such principles. There is a strong presumption that adherence to officially established accounting principles would in nearly all instances result in financial statements that are not misleading.

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

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

Examples of events which may justify departures from a principle are new legislation or the evolution of a new form of business transaction. An unusual degree of materiality or the existence of conflicting industry practices are examples of circumstances which would not ordinarily be regarded as unusual in the context of Rule 203.
Interpretation 203-2 (Status of FASB, GASB and FASAB Interpretations)  Council is authorized under Rule 203 to designate bodies to establish accounting principles. Council has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB Statements of Financial Accounting Standards, together with those Accounting Research Bulletins and APB Opinions which are not superseded by action of the FASB, constitute accounting principles as contemplated in Rule 203. Council has also designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities pursuant to Rule 203. Council has also designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities to Rule 203.

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

Interpretation 203-4 (Responsibility of Employees for Preparation of Financial Statements in Conformity with GAAP)  Rule 203 provides, in part, that a member shall not state affirmatively that financial statements or other financial data of an entity are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by Council to establish such principles that has a material effect on the statements or data taken as a whole.

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

AICPA Interpretations of Rules 301 and 302

RULE 301 – CONFIDENTIAL CLIENT INFORMATION

Interpretation 301-3 (Confidential Information and the Purchase, Sale, or Merger of a Practice)  Rule 301 prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client. The rule provides that it shall not be construed to prohibit the review of a member's professional practice under AICPA or state CPA society authorization.
For purposes of Rule 301, a review of a member's professional practice is hereby authorized to include a review in conjunction with a prospective purchase, sale, or merger of all or part of a member's practice. The member must take appropriate precautions (for example, through a written confidentiality agreement) so that the prospective purchaser does not disclose any information obtained in the course of the review, since such information is deemed to be confidential client information.

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

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

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

**RULE 302 – CONTINGENT FEES**

**Interpretation 302-1 (Contingent Fees in Tax Matters)**  This interpretation defines certain terms in Rule 302 and provides examples of the application of the rule.

**Definition of Terms**

(a) Preparation of an original or amended tax return or claim for tax refund includes giving advice on events which have occurred at the time the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a return or claim for refund.

(b) A fee is considered determined based on the findings of governmental agencies if the member can demonstrate a reasonable expectation, at the time of a fee arrangement, of substantive consideration by an agency with respect to the member's client. Such an expectation is deemed not reasonable in the case of preparation of original tax returns.
Examples

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

1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return.

2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case (involving a different taxpayer) or with respect to which the taxing authority is developing a position.

3. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation ($1 million at March 1991) or state taxing authority.

4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests.

5. Requesting, by means of "protest" or similar document, consideration by the state or local taxing authority of a reduction in the "assessed value" of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value.

6. Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute.

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

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

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

A: Yes. These are not prohibited transactions.

**Observation:** There are currently no rules in the 400 series.
AICPA Interpretations of Rules 501, 502 and 505

RULE 501 – ACTS DISCREDITABLE

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

Terminology

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

- **Client provided records** are accounting or other records belonging to the client that were provided to the member by or on behalf of the client.

- **Client records prepared by the member** are accounting or other records (for example, tax returns, general ledgers, subsidiary journals, and supporting schedules such as detailed employee payroll records and depreciation schedules) that the member was engaged to prepare for the client.

- **Supporting records** are information not reflected in the client’s books and records that are otherwise not available to the client with the result that the client’s financial information is incomplete. For example, supporting records include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries) that are produced by the member during an engagement (for example, an audit).

- **Member’s working papers** include, but are not limited to, audit programs, analytical review schedules, and statistical sampling results, analyses, and schedules prepared by the client at the request of the member.

Interpretation

When a client or former client (client) makes a request for client-provided records, client records prepared by the member, or supporting records that are in the custody or control of the member or the member’s firm (member) that have not previously been provided to the client, the member should respond to the client’s request as follows:8

- **Client provided records** in the member’s custody or control should be returned to the client.

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

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8 The member is under no obligation to retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed.
• **Supporting records** relating to a completed and issued work product should be provided to the client, except that such supporting records may be withheld if there are fees due to the member for the specific work product.

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

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

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

• Charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records and require that such fee be paid prior to the time such records are provided to the client;

• Provide the requested records in any format usable by the client;\(^9\) and

• Make and retain copies of any records returned or provided to the client.

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

**Interpretation 501-2 (Discrimination in Employment Practices)** Whenever a member is finally determined by a court of competent jurisdiction to have violated any of the antidiscrimination laws of the United States or any state or municipality thereof, including those related to sexual and other forms of harassment, or has waived or lost his/her right of appeal after a hearing by an administrative agency, the member will be presumed to have committed an act discreditable to the profession in violation of Rule 501.

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

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\(^9\) The member is not required to convert records that are not in electronic format. However, if the client requests records in a specific format and the member was engaged to prepare the records in that format, the client’s request should be honored.
Interpretation 501-3 (Failure to Follow Standards and/or Procedures or Other Requirements in Governmental Audits) Engagements for audits of government grants, government units or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules, and regulations, in addition to generally accepted auditing standards. If a member has accepted such an engagement and undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules and regulations, in addition to generally accepted auditing standards, he is obligated to follow such requirements. Failure to do so is an act discreditable to the profession in violation of Rule 501, unless the member discloses in his report the fact that such requirements were not followed and the reasons therefore.

Interpretation 501-4 (Negligence in the Preparation of Financial Statements or Records) A member shall be considered to have committed an act discreditable to the profession in violation of Rule 501 when, by virtue of his or her negligence, such member –

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

Interpretation 501-5 (Failure to Follow Requirements of Governmental Bodies, Commissions, or Other Regulatory Agencies) Many governmental bodies, commissions or other regulatory agencies have established requirements such as audit standards, guides, rules, and regulations that members are required to follow in the preparation of financial statements or related information, or in performing attest or similar services for entities subject to their jurisdiction. For example, the Securities and Exchange Commission, Federal Communications Commission, state insurance commissions, and other regulatory agencies, such as the Public Company Accounting Oversight Board, have established such requirements.

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

**Acts Discreditable**

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

A CPA firm was required to make contributions to the financial institution that managed the CPA firm’s employee SIMPLE IRA plan no later than the close of the 30 day period following the last day of the month in which amounts would otherwise have been payable to the employee in cash. The CPA firm informed employees that SIMPLE IRA funds would not be deposited by the date required. For a period of two years, the CPA firm did not make timely contributions to the financial institution managing the SIMPLE IRA plan. When the CPA firm deposited the funds, the CPA firm also deposited interest into each employee’s SIMPLE IRA plan.

**Interpretation 501-6 (Solicitation or Disclosure of CPA Examination Questions and Answers)** A member who solicits or knowingly discloses the May 1996 or later Uniform CPA Examination question(s) and/or answer(s) without the written authorization of the AICPA shall be considered to have committed an act discreditable to the profession in violation of Rule 501.

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

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

**Interpretation 501-8 (Failure to Follow Requirements of Governmental Bodies, Commissions, or Other Regulatory Agencies on Indemnification and Limitation of Liability Provisions in Connection With Audit and Other Attest Services)** Certain governmental bodies, commissions, or other regulatory agencies (collectively, regulators) have established requirements through laws, regulations, or published interpretations that prohibit entities subject to their regulation (regulated entity) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators or that provide that the existence of such provisions causes a member to be disqualified from providing such services to these entities. For example, federal banking regulators, state insurance commissions, and the Securities and Exchange Commission have established such requirements.
If a member enters into, or directs or knowingly permits another individual to enter into, a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the member should not include, or knowingly permit or direct another individual to include, an indemnification or limitation of liability provision that would cause the regulated entity or a member to be in violation of such requirements or that would cause a member to be disqualified from providing such services to the regulated entity. A member who enters into, or directs or knowingly permits another individual to enter into, such an agreement for the performance of audit or other attest services that would cause the regulated entity or a member to be in violation of such requirements, or that would cause a member to be disqualified from providing such services to the regulated entity, would be considered to have committed an act discreditable to the profession.


RULE 502 – ADVERTISING AND OTHER FORMS OF SOLICITATION

Interpretation 502-2 (False, Misleading or Deceptive Acts in Advertising or Solicitation) Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that:

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

Public Communications and Advertising

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

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

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

Interpretation 502-5 (Engagements Obtained Through Efforts of Third Parties)

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

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

RULE 505 – FORM OF ORGANIZATION AND NAME

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

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

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

Firm Names

No firm title need name every owner. Such a requirement could become unworkable. The firm may use the names of all or some of the owners. Or the firm may follow the name of one or more owners with designations “Company”, “and Company”, or “associates.” Thus, the firm “Howard, Fine and Howard” could choose instead to describe itself (among other possibilities) as “The Mo Howard Company,” “Mo Howard and Company,” “Howard, Fine and Associates,” or “Fine, Howard and Company.”
The firm name is a valuable asset, protected by law; it represents the professional competence and reliability of each member of the firm, whether the member’s own name is included in the title or not. No wonder the firm is slow to change it – even when individual owners die, retire or strike out on their own.

Rule 505 acknowledges this concern for continuity:

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

Fictitious Names

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

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

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

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

Interpretation 505-1 Deleted.

Interpretation 505-2 (Application of Rules of Conduct to Members Who Own a Separate Business) A member in the practice of public accounting may own an interest in a separate business that performs for clients any of the professional services of accounting, tax, personal financial planning, litigation support services, and those services for which standards are promulgated by bodies designated by Council. If the member, individually or collectively with his or her firm or with members of his or her firm controls the separate business (as defined by generally accepted accounting principles [GAAP] in the United States of America), the entity and all its owners (including the member) and employees must comply with all of the provisions of the Code of Professional Conduct. For example, in applying Rule 503, Commissions and Referral Fees, if one or more members individually or collectively can control the separate business, such business would be subject to Rule 503, its interpretations and rulings. With respect to an attest client, Rule 101 and all its interpretations and rulings would apply to the separate business, its owners and employees.
If the member, individually or collectively with his or her firm or with members of his or her firm, does not control the separate business, the provisions of the Code would apply to the member for his or her actions but not apply to the entity, its other owners and employees. For example, the entity could enter into a contingent fee arrangement with an attest client of the member or accept commissions for the referral of products or services to such attest client.

**Interpretation 505-3 (Application of Rule 505 to Alternative Practice Structures)**

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

The overriding focus of the Resolution is that CPAs remain responsible, financially and otherwise, for the attest work performed to protect the public interest. The Resolution contains many requirements that were developed to ensure that responsibility. In addition to the provisions of the Resolution, other requirements of the Code of Professional Conduct and bylaws ensure that responsibility:

- Compliance with all aspects of applicable state law or regulation.
- Enrollment in an AICPA-approved practice monitoring program.
- Membership in the SEC practice section if the attest work is for SEC clients (as defined by Council).
- Compliance with the independence rules prescribed by Rule 101, Independence.
- Compliance with applicable standards promulgated by Council-designated bodies (Rule 202, Compliance With Standards) and all other provisions of the Code, including, Applicability.

Taken in the context of all the above-mentioned safeguards of the public interest, if the CPAs who own the attest firm remain financially responsible, under applicable law or regulation, the member is considered to be in compliance with the financial interests provision of the Resolution.
CHAPTER 2 – REVIEW QUESTIONS

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

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

1. A potential audit client is owned by the CPA’s stepsister. Which of the following is true regarding Rule 101 (independence):

   a) a stepsister is considered a close relative and would impair independence
   b) a stepsister is not considered a relative and would never impair independence
   c) if the CPA’s relationship to the stepsister is very close, independence may be impaired
   d) none of the above

2. A CPA represents two clients. The clients have adverse interest involving a limited partnership of which both clients own a percentage. Which of the following is true regarding Rule 102:

   a) the CPA lacks independence and may not do any work for either of the clients
   b) the CPA lacks independence and must cease working for one of the clients
   c) although the CPA has a conflict of interest, he may continue working for both clients provided: 1) the work performed does not require independence, and 2) the relationships are disclosed to and consent is obtained from all appropriate parties
   d) none of the above

Use the following fact pattern for the next 4 questions

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

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

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

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

5. Jones decides to prepare his current year tax return himself. Jones demands that Smith provide a copy of Jones’s prior year tax return and the depreciation workpapers for the current year that Smith prepared for Jones’s current year tax return. Which of the following is true:

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

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

a) probably nothing; problems like this occur in business and are simply a fact of life
b) use an engagement letter to outline the obligations and expectations of both client and CPA
c) communicated with each other before the problem arose
d) both b and c would have helped
CHAPTER 2 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. A stepsister is not automatically considered a close relative.

   B: Incorrect. A stepsister could be a close relative.

   **C: Correct.** Independence is impaired only if the relationship is close.

   D: Incorrect. Independence may be impaired.

   (See Interpretation 101-1 in the course material.)

2. A: Incorrect. The clients have the adverse interest, not the CPA.

   B: Incorrect. A CPA may do work for two clients with adverse interests.

   **C: Correct.** The clients are better served by allowing the CPA to continue serving them both.

   D: Incorrect. The CPA has a conflict but may continue working for both clients.

   (See Interpretation 102-2 in the course material.)

3. A: Incorrect. The AICPA has extensive rules relating to CPA workpapers and the return of client records. In fact, failure to return client records is one of the most common complaints received by the AICPA ethics committee.

   B: Incorrect. Prior to being released, the completed tax return is considered to be part of the CPA’s workpapers and is the property of the CPA. Accordingly, the tax return need not be released to the client. The CPA may set the terms for releasing the tax return. Such terms may include receiving payment for some or all fees. The client has no right to demand the release of the return prior to paying fees as required by the CPA.

   C: Incorrect. Prior to being released, the completed tax return is considered to be part of the CPA’s workpapers and is the property of the CPA. Accordingly, the tax return need not be released to the client. The CPA may set the terms for releasing the tax return. Such terms may include receiving payment for some or all fees. The client has no right to pay only a portion of the fees and demand release of the tax return.

   **D: Correct.** Prior to being released, the completed tax return is considered to be part of the CPA’s workpapers and is the property of the CPA. Accordingly, the tax return need not be released to the client. The CPA may set the terms for releasing the tax return. Such terms may include receiving payment for some or all fees.

   (See Rule 501 and Interpretation 501-1 in the course material.)
4. A: Incorrect. Rule 501 requires the return of all client provided records upon request. Client provided records may not be withheld pending payment of current or prior engagement fees.

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

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

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

(See Interpretation 501-1 in the course material.)

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

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

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

(See Interpretation 501-1 in the course material.)

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

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

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

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

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

(See Rule 501 in the course material.)
CHAPTER 3: FLORIDA RULES AND STATUTES

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

- Discuss the Florida Board rules and statutes.
- Differentiate between the Florida rules and the AICPA Code of Professional Conduct.

RULES OF THE DEPARTMENT OF BUSINESS AND PROFESSIONAL REGULATION: BOARD OF ACCOUNTANCY (CHAPTER 61H1)

The following discussion includes significant rules of the Board of Accountancy related to ethics.

CHAPTER 61H1-21
INDEPENDENCE, INTEGRITY & ETC.

61H1-21.001 Independence

(1) A licensed firm shall not express an opinion on financial statements (as that term is defined in the Standards for Independence) of an enterprise or on the reliability of an assertion by one party for use by another (third) party unless the firm is independent with respect to such enterprise or the party making the assertion. A licensed firm is also precluded from expressing such an opinion if the firm is aware that an individual in the firm is not independent and that individual is a covered licensee or is otherwise required to be independent. A licensed individual shall not express such an opinion unless the individual is independent with respect to such enterprise or the party making the assertion. A licensed individual is also precluded from expressing such an opinion unless the individual is independent with respect to such enterprise or the party making the assertion. A licensed individual is also precluded from expressing such an opinion unless the individual or she is aware that an individual in the firm is not independent and that individual is a covered licensee or is otherwise required to be independent. All covered licensees and all other individuals who are required to be independent are required to disclose to the firm that they are not independent prior to the issuance of such an opinion; failure to do so is a violation of this rule. All firms are required to adopt appropriate policies to implement the disclosure requirement and to monitor compliance therewith.

(2) In order to delineate the standards against which a licensee’s independence or lack thereof is to be judged, the Board has created a document entitled "Standards for Determining Independence in the Practice of Public Accountancy for CPAs Practicing Public Accountancy in the State of Florida" (effective 5-1-2003) (hereinafter "Standards for Independence") which document is hereby incorporated by reference in this Rule. The standards contained in the "Standards for Independence" are similar to those contained in the Code of Professional Conduct promulgated by the American Institute of Certified Public Accountants.

NOTE: The complete "Standards for Determining Independence in the Practice of Public Accountancy for CPAs Practicing Public Accountancy in the State of Florida" is provided later in this chapter.
(3) In order to be considered independent a licensee must comply with the requirements set out in the "Standards for Independence" and the requirements of this rule.

**Board Opinion**

The Board of Accountancy was asked to consider the following scenario:

A Florida CPA provides bookkeeping, accounting and tax services for a Condominium Association ("Association"). The Association has several employees. Monthly homeowner maintenance receipts are deposited directly to a lockbox. The CPA makes some deposits and inter-account transfers on behalf of the Association as necessary. All disbursements are originated and executed by the Association through the use of a common software program that generates checks and an electronic file of disbursement data. The CPA provides daily deposit and any transfer information electronically to the Association. This information provides deposit control totals for the Association. Similarly, the CPA provides a monthly Bank Reconciliation Report for each bank account. Disbursement data is retrieved electronically from the Association by the CPA and combined with deposit information to create the Association monthly account records. The CPA provides monthly account details and Compiled Financial Statements for the monthly Association meetings and may offer pro-active guidance on financial matters such as financing options for vendor contracts.

The Board concluded that the CPA would not be independent to perform a review of the Association’s year-end financial statements.

**61H1-21.002 Integrity and Objectivity**

A certified public accountant shall not knowingly misrepresent facts, and, when engaged in the practice of public accounting, shall not subordinate his judgment to others including but not limited to clients, employers or other third parties. In tax practice, a licensee may resolve doubt in favor of his client as long as there is reasonable support for his position.

**Case Study**

**Integrity and Objectivity**

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

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

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

While Brown CPA represented the couple, Brown CPA was also representing Mr. Taylor with services that were related to the divorce proceedings. These separate services were adversarial to Mrs. Taylor.
Brown CPA did not request permission of Mrs. Taylor to represent only Mr. Taylor. Brown CPA accepted the engagement with Mr. Taylor even though it was adverse to Mrs. Taylor.

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

**POSSIBLE BOARD ACTION:** Violation of 61H1-21.002 Integrity and Objectivity.

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**Case Study**

**Integrity**

White, CPA prepared Smith’s 2007 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 2007 tax return. Smith knew at the time that she paid for ETS that she would not use White’s services again.

Smith’s 2007 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 61H1-21.002 Integrity and Objectivity.

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**61H1-21.003 Commission or Referral Fees**

(1) A CPA shall not pay or accept a commission or referral fee in connection with the sale of a product or referral of any services as defined in Section 473.302(7)(a), F.S. or prohibited to non-CPAs as listed in Section 473.322, F.S. These services include:

(a) Audit, review or compilation services.

(b) Services for any prospective financial data including forecasts or projections.

(c) Any special procedures engagement resulting in an expression of an opinion when the services fall within the definitions as set forth in Section 473.302(7)(a) and Section 473.322, F.S.

(2) The CPA must have an engagement letter signed by the client prior to beginning any engagement for which the CPA will receive a commission. The letter must include
complete details of the financial arrangements involving compensation for the services rendered.

(3) The CPA must hold appropriate licenses as required.

(4) If the CPA is not independent as described in 61H1-21.001, F.A.C., it must be disclosed in the engagement letter. However, if the only reason for not being independent is the fact that the Certified Public Accountant is being compensated by a commission or contingent fee then the lack of independence does not have to be disclosed.

**Observation / Board Opinion**

In many cases, it is permissible for an accounting firm to earn a commission or a referral fee, even where a product or service is being provided to clients. The key is providing adequate disclosure.

A Florida firm was considering reselling computer software to audit clients, to clients for whom they did not provide attestation services, and to non-clients. For this reselling, the firm would earn a commission/referral fee. The firm asked the Board of Accountancy whether this would violate either the Florida statute or the Board of Accountancy Rules.

F.S. Chapter 473.3205 states:

A licensee may not accept or pay a commission or referral fee in connection with the sale or referral of public accounting services as defined in s.473.302 (7)(a) and (c). Any certified public accountant or business that is engaged in the practice of public accounting and that accepts a commission for the sale of a product or service to a client must disclose that fact to the client in writing in accordance with rule adopted by the board. In interpreting Rule 61H1-21.003, the Board of Accountancy concluded that it is permissible for a Florida CPA firm to resell computer software to clients and to non-clients and earn a commission or referral fee so long as the firm makes all of the necessary disclosures required by 61H1-21.003 to their clients.

**61H1-21.005 Contingent Fees**

(1) A licensee shall not accept a fee contingent upon the findings or results of such services if the service is of the type for which a commission or referral fee could not be accepted (See Rule 61H1-21.003).

(2) A licensee shall not accept a contingent fee for tax filings with the federal, state, or local government unless the findings are those of the tax authorities and not those of the licensee. Unless the licensee has specific reason to know that the filing will be reviewed in detail by the taxing authorities, the findings will be presumed to be those of the licensee and a contingent fee is not permissible. An original or amended federal tax return or a claim for refund cannot be prepared for a contingent fee since the findings are not considered to be those of the taxing authority. If the taxing authority has begun an audit, any findings will be considered those of the taxing authority and a contingent fee may be accepted. Fees to be fixed by courts or other public authorities, which are of an indeterminate amount at the time a public accounting service is undertaken, shall not
be regarded as contingent fees for the purposes of this rule. However, a licensee’s fee may vary depending, for example, on the complexity of the service rendered.

**Comparison with AICPA**

This rule is similar to AICPA Rule 302 governing the payment of contingent fees. The AICPA rule prohibits the payment of a contingent fee in all cases for the preparation of an original or amended tax return as well as the following situations: (1) an audit or review of a financial statement; (2) a compilation of a financial statement when it will be used by a third party and the compilation does not disclose a lack of independence; and (3) an examination of prospective financial information.

**Commissions, Contingent Fees & Referral Fees**

The preceding rules 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.

**61H1-21.006 Communication with Client of Another Licensee**

If a client of one licensee requests a second licensee to provide professional advice on accounting or auditing matters in connection with an expression of opinion, the second licensee must consult with the first licensee, after obtaining the client’s consent, to make certain that he (the second licensee) is aware of all the relevant facts.
CHAPTER 61H1-22
COMPETENCE AND TECHNICAL STANDARDS

61H1-22.001 Competence (General Standards)

A licensee shall comply with the following general standards and must justify any departures therefrom.

(1) Professional competence. A licensee shall undertake only those engagements which he or his firm can reasonably expect to complete with professional competence. A CPA must be in charge of all public accounting services performed by the firm.

(2) Due professional care. A licensee shall exercise due professional care in the performance of an engagement.

(3) Planning and supervision. A licensee shall adequately plan and supervise an engagement.

(4) Sufficient relevant data. A licensee shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to an engagement.

Case Study

Competence and Technical Standards

Brown prepared Client’s 2007 tax returns and calculated that Client would receive a $6,000 tax refund from Arizona, owe $7,000 in taxes to Florida, and owe $6,500 in taxes to Internal Revenue Service. Client took tax information to another Certified Public Accountant who completed the returns and made the following determination: Client would receive a $10,000 refund from Arizona, owe $6,000 to Florida, and owe $5,500 to IRS.

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

LIKELY BOARD ACTION: Violation of 61H1-22.001Competence.

Case Study

Competency and Technical Standards

Able Accountants, CPAs (Firm) audited XYZ Company in 2005 and 2006. 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 2006, 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 2005 through 2007 and had a stockholders’ deficit of $109 million at the end of September 2007. ABC Company filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. The 2007 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 2005 and 2006 and issued unqualified opinions for both years.

**LIKELY BOARD ACTION:** Violations of Generally Accepted Auditing Standards in both 2005 and 2006.

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**CHAPTER 61H1-23**  
**RESPONSIBILITIES TO CLIENTS**

**61H1-23.001 Confidential Client Information**

A certified public accountant shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. This rule shall not be construed to relieve a certified public accountant of his obligation under Rules 61H1-22.002 and 22.003 or to contravene or contradict any of the provisions of 473, F.S. Furthermore, this rule shall not prohibit a confidential review of a certified public accountant's professional practice as a part of a quality review program.

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

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

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

**61H1-23.002 Records Disposition Responsibility**

1) A licensee shall furnish to a client or former client within a reasonable time after request of the document the following if they are in the licensee's possession or control at the time of the request: Any accounting or other records belonging to the client which the licensee may have had occasion to remove from client's premises, or to receive for the client's account, including records prepared as part of the service to the client which would be needed to reconcile to the financial statements or tax return prepared and issued by the certified public accountant. If the tax return or financial statement have not been issued, the certified public accountant must only return records received from the client, but this shall not preclude the licensee from making copies of such documents when same form the basis of work done by the licensee.
(2) This rule shall not preclude a licensee from making reasonable charges for costs incurred. A licensee shall not withhold those items contemplated above under any circumstances following a demand for same from the client.

(3) Provisions of this rule apply to Licensed Audit Firms and to all Certified Public Accountants practicing public accounting.

**Observation / Board Opinion**

While CPAs have an obligation to provide records to their clients, the Florida rules do not mandate them to retain records of former clients. The Board made this clear in response to the following inquiry:

A Florida limited liability partnership will be dissolved. One partner is retiring from public accounting, one partner is becoming a sole practitioner and the third partner along with a former partner will form a new practice. Each partner plans to retain the files and work papers of the current clients retained by him.

1. Since the existing partnership is dissolving, what happens to the tax, audit, correspondence, billing and other work papers files of former clients who either left the firm over the past several years or clients not retained by any of the partners?
2. Who has the responsibility of maintaining the former client files if they must be retained?
3. If they must be retained, how long must the former client files be retained?

The board concluded that the rules do not require retention of files. Therefore, the firm is free to dispose of them as they see fit providing they ensure confidentiality is not breached. However, the Board cautioned that they may want to consider the possible need for documentation should a complaint be filed with the Department of Business and Professional Regulation.

**Client Records and Working Papers**

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

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

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

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

**Explanation:** If the CPA 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.
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.

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 to adjust and close the general ledger. In that event, copies of both adjusting entries, with explanations and any supporting papers, and closing entries would be provided to the client.

If the client does not have a general ledger and only provides the CPA with transaction summaries that the CPA 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 prepared the fixed asset depreciation schedule because the client does not have one, or because the CPA adjusted the client’s schedule, a copy must be provided.

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

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

<table>
<thead>
<tr>
<th>Investments</th>
<th>Accounts payable</th>
<th>Prepaid expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued liabilities</td>
<td>Owner’s equity</td>
<td>Current portion of long-term debt</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>Bad debts</td>
<td>Income tax expenses and payable</td>
</tr>
</tbody>
</table>

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

CHAPTER 61H1-24
ADVERTISING

61H1-24.001 Advertising

(1) No licensee shall disseminate or cause the dissemination of any advertisement or advertising which is in any way fraudulent, false, deceptive, or misleading, if it, among other things:

(a) Contains a misrepresentation of facts; or

(b) Makes only a partial disclosure of relevant facts; or

(c) Creates false or unjustified expectations of beneficial assistance; or

(d) Appeals primarily to a layperson’s fears, ignorance, or anxieties regarding his state of financial well-being; or

(e) Contains any representation or claims, as to which the licensee, referred to in the advertising, does not expect to perform; or

(f) Contains any other representation, statement, or claim which misleads or deceives; or

(g) In the event that a licensee uses the term "specialty" or "specialist" or any other term tending to indicate an advanced standing in any aspect of the practice of public accountancy, in any advertisement or offering to the public, the advertisement must state that the use of the term is a self-designation and is not sanctioned by the state or federal government. This requirement shall not apply to any statement indicating the licensee has received any bona fide formal recognition or attainment; or
(h) Represents that professional services can or will be competently performed for a stated fee when this is not the case, or makes representations with respect to fees for professional services that do not disclose all variables affecting the fees that will in fact be charged; or

(2) As used in 473.302(6), F.S., and the rules of the Board, the terms "advertisement," "advertising" and "advertising as a part of a licensee's business activities" shall mean:

(a) Any statements, oral or written, disseminated to or before the public or any portion thereof, with the intent of furthering the purpose, either directly or indirectly, of selling public accounting services, or offering to perform public accounting services, or including members of the public to enter into any obligation relating to such public accounting services. For purposes of this rule, oral or written statements include:

1. Business cards
2. Letterhead
3. Signs
4. Listings in telephone and other media or communication directories
5. Display of certificate or license from this or any other state
6. Business reports
7. Transmittal letters or other written communication issued or associated with accompanying financial statements
8. Brochures
9. Forms filed with state and federal regulatory agencies
10. Press releases
11. Paid promotional listing in any media
12. Display of membership in CPA associations
13. Listings in professional directories
14. Presentation during court proceedings
15. Website, email, or any other electronic communication

(b) "Advertisement," "advertising" and "advertising as a part of a licensee's business activities" as defined terms by this rule does not include:

1. Verbal statements in a social context
2. Use of the designation by faculty members in an educational institution when functioning in the capacity of a faculty member, and
3. Use of the designation by authors when used only for identification as authors of books, articles or other publications, provided that such publications do not offer the performance of services or the sale of products (other than books, articles or other publications).
Case Study
Advertising


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 61H1-24.001 Advertising.

61H1-24.002 Solicitation

(1) A licensee may respond to any request for a proposal to provide public accounting services and may provide such services to those requesting same.

(2) A licensee may solicit an engagement to perform public accounting services provided the licensee complies with 61H1-24.001 and provided the licensee does not use coercion, duress, compulsion, intimidation, threats, or conduct that is overreaching, or vexatious or harassing.

(3) Any form of written communication to a potential client, invited or not, is permissible under this rule provided such communication conforms to the advertising guidelines of Rule 61H1-24.001.

**Observation / Board Opinion**

The Board of Accountancy has applied the definition of “advertising” contained in this rule very broadly. For example, a CPA asked the Board of Accountancy in 2000 whether a business card is really “advertising” and therefore must contain certain disclosures. The Board replied that any oral or written statements can be considered advertising, including business cards and listings in telephone and other media or communication directories. The issues in this case arose when a CPA who had attained the designation “Certified Specialist in Estate Planning” wished to use the “CSEP” designation on his business card without the disclosures mandated by 61H1-24.001(1)(g), above. When in doubt, therefore, licensees should assume that their proposed written or oral statements about themselves constitute advertising and must comply with all of the requirements of the rules in this chapter.

**CHAPTER 61H1-25**
**RESPONSIBILITY FOR OTHER PERSONS**

61H1-25.001 Responsibility for other persons

A licensee shall not permit others to carry out on his behalf, either with or without compensation, acts which, if carried out by the licensee would place him in violation of Chapters 455 and 473, F.S., or rules promulgated thereto.
CHAPTER 61H1-26
NAMES, TERMS, BRANCH OFFICES

61H1-26.001 Form of Practice and Name-Shared Office Space

(1) A certified public accountant may practice public accounting, whether as an owner or employee, only in the form of a proprietorship, a partnership or a professional corporation, or a limited liability company. A certified public accountant shall not allow any person to practice in his name that is not a partner or shareholder with him or in his employ. A certified public accountant shall not practice under a name which is misleading or deceptive as to the legal form of the firm or as to persons who are partners, officers, or shareholders of the firm or as to any other matter. In this regard:

(a) A licensee may practice public accounting under a fictitious name which is not misleading or deceptive as to the persons who are sole proprietors, partners, officers or shareholders; and

(b) A firm name may include the names of retired or deceased partners or shareholders or members who were active partners or shareholders or members of the entity. The provision permits a firm, in the same line of succession, to change from one form of business to another and continue to use the names of retired or deceased partners or shareholders or members.

(c) Use of the term "and Company" or "and Associates" requires at least one other fully employed licensee or non-CPA owner other than those named in the firm name; however, this rule does not preclude a licensee initially meeting this requirement from using the above-mentioned terms if the licensee subsequently does not fully employ at least one licensee other than those named in the firm name.

(d) A firm may use the term “Certified Public Accountants” in the firm’s name if all owners are CPAs. If there are non-CPA owners, the firm may use the terms “CPA Firm”, “CPAs and Associates” or “Certified Public Accountants and Associates” provided the firm has more than one CPA. Further, a CPA firm with non-CPA owners may not use the term Certified Public Accountants without indicating there are other owners such as Associates or Consultants.

(2) The term "certified public accountant(s)" or the abbreviation "CPAs" must appear with the name of the certified public accountant when used in connection with the expression of opinion.

(3) Certified Public Accountants may share office facilities provided there is adequate disclosure that would enable a reasonable person to determine the practice is not associated with the profession or occupation not regulated by the Board, such as written agreements, signs, etc.
**Question:** Bob Jones is a sole practitioner who employs a part-time secretary who is not a CPA. May Bob Jones use the firm "Bob Jones and Company, Certified Public Accountants?"

**Answer:** No. Bob Jones has violated the rules in two ways. First, the use of “and company” implies more than one CPA. Because the secretary is not a CPA, the plural designation is not permitted.

61H1-26.002 Minimum Capitalization or Adequate Public Liability Insurance for Public Accounting Corporations, Limited Liability Companies (LLCs) and Partnerships (LLPs).

A public accounting corporation, LLC, or LLP shall not engage in the practice of public accounting in this state unless:

(1) Assets in excess of liabilities and professional liability insurance combined are at least equal to $50,000 per shareholder, officer, member, or partner and any Florida licensed CPA to a maximum of $2,000,000, or

(2) It has an irrevocable letter of credit which meets the following criteria:

(a) The responsibility for repayment of any sums disbursed under the letter of credit is not an obligation of the CPA firm, its owners, or any entity affiliated with the CPA firm;

(b) The letter of credit contains an “evergreen clause,” which automatically renews the letter of credit unless the issuer of the letter of credit notifies the CPA firm and the Board within sixty (60) days of the decision not to renew; and

(c) The letter of credit is issued by a financial institution authorized to do so under applicable state or federal banking laws; or

(3) The corporation, each shareholder, and each officer who has authority over the practice of public accountancy, the LLC or the limited liability company and each member of the LLC, or the LLP and each partner have executed the waiver of limitation on liability approved by the Board which must be set forth as follows:

**WAIVER ON LIMITATION OF LIABILITY**

The shareholders, officers, members, or partners of ____ (name of firm), do jointly and severally covenant and agree that they will pay any award or judgment arising out of any claim the basis of which is grounded upon an allegation of negligence, incompetence, misconduct, fraud or deceit in the firm’s or its owners’, officers’, members’, or employees’ practice of public accounting as soon as the same shall become payable regardless of any limitation on liability provided by Chapter 621 and Chapter 608, and Chapter 620, F.S. (1985). Unless executed by a partnership and its partners, the members intend this agreement as a mutual covenant of assumption and not as a partnership, but should any court of competent jurisdiction construe same to be a partnership then it is the intention of the parties that such partnership be limited in scope to the uses for which this contract is executed and no other. Any individual who,
subsequent to the date of this instrument, becomes a shareholder, officer, member, or partner in ____ (name of firm), shall immediately become a party to this waiver and be bound to the conditions thereof. Said shareholder, officer, member, or partner shall execute an amended Waiver on Limitation of Liability which shall become a part of the original Waiver on Limitation of Liability. We the undersigned shareholders, officers, members, or partners in ____ (name of firm), do hereunto set our hands and seals to certify our acceptance of the Waiver on Limitation of Liability dated this _____ day of ____, 19__.

___________________________  _______________________
___________________________  _______________________
___________________________  _______________________
___________________________  _______________________
(Signatures of all shareholders, officers, members, or partners)

(4) For purposes of subsection 61H1-26.002(1), F.A.C., financial statements prepared to substantiate the excess of assets over liabilities must be submitted to the Board with the application for licensure. These financial statements must be prepared in accordance with generally accepted accounting principles and work-in-process may be considered as an unbilled receivable together with an appropriate evaluation allowance.

<table>
<thead>
<tr>
<th>Comparison with AICPA Rules</th>
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<td>The AICPA has no similar rule mandating minimum capitalization of CPA firms.</td>
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61H1-26.003 Licensure of Firm Names

Every firm practicing public accounting in Florida shall be certified for licensure by the Board on a biennial basis, and shall furnish its firm name, address and telephone numbers of main office and any branch offices in Florida as well as the names of all licensed professional staff and all non-licensed owners. The firm must also disclose whether any non-CPA owners have convictions or findings of guilt, regardless of adjudication, of a crime in any jurisdiction and judgment or settlements of civil lawsuits (excluding domestic matters), or having been acted against including denial of licensure by any regulatory agency by a court or regulatory agency and other matters which show a lack of good moral character. (Good moral character is defined in Section 473.306(4)(a) F.S.).

61H1-26.004 Licensure of Changes by Firms

(1) A firm licensed pursuant to Rule Chapter 61H1-26.003, shall file a written notification with the Department within thirty (30) days after the occurrence of any of the following events:

(a) the admission or addition of a non-CPA co-partner, shareholder or member in any Florida office; including whether any non-CPA co-partners, shareholders or members have convictions or findings of guilt, regardless of adjudication, of a crime in any jurisdiction; judgment or settlements of civil lawsuits (excluding domestic matters); having been acted against including denial of licensure, by any regulatory agency or by a court; and any other matters which show a lack of good moral character as defined in Section 473.306(4)(a)F.S.;
(b) the admission or addition of a CPA co-partner, shareholder or member in any Florida
office, including whether any CPA co-partners, shareholders or members have
convictions or findings of guilt, regardless of adjudication, of a crime in any jurisdiction;
judgment or settlements of civil lawsuits (excluding domestic matters); having the right to
practice acted against, including denial of licensure, by the Securities Exchange
Commission (SEC), Internal Revenue Service (IRS), or any other regulatory agency or
court; and any other matters which show a lack of good moral character as defined in
Section 473.306(4)(a), F.S.;

(c) the retirement or death of a co-partner or shareholder in any Florida office;

(d) a change in the name of the partnership, corporation or limited liability company;

(e) the termination of the partnership, corporation or limited liability company.

(f) when the firm or any existing CPA or Non-CPA co-partner, shareholder or member
has been the recipient of a conviction or finding of guilt, regardless of adjudication, of a
crime in any jurisdiction; has been the subject of a judgment or settlements of a civil
lawsuit (excluding domestic matters; has had the right to practice public accountancy
acted against, including denial of licensure, by the Securities Exchange Commission
(SEC), Internal Revenue Service (IRS), or any other regulatory agency or court; and any
other matters which show a lack of good moral character as defined in Section
473.306(4)(a), F.S.

(2) In the event of the formation of a new partnership, corporation or limited liability
company or a change in the name of a partnership, corporation or limited liability
company, such partnership, corporation or limited liability company shall within thirty (30)
days of the event, become certified for licensure by the Board in accordance with Rule
61H1-26.003 and pay the license fee required by Rule 61H1-31.001(5) and (6).

CHAPTER 61H1-36
DISCIPLINE

61H1-36.004 Disciplinary Guidelines; Range of Penalties; Aggravating and
Mitigating Circumstances

(1)(a) The Board sets forth below a range of disciplinary guidelines from which
disciplinary penalties will be imposed upon practitioners guilty of violating Chapter 473,
F.S. The purpose of the disciplinary guidelines is to give notice to licensees of the range
of penalties which will normally be imposed upon violations of particular provisions of
Chapter 473. The disciplinary guidelines are based upon a single count violation of each
provision listed. Multiple counts of violations of the same provision of Chapter 473 or the
rules promulgated thereto, or other unrelated violations contained in the same
administrative complaint will be grounds for enhancement of penalties. All penalties at
the upper range of the sanctions set forth in the guidelines i.e., suspension, revocation,
etc., include lesser penalties, i.e., fine, probation or reprimand which may be included in
the final penalty at the Board's discretion.

(b) Standard probationary terms will include, as applicable, a review of the licensee's
practice, including analysis of selected financial statements (including working papers),
restriction of the scope of the licensee's practice and review of internal controls put in
place by the licensee in order to eliminate the violation. All of the above will usually include the use of a CPA consultant employed by the Department of Business and Professional Regulation or approved by the Board and will usually require the licensee to assume the cost of the consultant's activities. Additional continuing education may also be required of a licensee where deficiencies in a particular practice area are noted. In all cases of probation or suspension a report showing compliance with the terms of the final order must be received and accepted by the Board prior to the termination of the probation or suspension. Other specific terms of probation or suspension may be imposed, as necessary, by the Board.

(2) The complete listing of disciplinary guidelines can be found on the Board’s website at http://www.state.fl.us/dbpr/cpa/rules_statutes/laws_and_rules_book.pdf.

(3) The Board shall be entitled to deviate from the above mentioned guidelines upon a showing of aggravating or mitigating circumstances by clear and convincing evidence presented to the Board prior to the imposition of a final penalty.

(a) Aggravating circumstances; circumstances which may justify deviating from the above set forth disciplinary guidelines and cause the enhancement of a penalty beyond the maximum level of discipline in the guidelines shall include but not be limited to the following:

1. History of previous violations of the Practice Act and the rules promulgated thereto.
2. In the case of negligence; of the magnitude and scope of the engagement and the damage inflicted upon the general public by the licensee's misfeasance.
3. Evidence of violation of professional Practice Acts in other jurisdictions wherein the licensee has been disciplined by the appropriate regulatory authority.
4. Violation of the provision of the Practice Act wherein a letter of guidance as provided in F.S. 455.225(3) has previously been issued to the licensee.
5. Multiple convictions of violations of the same provision of Chapter 473, F.S., or the rules promulgated thereto contained in the same administrative complaint.

(b) Mitigating circumstances; circumstances which may justify deviating from the above set forth disciplinary guidelines and cause the lessening of a penalty beyond the minimum level of discipline in the guidelines shall include but not be limited to the following:

1. In cases of negligence, the minor nature of the engagement in question and lack of danger to the public health, safety and welfare resulting from the licensee's misfeasance.
2. Lack of previous disciplinary history in this or any other jurisdiction wherein the licensee practices his profession.
3. Restitution of any damages suffered by the licensee's client.
4. The licensee's professional standing among his peers including continuing education.
5. Steps taken by the licensee or his firm to ensure the non-occurrence of similar violations in the future.

6. The degree of financial hardship incurred by a licensee as a result of the imposition of fines or the suspension of his practice.

7. Cooperation with the Department of Business and Professional Regulation and the Board including understanding and admission of the violation by the Respondent.

61H1-36.005 Citations

(1) Pursuant to Section 455.224, F.S. (1991), the Board sets forth in (3) of this rule those violations for which there is no substantial threat to the public health, safety and welfare; or, if there is a substantial threat to the public health, safety and welfare, such potential for harm has been removed prior to the issuance of the citation. Next to each violation is the fine to be imposed.

(2) Prior to issuance of the citation, the Department must confirm that the violation has been corrected or is in the process of being corrected. If the violation is a substantial threat to the public health, safety and welfare, such potential for harm must be removed prior to issuance of the citation.

(3) The following violations with accompanying fines may be disposed of by citation:

(a) Practicing on inactive license (Section 473.323(1)(i), F.S.) Reprimand and fine based on length of time in practice while inactive; $100/month or $5,000 maximum (penalty will require licensure or cease practice).

(b) Licensees practicing in an unlicensed firm (including sole proprietors) Reprimand and $100 per month fine to or otherwise in violation of Sections 473.309, 473.3101, and 473.323(1)(g), F.S. maximum of $5,000 and suspension of right to practice until corrected.

(c) Licensees who complete continuing professional education requirements timely but who are found deficient after December 1st of their renewal year (subsection 61H1-33.003(5), F.A.C.) Submit documentation that deficient hours have been completed and pay $50 fine within 60 days.

(d) Licensees who fail to timely submit complete documentation for a CE audit fined $100 per month

(4) Once the citation becomes a final order, the citation and complaint become a public record pursuant to Chapter 119, F.S., unless otherwise exempt from the provisions thereof. The citation and complaint may be considered as aggravating circumstances in future disciplinary actions pursuant to paragraph 61H1-36.004(3)(a), F.A.C.
(5) The procedures described herein apply only for an initial offense of the alleged violation. Subsequent violation(s) of the same rule or statute shall require the procedures of Section 455.225, F.S., to be applied. In addition, should an initial offense for which a citation could be issued occur in conjunction with violations not described herein, then the procedures of Section 455.225, F.S., shall apply.

**FLORIDA INDEPENDENCE RULES**

In early 2002, the Florida Board of Accountancy established a seven-member task force charged with reviewing and recommending changes to Florida’s independence rules for CPAs.

The task force was charged with examining a number of issues, including conflicts of interest, internal audit services, tax services and consulting, as well as the AICPA’s independence interpretations as defined under Section 101 (discussed in detail in Chapters 1 and 2 of this course). The primary focus was to keep the Florida rule as consistent with the AICPA’s independence standards as possible. The final rule text was submitted by the Board of Accountancy on May 1, 2003, for certification by the Joint Administrative Procedures Committee. The rule, the text of which is provided below, became effective on May 21, 2003.

### STANDARDS FOR DETERMINING INDEPENDENCE

**Note:** If you do not practice public accountancy, you may wish to skim this section.

**Section 101-1. Independence-General Provisions**

Independence shall be considered to be impaired if:

1. During the period of the professional engagement a covered licensee:
   a. Had or was committed to acquire any direct or material indirect financial interest in the client.
   b. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and
      • The covered licensee had the authority to make (individually or with others) investment decisions for the trust or estate; or
      • The trust or estate owned or was committed to acquire more than 10 percent of the client’s outstanding equity securities or other ownership interests; or
      • The value of the trust’s or estate’s holdings in the client exceeded 10 percent of the total assets of the trust or estate.
   c. Had a joint closely held investment that was material to the covered licensee.
   d. Except as specifically permitted in Section 101-5 herein, had any loan to or from the client, any officer or director of the client, or any individual owning ten percent or more of the client’s outstanding equity securities or other ownership interests.
(2) During the period of the professional engagement, a firm, a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than five percent of a client’s outstanding equity securities or other ownership interests.

(3) During the period covered by the financial statements or during the period of the professional engagement, a partner or professional employee of the firm was simultaneously associated with the client as a(n)

(a) Director, officer, or employee, or in any capacity equivalent to that of a member of management;

(b) Promoter, underwriter, or voting trustee; or

(c) Trustee for any pension or profit-sharing trust of the client.

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

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

(1) Participated on the attest engagement team or was an individual in a position to influence the attest engagement for the client when the attest engagement covers any period that includes his or her former employment or association with that client; or

(2) Was otherwise a covered licensee with respect to the client unless the individual first dissociates from the client by

(a) Terminating any relationships with the client described in Subsection 101-1(1)(c);

(b) Disposing of any direct or material indirect financial interest in the client;

(c) Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under Section 101-5.

(d) Ceasing to participate¹ in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and

¹ If a licensee participates in or receives benefits from a health and welfare plan (“the plan”) sponsored by a client and that licensee is a covered licensee then that covered licensee’s participation in a plan sponsored by a client would impair independence with respect to the client sponsor and the plan. However, if the covered licensee’s participation in the plan, or benefits received thereunder, arises as a result of the permitted employment of the covered licensee’s immediate family, independence would not be considered to be impaired provided that the plan is normally offered to all employees in equivalent employment positions.
(e) Liquidating or transferring all vested benefits in the client’s defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty\(^2\) significant to the benefits is imposed upon liquidation or transfer.

**Application of the Independence Rules to a Covered Licensee’s Immediate Family**

Except as stated in the following paragraph, a covered licensee’s immediate family is subject to Rule 61H1-21.001 and these Standards.

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

(1) An individual in a covered licensee’s immediate family was employed by the client in a position other than a key position.

(2) In connection with his or her employment, an individual in the immediate family of one of the following covered licensees participated in a retirement, savings, compensation, or similar plan that is a client, is sponsored by a client, or that invests in a client (provided such plan is normally offered to all employees in similar positions):

(a) A partner or manager who provides ten or more hours of non-attest services to the client; or

(b) Any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement.

For purposes of determining materiality under this Rule the financial interests of the covered licensee and his or her immediate family should be aggregated.

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

Independence would be considered to be impaired if:

(1) An individual participating on the attest engagement team has a close relative who had

(a) A key position with the client, or

(b) A financial interest in the client that

- Was material to the close relative and of which the individual has knowledge; or
- 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

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\(^2\) A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.
(a) A key position with the client; or

(b) A financial interest in the client that

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

Other Considerations

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

Section 101-2. Employment or Association with Attest Clients

A firm’s independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all of the following conditions are met:

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may be adjusted for inflation and interest may be paid on amounts due.

2. The former partner or professional employee is not in a position to influence the accounting firm’s operations or financial policies.

3. The former partner or professional employee does not participate in or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:

   - The individual provides consultation to the firm;
   - The firm provides the individual with an office and related amenities (for example, secretarial and telephone services);
   - The individual’s name is included in the firm’s office directory; and
   - The individual’s name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.

4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee’s prior knowledge of the audit plan, audit effectiveness could be reduced.
5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.

6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

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

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

### Considering Employment or Association with the Client

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

The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under Rule 61H1-21.002. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and individual involved.

### Section 101-4. Honorary Directorships and Trusteeships of Not-for-Profit Organization.

Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be
considered to impair independence under rule 61H1-21.001, provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or she must be identified as an honorary director or honorary trustee.

Section 101-5. Permitted Loans

This section describes the conditions a covered licensee (or his or her immediate family) must meet in order to have any loan to or from the client, any officer or director of the client, or any individual owning ten percent or more of the client’s outstanding equity securities or other ownership interests. Acceptable loans are termed “Grandfathered Loans” or “Other Permitted Loans.”

An inadvertent and isolated failure to meet conditions 4, 5 and 6, would not impair independence provided that the required procedures are performed promptly upon discovery of the failure to do so, and all other provisions of Section 101-2 are met.

Grandfathered Loans

Unsecured loans that are not material to the covered licensee’s net worth, home mortgages, and other secured loans are grandfathered if:

(1) they were obtained from a financial institution under that institution’s normal lending procedures, terms, and requirements,

(2) after becoming a covered licensee they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement, and

(3) they were:

(a) obtained from the financial institution prior to its becoming a client requiring independence; or

(b) obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or

(c) were obtained prior to April 1, 2003 and met the requirements of previous provisions of Rule 61H1-21.001; or

(d) obtained after April 1, 2003 from a financial institution client requiring independence by a borrower prior to his or her becoming a covered licensee with respect to that client.

An inadvertent and isolated failure to meet conditions 4, 5, and 6, would not impair independence provided that the required procedures are performed properly upon discovery of the failure to do so, and all other provisions of Section 101-2 are met.

The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered licensee’s net worth.

Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants.
In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained. For purposes of applying the grandfathered loans provision when the covered licensee is a partner in a partnership:

- a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered licensee who is a partner in the partnership on the basis of their legal liability as a limited or general partner if:
  - the covered licensee’s interest in the limited partnership, either individually or combined with the interest of one or more covered licensees, exceeds 50 percent of the total limited partnership interest; or
  - the covered licensee, either individually or together with one or more covered licensees, can control the general partnership.
- even if no amount of a partnership loan is ascribed to the covered licensee(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described below.

**Other Permitted Loans**

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

1. Automobile loans and leases collateralized by the automobile.
2. Loans fully collateralized by the cash surrender value of an insurance policy.
3. Loans fully collateralized by cash deposits at the same financial institution (e.g., “passbook loans”).
4. Credit cards and cash advances where the aggregate outstanding balance on the current statement is reduced to $10,000 or less by the payment due date.

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

**Section 101-6. The Effect of Actual or Threatened Litigation on Independence.**

In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

**Litigation between client and licensee**

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

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

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

(2) The commencement of litigation by the covered licensee against the present management alleging management fraud or deceit would be considered to impair independence.

(3) An expressed intention by the present management to commence litigation against the covered licensee alleging deficiencies in audit work for the client would be considered to impair independence if the covered licensee concludes that it is probable that such a claim will be filed.

(4) Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered licensee's firm or to the client company would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

**Litigation by security holders**

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

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

8 See Footnote 7.
(1) The existence of cross-claims filed by the client, its management, or any of its
directors to protect a right to legal redress in the event of a future adverse decision in the
primary litigation (or, in lieu of cross-claims, agreements to extend the statute of
limitations) would not normally affect the relationship between client management and
the covered licensee in such a way as to impair independence, unless there exists a
significant risk that the cross-claim will result in a settlement or judgment in an amount
material to the covered licensee’s firm or to the client.

(2) The assertion of cross-claims against the covered licensee by underwriters would not
generally impair independence if no such claims are asserted by the client or the present
management.

(3) If any of the persons who file cross-claims against the covered licensee are also
officers or directors of other clients of the covered licensee, independence with respect
to such other clients would not generally be considered to be impaired.

Other third-party litigation

Another type of third-party litigation against the covered licensee may be commenced by
a lending institution, other creditor, security holder, or insurance company who alleges
reliance on financial statements of the client with which the covered licensee is
associated as a basis for extending credit or insurance coverage to the client. In some
instances, an insurance company may commence litigation (under subrogation rights)
against the covered licensee in the name of the client to recover losses reimbursed to
the client. These types of litigation would not normally affect independence with respect
to a client who is either not the plaintiff or is only the nominal plaintiff, since the
relationship between the covered licensee and client management would not be
affected. They should be examined carefully, however, since the potential for adverse
interests may exist if the covered licensee alleges, in his defense, fraud, or deceit by the
present management.

If the real party in interest in the litigation (e.g., the insurance company) is also a client of
the covered licensee (“the plaintiff client”), independence with respect to the plaintiff
client may be impaired if the litigation involves a significant risk of a settlement or
judgment in an amount which would be material to the covered licensee’s firm or to
the plaintiff client.

Effects of impairment of independence

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

Termination of impairment

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


Introduction

Financial interests in non-clients that are related in various ways to a client may impair independence. Situations in which the non-client investor is a partnership are covered in other rulings.

The following definitions are to be used in only in Section 101-8 (all other definitions are contained at the end of the Standards).

The following specifically identified terms are used in Section 101-8 as indicated:

(1) Client. The term client means the person or entity with whose financial statements a covered member is associated.

(2) Investor. The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.

(3) Investee. The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

Interpretation

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

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

Other relationships, such as those involving brother-sister common control or client-non-client joint ventures, may affect the appearance of independence. The covered licensee should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.
In general, in brother-sister common control situations, an immaterial financial interest of a covered licensee in the non-client investee would not impair independence with respect to the client investee, provided the covered licensee could not exercise significant influence over the non-client investor. However, if a covered licensee’s financial interest in a non-client investee is material, the covered licensee could be influenced by the non-client investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered licensee in the non-client investor would not impair the independence of the covered licensee with respect to the client investor, provided that the covered licensee could not exercise significant influence over the non-client investor.

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

Section 101-10. The Effect on Independence of Relationships with Entities Included in the Governmental Financial Statements.

For purposes of this Section, a financial reporting entity’s basic financial statements, issued in conformity with generally accepted accounting principles in the United States of America, include the government-wide financial statements (consisting of the entity’s governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, non-major governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures, jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

Auditor of Financial Reporting Entity

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

9 Except for a financial reporting entity’s general purpose financial statements, which is defined within the text of this interpretation, certain terminology used throughout the interpretation is specifically defined by the Governmental Accounting Standards Board.
However, the covered licensee and his or her immediate family shall not hold a key position with a major fund, non-major fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

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

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

**Section 101-12. Independence and Cooperative Arrangements with Clients.**

Independence will be considered to be impaired if, during the period of a professional engagement, a licensee or his or her firm had any cooperative arrangement with the client that was material to the licensee’s firm or to the client.

Cooperative Arrangement – A cooperative arrangement exists when a licensee’s firm and a client jointly participate in a business activity. The following are examples, which are not all inclusive, of cooperative arrangements:

1. Prime/subcontractor arrangements to provide services or products to a third party;
2. Joint ventures to develop or market products or services;
3. Arrangements to combine one or more services or products of the firm with one or more services or products of the client and market the package with references to both parties;
4. Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the client’s products or services, or the client acts as the distributor or marketer of the products or services of the firm.

Nevertheless, joint participation with a client in a business activity does not ordinarily constitute a cooperative arrangement when all the following conditions are present:

- The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.
- The firm assumes no responsibility for the activities or results of the client, and vice versa.
- Neither party has the authority to act as the representative or agent of the other party.
• In addition, the licensee’s firm should consider the requirements of section 473.319 and section 473.3205.

FLORIDA STATUTES

A. General Statutes Applicable to Licensed Professionals

The following rules, provided for in the Florida Statutes, Chapter 455, apply generally to professions regulated by the Code. The following is a summary of the major provisions.

1. Investigations and Complaints

The Florida Board of Accountancy, along with the boards regulating other professionals, has authority to investigate complaints that are filed against licensees (Chapter 455, § 455.225). The Department is given authority under this section to investigate complaints as well as to undertake investigations on its own when it believes that a particular licensee or group of licensees has violated a Florida statute, or a rule of the Department of the Board.

When an investigation is undertaken, the licensee that is the subject of the investigation must normally receive written notification as well as the opportunity to respond. Notice is not required in certain cases, such as where the licensee is the target of a criminal investigation.

Following completion of its investigation, the Board is required to submit a report to the appropriate Board for review. The report contains the investigative findings and the recommendations of the department. The Department also has authority to dismiss the complaint following its investigation. A detailed procedure is set forth in the statute regarding the manner in which the board is required to review a complaint and avenues of appeal available for a licensee who is found to be in violation of the rules.

In the case of a minor violation, the Department may simply provide notice to a licensee of the violation. A violation is considered “minor” if “it does not demonstrate a serious inability to practice the profession, result in economic or physical harm to a person, or adversely affect the public health, safety, or welfare or create a significant threat of such harm.”

2. General Grounds for Discipline

Section 455.2255 gives the Department authority to classify incidents as either serious or minor.

3. Penalties

Penalties for violating any of these provisions include:

- Refusal to certify, or to certify with restrictions, an application for a license;
- Suspension or permanent revocation of a license;
Restriction of practice;
Imposition of an administrative fine not to exceed $5,000 for each count or separate offense;
Issuance of a reprimand; or
Placement of the licensee on probation for a period of time and subject to such conditions as the board.

B. Statutes Governing Public Accountancy

Chapter 473 relates specifically to the practice of public accountancy.

473.301 Purpose.--The Legislature recognizes that there is a public need for independent and objective public accountants and that it is necessary to regulate the practice of public accounting to assure the minimum competence of practitioners and the accuracy of audit statements upon which the public relies and to protect the public from dishonest practitioners and, therefore, deems it necessary in the interest of public welfare to regulate the practice of public accountancy in this state.

473.302 Definitions.--As used in this chapter, the term:

(1) "Board" means the Board of Accountancy.

(2) "Department" means the Department of Business and Professional Regulation.

(3) "Division" means the Division of Certified Public Accounting.

(4) "Certified public accountant" means a person who holds a license to practice public accounting in this state under the authority of this chapter.

(5) "Firm" means any entity that is engaged in the practice of public accounting.

(6) "Licensed audit firm" or "public accounting firm" means a firm licensed under s. 473.3101.

(7) "Practice of," "practicing public accountancy," or "public accounting" means:

(a) Offering to perform or performing for the public one or more types of services involving the expression of an opinion on financial statements, the attestation as an expert in accountancy to the reliability or fairness of presentation of financial information, the utilization of any form of opinion or financial statements that provide a level of assurance, the utilization of any form of disclaimer of opinion which conveys an assurance of reliability as to matters not specifically disclaimed, or the expression of an opinion on the reliability of an assertion by one party for the use by a third party;

(b) Offering to perform or performing for the public one or more types of services involving the use of accounting skills, or one or more types of tax, management advisory, or consulting services, by any person who is a certified public accountant who
holds an active license, including the performance of such services by a certified public accountant in the employ of a person or firm; or

(c) Offering to perform or performing for the public one or more types of service involving the preparation of financial statements not included within paragraph (a), by a certified public accountant who holds an active license, a firm of certified public accountants, or a firm in which a certified public accountant has an ownership interest, including the performance of such services in the employ of another person. The board shall adopt rules establishing standards of practice for such reports and financial statements; provided, however, that nothing in this paragraph shall be construed to permit the board to adopt rules that have the result of prohibiting licensees employed by unlicensed firms from preparing financial statements as authorized by this paragraph.

However, these terms shall not include services provided by the American Institute of Certified Public Accountants or the Florida Institute of Certified Public Accountants, or any full service association of certified public accounting firms whose plans of administration have been approved by the board, to their members or services performed by these entities in reviewing the services provided to the public by members of these entities.

473.309 Practice requirements for partnerships, corporations, and limited liability companies; business entities practicing public accounting.--

(1) A partnership may not engage in the practice of public accounting, as defined in s. 473.302(7)(a), unless:

(a) It is a form of partnership recognized by Florida law.

(b) Partners owning at least 51 percent of the financial interest and voting rights of the partnership are certified public accountants in some state. However, each partner who is a certified public accountant in another state and is domiciled in this state must be a certified public accountant of this state and hold an active license.

(c) At least one general partner is a certified public accountant of this state and holds an active license.

(d) All partners who are not certified public accountants in any state are engaged in the business of the partnership as their principal occupation.

(e) It is in compliance with rules adopted by the board pertaining to minimum capitalization, letters of credit, and adequate public liability insurance.

(f) It is currently licensed as required by s. 473.3101.

(2) A corporation may not engage in the practice of public accounting, as defined in s. 473.302(7)(a), unless:

(a) It is a corporation duly organized in this or some other state.

(b) Shareholders of the corporation owning at least 51 percent of the financial interest and voting rights of the corporation are certified public accountants in some state and
are principally engaged in the business of the corporation. However, each shareholder who is a certified public accountant in another state and is domiciled in this state must be a certified public accountant of this state and hold an active license.

(c) The principal officer of the corporation is a certified public accountant in some state.

(d) At least one shareholder of the corporation is a certified public accountant and holds an active license in this state.

(e) All shareholders who are not certified public accountants in any state are engaged in the business of the corporation as their principal occupation.

(f) It is in compliance with rules adopted by the board pertaining to minimum capitalization, letters of credit, and adequate public liability insurance.

(g) It is currently licensed as required by s. 473.3101.

(3) A limited liability company may not engage in the practice of public accounting, as defined in s. 473.302(7)(a), unless:

(a) It is a limited liability company duly organized in this or some other state.

(b) Members of the limited liability company owning at least 51 percent of the financial interest and voting rights of the company are certified public accountants in some state. However, each member who is a certified public accountant in some state and is domiciled in this state must be a certified public accountant of this state and hold an active license.

(c) At least one member of the limited liability company is a certified public accountant and holds an active license in this state.

(d) All members who are not certified public accountants in any state are engaged in the business of the company as their principal occupation.

(e) It is in compliance with rules adopted by the board pertaining to minimum capitalization, letters of credit, and adequate public liability insurance.

(f) It is currently licensed as required by s. 473.3101.

(4) A partnership, corporation, limited liability company, or any other business entity is engaged in the practice of public accounting if its employees are engaged in the practice of public accounting. Notwithstanding any other provision of law, a licensed audit firm may own all or part of another licensed audit firm.

473.3101 Licensure of sole proprietors, partnerships, corporations, limited liability companies, and other legal entities.--

(1) Each sole proprietor, partnership, corporation, limited liability company, or any other legal entity seeking to engage in the practice of public accounting, as defined in s. 473.302(7)(a), in this state must file an application for licensure with the department and supply the information the board requires. An application must be made upon the
affidavit of a sole proprietor, general partner, shareholder, or member who is a certified public accountant.

(2) The board shall determine whether the sole proprietor, partnership, corporation, limited liability company, or any other legal entity meets the requirements for practice and, pending that determination, may certify to the department the partnership, corporation, or limited liability company for provisional licensure.

(3) Each license must be renewed every 2 years. Each sole proprietor, partnership, corporation, limited liability company, or any other legal entity licensed under this section must notify the department within 1 month after any change in the information contained in the application on which its license is based.

473.315 Independence, technical standards.--

(1) A certified public accountant shall not express an opinion on the financial statements of an enterprise unless she or he and her or his firm are independent with respect to such enterprise.

(2) A certified public accountant shall not undertake any engagement in the practice of public accounting which she or he or her or his firm cannot reasonably expect to complete with professional competence.

(3) The board shall adopt rules establishing the standards of practice of public accounting, including, but not limited to, independence, competence, and technical standards.

(4) Attorneys who are admitted to practice law by the Supreme Court of Florida are exempt from the standards of practice of public accounting as defined in s. 473.302(7)(b) and (c) when such standards conflict with the rules of The Florida Bar or orders of the Florida Supreme Court.

Board Opinion

A Florida CPA firm presented the following hypothetical to the Board of Accountancy for their consideration of whether it violated this statute governing accountant independence as well as the Board rule (provided above) covering the same issue:

A Florida CPA firm pays retirement benefits to a retired partner. In addition the retired partner receives from the firm less than $5,000 annually in fees for services performed. The retired partner is not held out as being associated with the firm. After his retirement from the firm, the retired partner is asked to become a member of the Board of Directors of a company that is an audit client of the CPA firm. The retired partner was previously the engagement partner on this audit. The retired partner's retirement benefits are not materially affected by the audit fees of this client. This client's audit fees represent approximately 2% of the total CPA firm's billing, which are $2 million. Based on Chapter 473.315 (1), F.S. and Rule 61H1-21.001 (3), the Board concluded that the fact that a retired partner becomes a member of the board of directors of an audit client of his former CPA firm would not impair the firm's independence provided that:
(a) The retired partner is no longer active in the firm.
(b) The fees received from the audit client do not have a material affect on the retired partner’s retirement benefits.
(c) The retired partner is not being held out as being associated with the CPA firm; and
(d) The $5,000 in fees paid to the retired partner are not a result of work the retired partner performed for the audit client.

473.316 Communications between the accountant and client privileged.--

(1) For purposes of this section:

(a) An "accountant" is a certified public accountant.

(b) A "client" is any person, public officer, corporation, association, or other organization or entity, either public or private, who consults an accountant with the purpose of obtaining accounting services.

(c) A communication between an accountant and her or his client is "confidential" if it is not intended to be disclosed to third persons other than:

1. Those to whom disclosure is in furtherance of the rendition of accounting services to the client.

2. Those reasonably necessary for the transmission of the communication.

(d) A "quality review" is a study, appraisal, or review of one or more aspects of the professional work of a licensee in the practice of public accountancy which is conducted by a professional organization for the purpose of evaluating quality assurance required by professional standards, including a quality assurance or peer review.

(e) A "review committee" is any person or persons who are not owners or employees of a licensee that is the subject of a quality review and who carry out, administer, or oversee a quality review.

(2) A client has a privilege to refuse to disclose, and to prevent any other person from disclosing, the contents of confidential communications with an accountant when such other person learned of the communications because they were made in the rendition of accounting services to the client. This privilege includes other confidential information obtained by the accountant from the client for the purpose of rendering accounting advice.

(3) The privilege may be claimed by:

(a) The client.

(b) A guardian or conservator of the client.

(c) The personal representative of a deceased client.
(d) A successor, assignee, trustee in dissolution, or any similar representative of an organization, corporation, or association or other entity, either public or private, whether or not in existence.

(e) The accountant, but only on behalf of the client. The accountant's authority to claim the privilege is presumed in the absence of contrary evidence.

(4) There is no accountant-client privilege under this section when:

(a) The services of the accountant were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or should have known was a crime or fraud.

(b) A communication is relevant to an issue of breach of duty by the accountant to her or his client or by the client to her or his accountant.

(c) A communication is relevant to a matter of common interest between two or more clients, if the communication was made by any of them to an accountant retained or consulted in common when offered in a civil action between the clients.

(5) Communications are not privileged from disclosure in any disciplinary investigation or proceeding conducted pursuant to this act by the department or before the board or in any judicial review of such a proceeding. In any such proceeding, a certified public accountant or public accountant, without the consent of her or his client, may testify with respect to any communication between the accountant and the accountant's client or be compelled, pursuant to a subpoena of the department or the board, to testify or produce records, books, or papers. Such a communication disclosed to the board and records of the board relating to the communication shall for all other purposes and proceedings be a privileged communication in all of the courts of this state.

(6) The proceedings, records, and workpapers of a review committee are privileged and are not subject to discovery, subpoena, or other means of legal process or to introduction into evidence in a civil action or arbitration, administrative proceeding, or state accountancy board proceeding. A member of a review committee or person who was involved in a quality review may not testify in a civil action or arbitration, administrative proceeding, or state accountancy board proceeding as to any matter produced or disclosed during the quality review or as to any findings, recommendations, evaluations, opinions, or other actions of the review committee or any members thereof. Public records and materials prepared for a particular engagement are not privileged merely because they were presented during the quality review. This privilege does not apply to disputes between a review committee and a person subject to a quality review.

473.318 Ownership of working papers.--All statements, records, schedules, working papers, and memoranda made by a licensee or her or his employee incident to, or in the course of, professional services to a client, except the reports submitted by the licensee to the client and except for records which are part of the client's records, shall be and remain the property of the licensee in the absence of an express agreement between the licensee and the client to the contrary.

473.319 Contingent fees.--Public accounting services as defined in s. 473.302(7)(a) and (c), and those that include tax filings with federal, state, or local government, shall
not be offered or rendered for a fee contingent upon the findings or results of such service. This section does not apply to services involving federal, state, or other taxes in which the findings are those of the tax authorities and not those of the licensee. Fees to be fixed by courts or other public authorities, which are of an indeterminate amount at the time a public accounting service is undertaken, shall not be regarded as contingent fees for purposes of this section.

473.3205 Commissions or referral fees.--A licensee may not accept or pay a commission or referral fee in connection with the sale or referral of public accounting services as defined in s. 473.302(7)(a) and (c). Any certified public accountant or business entity that is engaged in the practice of public accounting and that accepts a commission for the sale of a product or service to a client must disclose that fact to the client in writing in accordance with rules adopted by the board. However, this section shall not prohibit:

(1) Payments for the purchase of an accounting practice;

(2) Retirement payments to individuals formerly engaged in the practice of public accounting or payments to their heirs or estates; or

(3) Payment of fees to a referring licensee for public accounting services to either the successor licensee or the client in connection with an engagement.

473.321 Fictitious names.--

(1) A certified public accountant, partnership, corporation, or limited liability company may not practice public accountancy in this state under any name that is misleading or deceptive as to the legal form; as to persons who are partners, officers, shareholders, or members of the firm; or as to any other matter. However, a firm name may include the names of retired or deceased persons who were active partners, shareholders, or members of the firm.

(2) This section does not prohibit any licensee from practicing public accounting under a fictitious name that is not misleading or deceptive as to the persons who are partners, officers, shareholders, or members.

(3) The board shall adopt rules for interpretation of this section.

**Case Study**

**Notification of Fictitious Names**

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 473.321 Fictitious names.
473.322 Prohibitions; penalties.--

(1) A person may not knowingly:

(a) Practice public accounting unless the person is a certified public accountant or a public accountant;

(b) Assume or use the titles or designations "certified public accountant" or "public accountant" or the abbreviation "C.P.A." or any other title, designation, words, letters, abbreviations, sign, card, or device tending to indicate that the person holds a license to practice public accounting under this chapter or the laws of any other state, territory, or foreign jurisdiction, unless the person holds an active license under this chapter;

(c) Perform or offer to perform any services described in s. 473.302(7)(a) unless such person holds an active license under this chapter and is a licensed audit firm or provides such services through a licensed audit firm. This paragraph does not prohibit the performance by persons other than certified public accountants of other services involving the use of accounting skills, including the preparation of tax returns and the preparation of financial statements without expression of opinion thereon;

(d) Present as her or his own the license of another;

(e) Give false or forged evidence to the board or a member thereof;

(f) Use or attempt to use a public accounting license that has been suspended, revoked, or placed on inactive or delinquent status;

(g) Employ unlicensed persons to practice public accounting; or

(h) Conceal information relative to violations of this chapter.

(2) Any person who violates any provision of this section commits a misdemeanor of the first degree, punishable as provided in s. 775.082 or s. 775.083.

473.323 Disciplinary proceedings.--

(1) The following acts constitute grounds for which the disciplinary actions in subsection (3) may be taken:

(a) Violation of any provision of s. 455.227(1) or any other provision of this chapter.

(b) Attempting to procure a license to practice public accounting by bribery or fraudulent misrepresentations.

(c) Having a license to practice public accounting revoked, suspended, or otherwise acted against, including the denial of licensure, by the licensing authority of another state, territory, or country.

(d) Being convicted or found guilty of, or entering a plea of nolo contendere to, regardless of adjudication, a crime in any jurisdiction which directly relates to the practice of public accounting or the ability to practice public accounting.
(e) Making or filing a report or record that the licensee knows to be false, willfully failing to file a report or record required by state or federal law, willfully impeding or obstructing such filing, or inducing another person to impede or obstruct such filing. Such reports or records include only those that are signed in the capacity of a certified public accountant.

(f) Advertising goods or services in a manner that is fraudulent, false, deceptive, or misleading in form or content.

(g) Committing an act of fraud or deceit, or of negligence, incompetency, or misconduct, in the practice of public accounting.

(h) Violation of any rule adopted pursuant to this chapter or chapter 455.

(i) Practicing on a revoked, suspended, inactive, or delinquent license.

(j) Suspension or revocation of the right to practice before any state or federal agency.

(k) Performance of any fraudulent act while holding a license to practice public accounting.

(l) Failing to maintain a good moral character as provided in s. 473.306.

(m) Failing to provide any written disclosure to a client or the public which is required by this chapter or rule of the board.

(2) The board shall specify, by rule, what acts or omissions constitute a violation of subsection (1).

(3) When the board finds any licensee guilty of any of the grounds set forth in subsection (1), it may enter an order imposing one or more of the following penalties:

(a) Denial of an application for licensure.

(b) Revocation or suspension of a license.

(c) Imposition of an administrative fine not to exceed $5,000 for each count or separate offense.

(d) Issuance of a reprimand.

(e) Placement of the licensee on probation for a period of time and subject to such conditions as the board may specify, including requiring the licensee to attend continuing education courses or to work under the supervision of another licensee.

(f) Restriction of the authorized scope of practice by the certified public accountant.

(4) The department shall reissue the license of a disciplined licensee upon certification by the board that the disciplined licensee has complied with all of the terms and conditions set forth in the final order.
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; and
- 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, increasing the likelihood that the client will have complaints about fees charged.

Address Changes

To ensure that you receive correspondence from the Board, applicants and licensees are responsible for making sure that the Board has a current mailing address for you. You can change your mailing address online at http://www.myfloridalicense.com. If you use a post office box as a mailing address, you must also provide a location address.
CHAPTER 3 – REVIEW QUESTIONS

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

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

1. Florida CPAs are required to comply with the "Standards for Determining Independence in the Practice of Public Accountancy for CPAs Practicing Public Accountancy in the State of Florida."
   a) true
   b) false

2. Florida CPAs are prohibited from accepting contingent fees under any circumstances.
   a) true
   b) false

3. Letterhead and business cards are not considered “advertisements” for purposes of the Board of Accountancy rules.
   a) true
   b) false

4. Florida CPAs are permitted to practice accounting under a fictitious name.
   a) true
   b) false

5. Florida imposes minimum capitalization rules on CPAs before they are permitted to practice accounting.
   a) true
   b) false

6. Under the Florida “Standards for Determining Independence,” a firm’s independence can be impaired if a partner leaves the firm and is subsequently employed by an attest client in a key position.
   a) true
   b) false
7. Florida’s “Standards for Determining Independence” prohibit a member of an attest team from securing a loan of any size from a client under any circumstances.

a) true
b) false
CHAPTER 3 – SOLUTIONS AND SUGGESTED RESPONSES

1. **A: True is correct.** The Board of Accountancy Rule 61H1-21.001 requires Florida CPAs to comply with these rules as well as the Board’s other rules governing accountant independence.

   B: False is incorrect. The “Standards for Independence” are similar to those contained in the Code of Professional Conduct promulgated by the American Institute of Certified Public Accountants. They must be complied with by Florida CPAs.

   (See pages 3-1 to 3-2 of the course material.)

2. A: True is incorrect. While CPAs are limited in the circumstances in which contingent fees can be collected, they are not completely prohibited.

   B: False is correct. Rule 61H1-21.005 prohibited CPAs from accepting contingent fees in certain circumstances only, including for tax filings with the federal, state, or local government unless the findings are those of the tax authorities and not those of the licensee.

   (See pages 3-4 to 3-5 of the course material.)

3. A: True is incorrect. The definition of “advertising” contained in the Board rules is very broad, and clearly includes business cards as well as letterhead.

   B: False is correct. Board Rule 61H1-24.001 defines “advertising” as “Any statements, oral or written, disseminated to or before the public or any portion thereof, with the intent of furthering the purpose, either directly or indirectly, of selling public accounting services, or offering to perform public accounting services, or including members of the public to enter into any obligation relating to such public accounting services.” The rule provides a list of examples, including business cards, letterhead, signs and displays in a telephone directory.

   (See pages 3-10 to 3-11 of the course material.)

4. **A: True is correct.** Rule 61H1-26 permits Florida CPAs to practice public accounting “under a fictitious name which is not misleading or deceptive as to the persons who are sole proprietors, partners, officers or shareholders.”

   B: False is incorrect. Subject to certain rules, Florida CPAs are permitted by the Board of Accountancy rules to practice under a fictitious name.

   (See page 3-13 of the course material.)
5. **A: True is correct.** Rule 61H1-26.002 prohibits limited liability companies, partnerships, corporations or limited liability partnerships from practicing accounting without meeting specific capitalization requirements.

B: False is incorrect. Firms must meet the requirements based on the number of shareholders or partners in the firm, up to a maximum of $2 million.

(See page 3-14 of the course material.)

6. **A: True is correct.** Section 101-2 provides that a firm will lose its independence in such a situation unless one of a number of conditions is met, including that the former partner is not in a position to influence the accounting firm’s operations or financial policies.

B: False is incorrect. Unless certain conditions are met, such a situation will cause the accounting firm to lose its independence.

(See page 3-22 of the course material.)

7. A: True is incorrect. Section 101-5 limits but does not expressly prohibit all such loans.

**B: False is correct.** Section 101-5 describes the conditions a covered licensee (or his or her immediate family) must meet in order to have any loan to or from the client, any officer or director of the client, or any individual owning ten percent or more of the client’s outstanding equity securities or other ownership interests. Automobile loans, for example, are permissible from a client that is a financial institution so long as the loan was obtained pursuant to the client’s normal lending procedures.

(See pages 3-24 to 3-25 of the course material.)
CHAPTER 4: ETHICS FOR INDUSTRY CPAs

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

- Discuss AICPA guidance for Management Accountants.
- Identify ethical guidance promulgated by the Institute of Management Accountants (IMA).
- Compare and contrast the guidance issued by IMA and the AICPA.

Introduction

Although all 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.

AICPA GUIDANCE

Rule 102 – Integrity and objectivity has particular importance to CPAs in industry. Rule 102 is very broad in its dictate that “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.”

Following are summaries and discussion of the AICPA Rule 102 Interpretations relating to Management Accountants.

Interpretation 102-2 (Conflicts of Interest) A conflict of interest may arise when a member performs a professional service for a client or employer and has a “significant relationship” with another party. For example, the firm may provide investment advice for a client but may have a relationship with a financial product that is sold to the client. This situation is not prohibited if the client is informed of the relationship. In making the disclosure to the client the member should make sure that Rule 301 (Confidential Client Information) is not violated. The disclosure and consent option is available only for conflicts of interest. Impairments of independence cannot be so eliminated.

Interpretation 102-3 (Obligations of a Member to His or Her Employer’s External Accountant) When a member who is not in public practice communicates with his or her employer’s external accountant, the member “must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts.” This guidance applies, for example, to written representations requested by the employer’s external accountant.
Interpretation 102-4 (Subordination of Judgment by a Member) During the performance of a professional service (all services performed by a member while holding out as a CPA), a member should not subordinate his or her judgment to the position taken by a supervisor. Specifically, if there is a disagreement about the preparation of financial statements or the recording of a transaction, the member should observe the following guidelines.

- Determine whether the position taken by the supervisor is consistent with an acceptable alternative accounting principle. If the principle is generally acceptable, the member does not need to take additional action.

- If the member determines that the alternative accounting principle is not acceptable, the member should communicate the disagreement to an “appropriate higher level(s) of management with the organization.” This higher level could include the supervisor’s supervisor, members of senior management, or the audit committee.

- If, after the appropriate higher level(s) of management was informed of the disagreement, appropriate action was not taken, the member should consider whether to continue as an employee and whether there is any responsibility to notify appropriate regulatory agencies or the employer’s current or former external accountant. Consultation with legal counsel may be appropriate before communicating with external parties.

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?

Answer: 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.

The member should be aware of obligations established under Interpretation 102-3.

The AICPA has also issued one ruling of interest to CPAs in industry. When may an industry CPA use the CPA designation? The AICPA believes it is proper for the CPA to use the CPA designation provided it is not done in a manner that implies the CPA is independent of the employer.
Following are questions asked by AICPA members. The answers are from the AICPA Professional Ethics division:

1. A member is hired by a company as the chief financial officer. The member later discovers that, prior to his or her employment, material false and misleading entries were recorded in the books and records of the company. If he or she fails to record a correcting entry, is the member in violation of the AICPA Code of Professional Conduct?

Yes. Rule 102 requires that in the performance of any professional service, a member shall not knowingly misrepresent facts. Interpretation 102-1 states that a member shall have knowingly misrepresented facts if he or she knowingly fails to correct an entity’s financial statements or records that are materially false and misleading when the member has the authority to record such an entry.

2. A member is the controller of a company. The company’s external auditors request, and the member provides them with, copies of documents relating to the company’s revenue-recognition policy. However, the member does not disclose the existence of other documents that would reveal the company is improperly and prematurely recording revenue which has a material impact on the company’s financial statements. Is the member in violation of the AICPA code?

Yes. Under Interpretation 102-3, when dealing with his or her employer’s external accountant, a member must be candid and not knowingly misrepresent facts or fail to disclose material facts.

3. A supervisor instructs a member to record a transaction that would result in a material misstatement of the financial statements. If, after appropriate research and consultation, the member determines that the transaction cannot be recorded using an acceptable alternative, should he or she comply with the supervisor’s instructions?

No. Interpretation 102-4 prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. If the member concludes that the financial statements could be materially misstated, he or she should discuss the concerns with the appropriate higher level(s) of management and consider documenting his or her understanding of the facts, the accounting principles involved, the application of the accounting principles to the facts and the parties with whom the matters were discussed. If the member then concludes that appropriate action was not taken, that member may wish to consider his or her continuing relationship with the employer and any responsibility to communicate the matter to third parties, including the employer’s external accountants. The member also may wish to consult with legal counsel.

4. A member in industry is assigned by his or her employer to facilitate a transaction between two entities. During this process, the member creates false and misleading documents that are presented to one of the entities. Is the member in violation of the AICPA code?

Yes. Rule 102 requires that, in the performance of any professional service, a member shall not knowingly misrepresent facts.
5. A member employed as the controller of a company is directed by its president to record a sale material to the company’s financial statements. The member records the sale without obtaining the necessary documents to determine whether the transaction is in compliance with GAAP. It is later discovered that the sale occurred after the reporting period and resulted in materially overstated earnings in the financial statements. Is the member in violation of the AICPA code?

Yes. Under Interpretation 501-4, if the member, by virtue of his or her negligence, makes, or permits or directs another to make, materially false or misleading entries in the financial statements or records of an entity, he or she shall be considered to have committed an act discreditable to the profession.

6. A member who is a CFO has been asked to sign a management representation letter stating that the company’s financial statements are in conformity with GAAP when he or she is aware of a material departure from an established accounting principle. Should the member sign the letter?

No. Rule 203 provides that a member shall not state affirmatively that the financial statements are in conformity with GAAP if such financial statements contain any departure from an established accounting principle that has a material effect on them. In addition, Rule 102 requires that in the performance of any professional service a member shall not knowingly misrepresent facts.

STANDARDS OF ETHICAL CONDUCT FOR MANAGEMENT ACCOUNTANTS

Management accountants have an obligation to the organizations they serve, their profession, the public and themselves to maintain the highest standards of ethical conduct. In recognition of this obligation, the Institute of Management Accountants has promulgated the following standards of ethical conduct for management accountants. Adherence to these standards is integral to achieving the Objectives of Management Accounting. Management accountants shall not commit acts contrary to these standards nor shall they condone the commission of such acts by others within their organizations.

Members shall abide by the more stringent code of ethical conduct, whether that is the standards widely practiced in their country or IMA’s Standards of Ethical Conduct. In no case will a member conduct herself or himself by any standard that is not at least equivalent to the standards identified for members in IMA’s Standards of Ethical Conduct.

COMPETENCE

Management accountants have a responsibility to:

- Maintain an appropriate level of professional competence by ongoing development of their knowledge and skills

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• Perform their professional duties in accordance with relevant laws, regulations, and technical standards

• Prepare complete and clear reports and recommendations after appropriate analyses of relevant and reliable information.

CONFIDENTIALITY

Management accountants have a responsibility to:

• Refrain from disclosing confidential information acquired in the course of their work except when authorized, unless legally obligated to do so

• Inform subordinates as appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality

• Refrain from using or appearing to use confidential information acquired in the course of their work for unethical or illegal advantage either personally or through third parties.

INTEGRITY

Management accountants have a responsibility to:

• Avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict

• Refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically

• Refuse any gift, favor, or hospitality that would influence or would appear to influence their actions

• Refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives

• Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity

• Communicate unfavorable as well as favorable information and professional judgments or opinions

• Refrain from engaging in or supporting any activity that would discredit the profession.
OBJECTIVITY

Management accountants have a responsibility to:

- Communicate information fairly and objectively
- Disclose fully all relevant information that could reasonably be expected to influence an intended user’s understanding of the reports, comments and recommendations presented.

RESOLUTION OF ETHICAL CONFLICT

In applying the standards of ethical conduct, management accountants may encounter problems in identifying unethical behavior or in resolving an ethical conflict. When faced with significant ethical issues, management accountants should follow the established policies of the organization bearing on the resolution of such conflict. If these policies do not resolve the ethical conflict, management accountants should consider the following courses of action.

- Discuss such problems with the immediate superior except when it appears that the superior is involved, in which case the problem should be presented initially to the next higher managerial level. If satisfactory resolution cannot be achieved when the problem is initially presented, submit the issues to the next higher managerial level.

- If the 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 the superior’s knowledge, assuming the superior is not involved.

- Clarify relevant concepts by confidential discussion with an objective adviser to obtain an understanding of possible courses of action.

- If the ethical conflict still exists after exhausting all levels of internal review, the management accountant may have no other recourse on significant matters than to resign from the organization and to submit an informative memorandum to an appropriate representative of the organization.

After resignation, depending on the nature of the ethical conflict, it may also be appropriate to notify other parties.

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.

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.

INTERNAL AUDITORS

The Institute of Internal Auditors has issued an exposure draft to revise its code of ethics. It would require compliance by all internal auditors not just Institute members.
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.

The high-level warning came from Richard H. Walker, the SEC’s director of enforcement, who said in a speech that the agency continues “to see an unacceptably high number of busted audits.”

To reduce corporate bookkeeping frauds, Mr. Walker said, the agency plans to work more closely with U.S. attorneys’ offices across the country to pursue criminal charges against executives involved in such fraudulent behavior. The SEC’s top enforcement official said an “increasing number of our cases are also accompanied by criminal charges,” and cited the success of a so-called “SWAT-team approach” the agency executed in conjunction with U.S. attorneys in New York in a fraud case against executives of Livent, Inc., the Canadian producer of Broadway shows.

“Cook the books, and you will go directly to jail without passing Go,” Mr. Walker said.

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 commitment to purchase, preferably in writing.
- The buyer must request the bill-and-sale 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.

Enron had one of the most pervasive impacts on the accounting profession and the investment community since the Depression. The largest bankruptcy in American history has called into question the effectiveness of auditors and the integrity of the accounting profession, as a whole. In the post-Enron era, dramatic reforms have been passed, several of which have impacted the ability of the accountants to continue as a self-regulated profession.
Other players in the Enron saga, including financial analysts and lawyers, will also feel the effects of Enron’s demise, which will likely result in sweeping reforms in independence, conflict of interest rules and liability limits.

It will take years to sort out the criminal and tort litigation that is a byproduct of Enron’s failure. On a short-term basis, Congress is quickly forcing dramatic changes as the public watches and demands accountability for the billions lost by Enron shareholders and creditors. Some of the changes that Congress will make will be positive and constructive, while others will be window dressing. Oddly enough, the changes by Congress will bring Washington’s hypocrisy to the forefront. Many of the same Congressmen who now demand changes to the accounting rules were lobbied to oppose those same changes when proposed by the FASB years ago.

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.

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 announced that financial professionals can now get free, confidential guidance on ethical issues through the IMA Ethics Hotline.

Since Enron and other corporate accounting scandals, ethics programs and hotlines are fast becoming 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 1-800-638-4427 x 1662, or send their inquiry via e-mail to ethics@imanet.org. The IMA does not record phone numbers or e-mail addresses. Those who contact the hotline can be provided with a numerical code for identification, to maintain confidentiality.

FEDERAL SENTENCING GUIDELINES

Under the newly 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.

**STOCK OPTION BACKDATING**

In 2006 and 2007, 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):

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**: Lawyers still haven’t quite sorted out all the 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.

**GREED**

Excessive executive compensation seems to be an issue that just won’t go away. The theory seems to be that a good CEO is worth any price a company will pay. Any gain a company makes is assumed to be the sole result of the extraordinary wisdom of this one very special person, not the collective efforts of hundreds or thousands of employees. Despite all the editorials, all the accounting rule changes, and all the new laws, nothing much seems to change except the particular manner in which so many executives get overpaid. Chances are this particular practice will now go away, but another one will surface all too soon. The question is – How will you react to the next scandal? Will you have the courage to question and stop the practice? Check out the latest at www.NCEO.org.
CHAPTER 4 – REVIEW QUESTIONS

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

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

1. Smith is a member of the AICPA and is the controller for a large wholesale distribution company. In the current year, sales were down 10% from the prior year. The Vice President of Finance has instructed Smith to “keep the books open” for a few days in January so that some anticipated large orders could be booked in the prior year. What should Smith do?

   a) determine if “leaving the books open” for a few days is an acceptable alternative accounting principle
   b) communicate the disagreement to the appropriate higher level of management
   c) if higher level management fails to take action, Smith should consider quitting employment
   d) all of the above

2. Which of the following is an attribute of the internal control system required by the Foreign Corrupt Practices Act:

   a) transactions must occur under the authorization of management
   b) transactions must be properly recorded
   c) there must be reasonable controls over access to assets
   d) all of the above
CHAPTER 4 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. He must do more than simply analyze the circumstances.

   B: Incorrect. While a proper second step, claiming, “I was only following orders” is not acceptable.

   C: Incorrect. Quitting may be required, but it is not the only requirement.

   D: Correct. A CPA should take all of the above steps.

   (See Interpretation 102-4 in the course material.)

2. A: Incorrect. Authorization is just one of the requirements.

   B: Incorrect. Being properly recorded is just one of the requirements.

   C: Incorrect. Having reasonable controls over access to assets is just one of the requirements.

   D: Correct. All of the above are required. In addition, there must be a periodic reconciliation of recorded to actual assets with an investigation of any differences.

   (See Foreign Corrupt Practices Act in the course material.)
The terms included in this glossary are related to the ethics area in general, but may not be specifically used in this material. They are provided for greater clarification and educational purpose.

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