Ohio Professional Standards and Responsibilities

Course #4850J
Course Material
# Ohio Professional Standards and Responsibilities
(Course #4850J)

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**Glossary**

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Introduction

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

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

ACCOUNTANCY BOARD OF OHIO -- http://acc.ohio.gov

The Accountancy Board of Ohio’s legal mandate is to regulate the accounting profession for the public interest by establishing and maintaining entry standards of qualification and conduct within the accounting profession, primarily through its authority to license. The Board regulates Certified Public Accountants (CPAs) in Ohio through a program of examination, licensure (individuals and firms), consumer protection (enforcement), continuing professional education and peer reviews.

The Board may impose penalties on persons using the CPA title in Ohio or firms providing attest services or compilation services to persons or entities located in Ohio, or on a person or firm who does not hold an Ohio license or who does not meet the requirements to use the CPA title in Ohio in accordance with the Code of Ohio Statutes and/or Board Regulations.

Ohio Permit and Ohio Registration

Ohio Permit holders sign - CPA

Ohio Registration holders sign - CPA Inactive

Individuals who perform the following services must hold an Ohio permit:

- Audits
- Reviews
- Compilations
- Attestation engagements

Individuals who perform the following services and use the CPA designation must hold an Ohio permit:

- Tax services
- Personal financial planning services
- Consulting services
- Regulated services performed outside a CPA firm as a CPA
Individuals who do not perform the above services may choose to hold an Ohio permit or an Ohio registration. Ohio registration holders must use “inactive” after the CPA designation. The regular license is valid for three years, except for new CPAs who receive a two-year license.

Firm Registration and Peer Review

Firms that perform attest services (audits, reviews, compilations, attestation engagements), must register with the Board and obtain a peer review every three years. The Ohio Society of CPAs (OSCPA) is the Board’s agent for peer review administration. Firms performing engagements subject to peer review must register with the Board within 90 days and complete a peer review within 18 months.

Tax and consulting firms that advertise as CPA firms must also register with the Board every three years.

Renewal Dates and Late Fees

- Individuals – January 2, 2013
- Peer Review Firms – October 31, 2012
- Tax/Consulting Firms – July 31, 2012

Individual Late Fees

Late fees are $100 for every month late up to a maximum of 12 months (maximum $1,200) for permit holders who perform attest services and/or tax or consulting services as a CPA. For all other licensees, late fees are $50 for every month late, up to a maximum of 6 months (maximum $300).

Firm Late Fees (depends on the size of the firm):

1-4 licensees $150
5-9 licensees $360
10+ licensees $900

Board Hearings

The Board conducts formal hearings about alleged violations of the Ohio accountancy law. The Board also holds hearings for CPAs who request reinstatement of their CPA certificates after they have been revoked. The most common reasons for hearings are:

- Failure to renew individual and/or firm license
- Failure to obtain peer review
- Inability to verify CPE
- Criminal convictions
- Client complaints
- Suspension/revocations by the SEC, IRS, other federal/state agencies
- Failure to respond to Board communications
- Failure to appear before the Board
To avoid coming before the Board:

- When you move, change your address on the Board’s website
- Renew your individual and firm license(s) on time
- Fulfill your CPE requirements
- Complete your firm peer review promptly
- Provide professional client service
- Return client records when requested
- Reply to Board communications
- When ordered, immediately cease and desist using the CPA designation
Chapter 1: Professional Ethics Statutes

Objectives:

After completing this chapter, you will be able to:

- Identify the professional ethics statutes as enacted by the General Assembly.
- Differentiate between the Ohio statutes and the Board rules.

INTRODUCTION

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

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

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

PROFESSIONAL ETHICS STATUTES (OHIO REVISED CODE)

- **Sec. 4701.12. ADVERTISEMENTS.** Definition.

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

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

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

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

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

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

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

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

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

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

Sec. 4701.14. UNAUTHORIZED PRACTICE

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sec. 4701.15. EMPLOYEES

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

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

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

Sec. 4701.16. DISCIPLINARY ACTIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**BOARD INVESTIGATIONS**

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

**INVESTIGATIONS CONCLUDED OVER A TWO-YEAR PERIOD**

*Cases involving:*

<table>
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<th>Cases involving</th>
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<tr>
<td>Unethical Conduct</td>
<td>427</td>
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<tr>
<td>Unlawful Practice</td>
<td>197</td>
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<tr>
<td>Firm Registration Compliance</td>
<td>81</td>
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<tr>
<td>Records Retention</td>
<td>59</td>
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<tr>
<td>Unlawful Advertising</td>
<td>47</td>
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<tr>
<td>Criminal Conviction</td>
<td>11</td>
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<tr>
<td>Federal Agency Referral</td>
<td>9</td>
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<tr>
<td>Continuing Education Compliance</td>
<td>8</td>
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<tr>
<td>Other State Board Referral</td>
<td>5</td>
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<tr>
<td>Child Support Default</td>
<td>1</td>
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<tr>
<td><strong>Total Cases</strong></td>
<td><strong>845</strong></td>
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**INVESTIGATIVE ACTIVITY**

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

**Most Frequent Complaints**

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

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

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

Upon application in writing and after hearing pursuant to notice, the accountancy board may reissue or reinstate a certificate to a certified public accountant whose certificate has been revoked or suspended or reregister anyone whose registration has been revoked or suspended. The board may require a reasonable waiting period, commensurate with the offense, before a certificate holder or registrant whose certificate or registration has been revoked or suspended may apply to have the certificate or registration reissued or reinstated. The Board may require compliance with any or all requirements of section 4701.06 of the Revised Code, including the taking of any examination described in division (E) of that section as a prerequisite for recertification. The board may require compliance with any or all of the requirements of section 4701.07 of the Revised Code, including the taking of any examination described in division (E) of that section as a prerequisite for reregistration.

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

Sec. 4701.18. INJUNCTIONS

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

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

Sec. 4701.19. RECORDS

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

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

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

**Sec. 4701.28 EFFECT OF CHILD SUPPORT DEFAULT ON CERTIFICATE OR PERMIT**

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

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

**Sec. 4701.29 CONDUCT OF INVESTIGATIONS**

(A) The accountancy board may investigate whether a person has violated any provision of this chapter or rule adopted under it before commencing a disciplinary proceeding pursuant to section 4701.16 of the Revised Code or taking legal action pursuant to section 4701.18 of the Revised Code. An investigation under this section is not subject to Chapter 119. of the Revised Code.
Chapter 1 – Review Questions

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

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

1. Section 4701.14 regulates the use of certain titles. The prohibition on the use of which of the following titles is not enforced:

   a) CPA
   b) PA
   c) LA
   d) none of the above

2. A registered CPA partnership may use the designation “CPA” if _____ of its partners are CPAs.

   a) 25%
   b) a majority
   c) 66 2/3%
   d) 100%

3. What happens if two statutes conflict with each other:

   a) the court must decide which statute controls
   b) the court may order the General Assembly to correct the conflict but may not decide which statute is controlling
   c) the more restrictive of the two statutes controls
   d) in Ohio, the most liberal application of a statute is controlling

4. Which of the following types of Board investigations is the most common:

   a) unethical conduct
   b) records retention
   c) unlawful advertising
   d) none of the above
Chapter 1 – Solutions and Suggested Responses

1. A: Incorrect. The Board vigorously prosecutes the unlawful use of the “CPA” title.
   B: Incorrect. The Board vigorously prosecutes the unlawful use of the “PA” title.
   C: Correct. The Board does not enforce the provision related to the use of the “LA” title.
   D: Incorrect. The Board investigates 50-60 cases per year dealing with the unlawful use of the “CPA” title.
   (See page 1-3 of the course material.)

2. A: Incorrect. In order to use the title “CPA,” greater than 50% of its owners must be CPAs.
   B: Correct. In order to use the title “CPA,” a majority of its owners must be CPAs.
   C: Incorrect. In order to use the title “CPA,” fewer than two-thirds of its owners must be CPAs.
   D: Incorrect. In order to use the title “CPA,” only a majority of its owners must be CPAs, not all of them.
   (See pages 1-4 to 1-5 of the course material.)

3. A: Incorrect. When two statutes conflict, the most liberal statute applies.
   B: Incorrect. When two statutes conflict, the most liberal statute applies.
   C: Incorrect. When two statutes conflict, the most liberal statute applies.
   D: Correct. In an effort to promote freedom, Ohio has a long-standing tradition of using the most liberal interpretation.
   (See page 1-7 of the course material.)

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

Objectives:

After completing this chapter, you will be able to:

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

INTRODUCTION

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

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

PROFESSIONAL ETHICS: TECHNICAL STANDARDS RULES

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

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

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

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

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

PROFESSIONAL ETHICS: BEHAVIORAL STANDARDS RULES

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

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

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

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

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

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

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

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

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

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

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

PROFESSIONAL ETHICS: PROFESSIONAL STANDARDS RULES

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

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

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

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

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

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

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

(B) A certified public accountant or public accountant who performs or offers to perform any services described in paragraph (A) of this rule must hold an Ohio permit and be affiliated with a registered firm.
PRACTICE POINTER: A permit holder may use his CPA title on his business card or letterhead without “practicing public accountancy.” However, having a yellow pages ad, an outdoor sign, or an Internet website is typically indicative of someone who is practicing public accountancy.

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

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

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

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

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

CPA LICENSING FREQUENTLY ASKED QUESTIONS

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

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

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

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

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

RULE 4701-9-01: INTEGRITY AND OBJECTIVITY

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

(B) Notwithstanding rule 4701-11-01 of the Administrative Code, if an Ohio permit holder has a conflict of interest between the interest of a client or employer and another person, but the Ohio permit holder believes that professional services can be performed with integrity and objectivity, this rule shall not prohibit the performance of professional services by the Ohio permit holder if the conflict of interest is disclosed to, and consent is obtained from, such client or employer and the other person.

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

AICPA Rule 102 – Integrity and Objectivity

In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

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

Interpretation 102-1 (Knowing Misrepresentations in the Preparation of Financial Statements or Records)

A member shall be considered to have knowingly misrepresented facts in violation of Rule 102 when he or she knowingly:
a. Makes, or permits or directs another to make, materially false and misleading entries in an entity’s financial statements or records; or

b. Fails to correct an entity’s financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or

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

Interpretation 102-2 (Conflicts of Interest)

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

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

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

- A member has been asked to perform litigation services for the plaintiff in connection with a lawsuit filed against a client of the member’s firm.
- A member has provided tax or personal financial planning (PFP) services for a married couple who are undergoing a divorce, and the member has been asked to provide the services for both parties during the divorce proceedings.
- In connection with a PFP engagement, a member plans to suggest that the client invest in a business in which he or she has a financial interest.
- A member provides tax or PFP services for several members of a family who may have opposing interests.
- A member has a significant financial interest, is a member of management, or is in a position of influence in a company that is a major competitor of a client for which the member performs management consulting services.
- A member serves on a city’s board of tax appeals, which considers matters involving several of the member’s tax clients.
- A member has been approached to provide services in connection with the purchase of real estate from a client of the member’s firm.
- A member refers a PFP or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement to do so.
- A member recommends or refers a client to a service bureau in which the member or partner(s) in the member’s firm hold material financial interest(s).

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

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

Interpretation 102-3 (Obligations of a Member to His or Her Employer’s External Accountant)

Under Rule 102, a member must maintain objectivity and integrity in the performance of a professional service. In dealing with his or her employer’s external accountant, a member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which his or her employer’s external accountant requests written representation.

Interpretation 102-4 (Subordination of Judgment by a Member)

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

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

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

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

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

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**Example**

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

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

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**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.

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**Interpretation 102-6 (Professional Services Involving Client Advocacy)**

A member or a member's firm may be requested by a client—

1. To perform tax or consulting services engagements that involve acting as an advocate for the client.
2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.
Services provided or actions taken pursuant to such types of client requests are professional services governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201, *General Standards*, Rule 202, *Compliance With Standards*, and Rule 203, *Accounting Principles*, and interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with Rule 102, which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with Rule 101 of the Code of Professional Conduct.

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

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**Case Study**

**Integrity and Objectivity**

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

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

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

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

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

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

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

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

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

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

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

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

RULE 4701-9-03: GENERALLY ACCEPTED AUDITING STANDARDS

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

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

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

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

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

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

RULE 4701-9-04: GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

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

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

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

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

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

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

RULE 4701-9-05: ATTESTATION STANDARDS

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

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

(C) Attestation standards for government agencies or entities receiving significant federal financial assistance are defined in the "Government Auditing Standards" issued by the "Comptroller General of the United States" and published on the "Government Accountability Office" website (www.gao.gov) as of December 2011.

(D) Attestation standards for all entities except those specified in paragraph (C) of this rule are defined as "Statements on Standards for Attestation Engagements" issued by the "American Institute of Certified Public Accountants", and published in “AICPA Professional Standards, Volume 2, as of June 1, 2012.

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

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

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

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

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

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

Competence and Other Professional Standards

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

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

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

RULE 4701-9-09: TAX SERVICES STANDARDS

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

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

Case Study

Competence and Tax Services Standards

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

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

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

Mr. and Mrs. Client donated an old house to the fire department for a training exercise during 2011. The fire department burned the donated house. Green, CPA prepared Client’s 2011 tax return and took a charitable contribution deduction for the appraised value of the donated house.

The IRS notified Client that it would audit their tax return for 2011. Client contacted Green CPA and asked if Green would represent Client during the IRS audit. Green CPA told Client that they didn’t need to be represented and instructed Client to represent themselves.

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

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

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

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

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

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

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

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

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

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

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

- Independence in Fact – Meeting the letter of the law of all the various independence rules.

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

RULE 4701-11-02: CONFIDENTIAL CLIENT INFORMATION

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

(B) This rule shall not be construed:

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

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

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

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

(C) Members of the accountancy board, a professional accounting organization ethics committee, or trial board described in paragraph (B)(4) of this rule, as well as professional practice reviewers, shall not disclose any confidential client information which comes to their attention in disciplinary proceedings or otherwise in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with an aforementioned duly constituted investigative or disciplinary body.
OBSERVATION: An auditor should have access to a variety of information held by the client if the engagement is to be successful. The client will grant the auditor access to sensitive files and reports only if it can expect the auditor to hold the information in confidence. The purpose of Rule 4701-11-02 is to encourage a free flow of information from the client to the CPA; however, the rule makes it clear that the principle of confidentiality is not absolute. The confidentiality concept does not allow the client to omit information that is required by generally accepted accounting principles. SAS-32 (Adequacy of Disclosure in Financial Statements) reinforces the position that if a client omits information that is required by GAAP, a qualified or adverse opinion must be expressed. On the other hand, SAS-32 does note that an auditor ordinarily should not make available information that is not required to be disclosed to comply with GAAP.

Rule 4701-11-02 recognizes the confidentiality of client information, but makes it clear that the information does not constitute privileged communication. In most states, and most federal courts, the CPA can be forced to testify in a case involving the client. Thus, the rule recognizes that an auditor must respond to a subpoena or summons.

In recent years, the concept of peer review has been accepted by the profession. Rule 4701-11-02 allows a peer or quality review of a CPA's professional practice as part of an AICPA or state society of CPAs program.

Finally, Rule 4701-11-02 states that it is not a violation of confidentiality when a member initiates a complaint with or responds to inquiries from a recognized investigative or disciplinary body such as the AICPA’s Professional Ethics Division or Trial Board.

PRACTICE POINTER: The Ethics of Outsourcing Client Tax Returns

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

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

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

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

If your CPA firm has professional liability insurance coverage, you should check with your insurance carrier to see if your policy covers the firm when using an outsource center.
The accuracy of the tax return remains the ultimate responsibility of the CPA firm, and all returns prepared by an outsource center must be reviewed by the CPA firm and the signing CPA.

If your CPA firm is considering outsourcing the preparation of client tax returns, remember that a CPA is responsible for ensuring that any partner, shareholder, officer, director, unlicensed principal, proprietor, employee or agent, including outsource personnel, comply with the AICPA’s rules on Professional Ethics and Conduct.

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

Example

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

A: No. A CPA cannot release confidential client information without the specific consent of the client unless the CPA receives a validly issued and enforceable subpoena or summons.

RULE 4701-11-03: CONTINGENT FEES

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

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

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

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

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

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

(B) The prohibitions outlined in paragraph (A)(1) of this rule apply during the period in which the Ohio permit holder or the Ohio permit holder’s registered firm is engaged to perform any of the services described in paragraphs (A)(1)(a), (A)(1)(b), (A)(1)(c) of this rule, as well as during any period covered by any historical financial statements associated with those services.
EXAMPLE: Nash, CPA is hired December 1, 2012 to complete a review of XYZ, Inc.'s calendar year financial statements. Field work concludes in early February and the review report is issued March 1, 2013. The period of prohibition extends from January 1, 2012 through March 1, 2013.

What if Nash CPA had performed contingent fee services for XYZ, Inc. earlier in the year before accepting the review engagement? In such a case, Nash CPA could not accept the review engagement for 2012.

(C) A contingent fee is a fee established for the performance of any service pursuant to an agreement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. However, an Ohio permit holder’s fees may vary depending, for example, on the complexity of the services rendered.

(D) Fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

AICPA RULE 302 – CONTINGENT FEES

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

Interpretation 302-1 (Contingent Fees in Tax Matters)

This interpretation defines certain terms in Rule 302 and provides examples of the application of the rule.

Definition of Terms

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

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

Examples

The following are examples, not all-inclusive, of circumstances where a contingent fee would be permitted:
1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return.
2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case (involving a different taxpayer) or with respect to which the taxing authority is developing a position.
3. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation ($1 million at March 1991) or state taxing authority.
4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests.
5. Requesting, by means of "protest" or similar document, consideration by the state or local taxing authority of a reduction in the "assessed value" of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value.
6. Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute.

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

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

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

A: Yes. This is not a prohibited transaction.

RULE 4701-11-04: COMMISSIONS AND REFERRAL FEES

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

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

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

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

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

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

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

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

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

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

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**Commissions, Contingent Fees & Referral Fees**

Rules 4701-11-03 and 4701-11-04 describe the circumstances when licensees are prohibited from paying or receiving commissions, referral fees and contingent fees. The prohibitions apply when the holder of a permit or any partner, officer, shareholder, member, manager or owner of the firm performs any of the following services for a client who is also the subject of the commissions, referral fees or contingent fees:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Rule 505 acknowledges this concern for continuity:

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

Fictitious Names

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

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

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

Association Without Partnership

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

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

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

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

### FIRM NAMES – FAQ

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

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

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

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

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

### RULE 4701-11-06: RETENTION OF CLIENT RECORDS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

AICPA RULE 501 – ACTS DISCREPANT

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

When a client of former client (client) makes a request for client-provided records, client records prepared by the member, or supporting records that are in the custody or control of the member or the member’s firm (member) that have not previously been provided to the client, the member should respond to the client’s request as follows:¹

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

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

- **Supporting records** relating to a completed and issued work product should be provided to the client, except that such supporting records may be withheld if there are fees due to the member for the specific work product.

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

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

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

¹ The member is under no obligation to retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed.
• Charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records and require that such fee be paid prior to the time such records are provided to the client;

• Provide the requested records in any format usable by the client;\(^2\) and

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

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

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

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<th>PROFESSIONAL ETHICS – FAQ</th>
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<td><strong>Retention of Client Records</strong></td>
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<td><strong>Q:</strong> I am a CPA and my client owes me for a past due bill. May I withhold the client’s records until I am paid?</td>
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<td><strong>A:</strong> Rule 4701-11-06 states that you must return client records 30 days after the client makes a written request for the records. This time period may be used by you to collect past due fees. However, if the client still does not pay after the 30-day period expires, you must return the client records and enforce collection by other means.</td>
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<td><strong>Q:</strong> AICPA ethics Interpretation 501-1 (ET section 501.02) seems to permit me to hold on to records until I get paid by the client. Why is the Board’s rule different?</td>
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<td><strong>A:</strong> The AICPA ethics interpretation has no deadline for return of client records. The Board’s opinion is that a rule without a deadline is not enforceable; consequently, the Board’s rule balances the interests of the client with those of the CPA.</td>
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\(^2\) The member is not required to convert records that are not in electronic format. However, if the client requests records in a specific format and the member was engaged to prepare the records in that format, the client’s request should be honored.
Case Study

Client records and working papers
Requested records

In 2010, Green decided to close her public accounting office and accept a position in private industry. Green notified clients that she was closing her office and referred clients to another Certified Public Accountant.

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

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

POSSIBLE BOARD ACTION: Violation of Rule 4701-11-06 Retention of Client Records.

RULE 4701-11-07: BOARD COMMUNICATIONS

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

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

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

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

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

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

Failure to Respond to a Board Communication

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

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

RULE 4701-11-09: ACTS DISCREDITABLE

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

AICPA RULE 502 – ADVERTISING AND OTHER FORMS OF SOLICITATION

Interpretation 502-2 (False, Misleading, or Deceptive Acts in Advertising or Solicitation)

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

• Create false or unjustified expectations of favorable results

• Imply the ability to influence any court, tribunal, regulatory agency or similar body or official

• Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood

• Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived
AICPA RULE 502

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

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

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

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

Designation as Expert

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

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

Testimonials and Endorsements

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

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

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

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

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

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

**Acts Discreditable to the Profession**

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

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

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

**Public Communications and Advertising by Firm**


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

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

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**Case Study**

**Professional Misconduct**

White, CPA prepared Smith’s 2011 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 2011 tax return. Smith knew at the time that she paid for ETS that she would not use White’s services again.

Smith’s 2011 tax return was selected for audit. White refused to represent Smith, because Smith was not a continuing client.

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

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

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

Murphy neglected to file tax returns or pay state income tax liabilities for tax years 2008 through 2012. Department of Revenue notified the Board of Accountancy. The Board suspended Murphy’s CPA permit until such time that Murphy filed tax returns and paid outstanding taxes.

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

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

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

(A) Pursuant to division (D)(8) of section 4701.04 of the Revised Code, a person who holds an equity interest in a public accounting firm, but does not hold an Ohio permit or a foreign certificate, shall be subject to either the “Code of Professional Conduct” issued by the “American Institute of Certified Public Accountants” and published on that organization’s website (www.aicpa.org), or a comparable code of conduct applicable to the person’s profession.

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

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

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

The December 31st CPE deadline is now the same as the CPE reporting deadline.
**Engagement Letters**

The Board receives frequent inquiries regarding fees charged by licensees. Many times the caller is surprised by the amount of a bill they have received for CPA services and report it to the Board as a complaint.

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

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

Common provisions in an engagement letter include the following:

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

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

Well-structured engagement letters help reduce misunderstandings regarding fees and services to be performed, decreasing the likelihood that the client will have complaints about fees charged.
Chapter 2 – Review Questions

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

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

1. The term “practice of public accountancy” means the performance of or offering to perform any engagement that will result in the issuance of an attest report in accordance with professional standards. This rule applies to reports issued in accordance with which of the following:
   a) auditing standards
   b) GAAP
   c) compilation and review standards
   d) all of the above

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

3. Nash CPA is hired November 1, 2012 to complete a review of XYZ, Inc.’s calendar year financial statements. Field work concludes February 28th and the review report is issued March 31, 2013. Nash CPA also wants to do an engagement for XYZ, Inc. on a contingent fee basis. What is the period of exclusion in which Nash CPA may not do a contingent fee engagement for XYZ, Inc.:
   a) November 1, 2012 through February 28, 2013
   b) November 1, 2012 through March 31, 2013
   c) January 1, 2012 through February 28, 2013
   d) January 1, 2012 through March 31, 2013
Chapter 2 – Solutions and Suggested Responses

1. A: Incorrect. Auditing standards is just one of the types of reports specified.
   
   B: Incorrect. GAAP is just one of the types of reports specified.
   
   C: Incorrect. Compilation and review standards is just one of the types of reports specified.
   
   **D: Correct.** The rule applies to all attest engagements.
   
   (See pages 2-3 to 2-4 of 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 page 2-7 of the course material.)

3. A: Incorrect. The exclusion period begins on January 1, 2012, the beginning of the client’s fiscal year.
   
   B: Incorrect. The exclusion period begins on January 1, 2012, the beginning of the client’s fiscal year.
   
   C: Incorrect. The exclusion period ends when the engagement ends.
   
   **D: Correct.** The exclusion period encompasses the entire period covered in the financial statements and the entire period the CPA is engaged to review the financial statements.
   
   (See pages 2-17 to 2-18 of the course material.)
Chapter 3: Ethics for Industry CPAs

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

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

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

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.

ACTS DISCREDITABLE

Rule 501 applies to CPAs in industry as well as to those in public practice.

Interpretation 501-7, Failure to file tax return or pay tax liability, is highlighted in the case study below.

Case Study

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

John may not realize it, but he has a responsibility under Rule 501 to timely file all tax returns and to pay all applicable taxes. More importantly, most state boards of accountancy have similar rules, and the states have the ability to discipline their licensees.
Case Study –
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Unexplained Prosperity

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

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

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

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

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

What are the ethical issues?

What should Monterrey do?
Suggested Answer

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

Resign from the company

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

Report suspicions to law enforcement officers

- Accountant violates obligation to client, (employer) exceeds approved limits of actions
- Owners’ possible illegal activity may be uncovered
- Drug peddling may be stopped
- Candy stores may close, employees lose jobs
- Accountant may be sued by owner, censured by state Board
- Accountant’s income decreases

Accept the owners’ explanation, prepare the report

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

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

IMA STATEMENT OF ETHICAL PROFESSIONAL PRACTICE

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

PRINCIPLES

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

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STANDARDS

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

I. COMPETENCE

Each member has a responsibility to:

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

II. CONFIDENTIALITY

Each member has a responsibility to:

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

III. INTEGRITY

Each member has a responsibility to:

1. Mitigate actual conflicts of interest, regularly communicate with business associates to avoid apparent conflicts of interest, and advise all parties of any potential conflicts.
2. Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
3. Abstain from engaging in or supporting any activity that might discredit the profession.

IV. CREDIBILITY

Each member has a responsibility to:

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

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

1. Discuss the issue with your immediate supervisor except when it appears that the supervisor is involved. In that case, present the issue to the next level. If you cannot achieve a satisfactory resolution, submit the issue to the next management level. If your immediate superior is the chief executive office or equivalent, the acceptable reviewing authority may be a group such as the audit committee, executive committee, board of directors, board of trustees, or owners. Contact with levels above the immediate superior should be initiated only with your superior’s knowledge, assuming he or she is not involved. Communication of such problems to authorities or individuals not employed or engaged by the organization is not considered appropriate, unless you believe there is a clear violation of the law.

2. Clarify relevant ethical issues by initiating a confidential discussion with an IMA Ethics Counselor or other impartial advisor to obtain a better understanding of possible courses of action.

3. Consult your own attorney as to legal obligations and rights concerning the ethical conflict.

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.

**COOK THE BOOKS & GO TO JAIL**

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

The high-level warning came from Richard H. Walker, a former director of enforcement of the SEC, 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.
Case Study – Douglas Wachtel


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

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

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

MANAGEMENT ACCOUNTANTS SHOULD HEED THE ABOVE WARNING

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

- The risks of ownership must have passed to the buyer.
- The customer must have a 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.
THE ENRON CASE

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, have also felt the effects of Enron’s demise, which has resulted in sweeping reforms in independence, conflict of interest rules and liability limits.

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 provides financial professionals free, confidential guidance on ethical issues through the IMA Ethics Hotline.

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

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

FEDERAL SENTENCING GUIDELINES

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

1. Create a formal, written ethics policy.
2. Require managers to monitor ethics compliance.
3. Screen potential employees carefully before hiring.
4. Develop incentives to promote compliance.
5. Encourage employees to speak up when they encounter problems.
Companies that embrace the five items above will receive lighter sentences in the event they are convicted of wrongdoing.

**STOCK OPTION BACKDATING**

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

1. **Shareholder Litigation:** Backdating will be a field day for securities lawyers for a number of reasons. If a company said it was issuing options at fair market value, but really didn’t, shareholders could sue because they never approved such a plan. Furthermore, IRS rules make shareholder approval a condition of tax-qualified incentive stock option plans.

2. **SEC Enforcement:** There are numerous violations that could be involved with backdating. If an executive got options timed just before the release of data that would affect the stock price, that’s potentially insider trading. If the options were granted in a way not in accordance with the plan, that could mean that proper disclosures from the executive to the SEC had not been made. If the two-day rule for reporting grants was effectively violated (because the grant date was pushed back more than two days over what the company actually claimed it was), then the securities laws are violated again.

3. **Corporate Taxes:** It’s not entirely clear how the new rules on the taxation of deferred compensation will apply to backdated options issued before the effective date of the new deferred compensation rules under Internal Revenue Code Section 409A, which says that certain kinds of deferred compensation will be heavily taxed unless the recipient specified well in advance when the award would be paid. Options generally do not require such an advance election (you can exercise whenever you like once they are vested until they expire; that’s why they are so appealing). Option grants at fair market value are not covered by Section 409A, but discounted options are. More clear is that if the options were incentive stock options, then the backdating would disqualify the option as an incentive option, and the executive would owe big-time back taxes on the exercised award, even if the stock had not yet been sold. If the exercise date is bogus, that means the company has underwithheld taxes on the exercise, and that means it owes the government, with penalties and interest. Failure to withhold payroll taxes on non-qualified options can result in the denial of the corporate tax deduction for the compensation element of the stock option award. This alone could result in hundreds of millions of dollars in unpaid corporate income taxes.
4. **Financial Statements and Restatements:** Rules for recording the impact of options expenses have changed, but under both the old rules and the new rules, pretending the awards were granted at a price they were not requires companies to go back and restate earnings.

5. **Excess Compensation:** Companies can take tax deductions for compensation to top executives over $1 million only if it is performance-based. Backdated options are not, so there may well be tax penalties.

6. **The Alternative Minimum Tax:** Employees who have incentive stock options do not have to pay any tax when they exercise the option, only when they sell the stock (provided they hold the shares for one year after exercise and two years after grant). At sale, they only would pay capital gains taxes, but they may be subject to the alternative minimum tax (AMT) requiring them to count the spread on the option at exercise as a “preference” item. Many employees (especially executives) would have held on to the stock after exercise for at least a year and paid the AMT. But backdated options cannot be incentive options because incentive options must be issued at fair market value. So, that means they now owe regular tax on the exercise of the option from years ago.

7. **Changes to Option Programs:** This scandal could force companies to reduce or eliminate the granting of options. Why risk the hassle? Just cancel the plan.

**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?
AICPA Ethics Guidance for CPAs in Business and Industry

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

- Do your best to resolve the issue within your own organization, whether that is your department in a larger organization or the company as a whole. Most issues are easily resolved.
- Be cognizant of your obligations to your employer’s external accountant. You must be candid and must not knowingly misrepresent facts or fail to disclose material information to them (Ethics Interpretation 102-3). The full text of the interpretation is provided on the fourth page of this document for your convenience.
- One of the most common ethics violations by CPAs in business and industry relates to Ethics Interpretation 102-4 on Subordination of Judgment. This interpretation may be especially relevant if the CPA has a disagreement or dispute with their manager on the preparation of financial statements or the recording of transactions. The full text of the interpretation is also provided herein for your convenience.
- Don’t overlook an ethics policy or statement in place at your company. In a smaller company, you might need to rely on outside resources as ethics policies might not be fully developed or documented.
- Maintain professional skepticism. If you get an explanation for the situation, think about whether it makes sense. Continue to observe over time to see if the situation plays out as expected.
- Maintain documentation of the issue – your thoughts and decisions all along the way, and the parties with whom you discussed these issues – to review later as may be necessary.
- Even if you are successful in a particular situation, you might find that there are other implications that make it impossible to continue working at a company. In this situation, you should seek employment elsewhere.
- Depending on the severity of the issue, you may want to consult with people that you respect from outside the company. Also, consider whether you need to consult with an attorney.
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. 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 3 – 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 page 3-2 of 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 pages 3-8 to 3-9 of the course material.)
## Glossary of Ethics Terms

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

<table>
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<tr>
<th>TERM</th>
<th>DEFINITION</th>
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<tr>
<td>Alternative Practice Structures (APS)</td>
<td>A nontraditional structure for the practice of public accounting in which a traditional CPA firm engaged in auditing and other attestation services might be closely aligned with another organization, public or private, that performs other professional services (e.g., tax and consulting).</td>
</tr>
<tr>
<td>American Institute of Certified Public Accountants (AICPA)</td>
<td>The national professional organization for all certified public accountants (CPAs).</td>
</tr>
<tr>
<td>Client’s records</td>
<td>Any accounting or other records belonging to the client that were given to the member by, or on behalf of, the client.</td>
</tr>
<tr>
<td>Close relative</td>
<td>Close relatives are the member’s nondependent children (including grandchildren and stepchildren), brothers and sisters, grandparents, parents, and parents-in-law. Spouses of any of the above are also close relatives. The SEC definition of close relatives expands the above to include a spouse’s brothers and sisters and their spouses.</td>
</tr>
<tr>
<td>Code of Professional Conduct (the Code)</td>
<td>The Code was adopted by the membership of the AICPA to provide guidance and rules to all members on various ethics requirements. The Code consists of: 1) Principles, 2) Rules, 3) Interpretations, and 4) Ethics Rulings.</td>
</tr>
<tr>
<td>Conflict of interest</td>
<td>A conflict of interest may occur if a member performs a professional service for a client or employer, and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member’s professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member’s objectivity.</td>
</tr>
</tbody>
</table>
| Consulting process                     | The analytical approach applied in performing a consulting service. The process typically involved some combination of the following:  
  - Determining the client’s objective  
  - Fact-finding  
  - Defining problems or opportunities  
  - Evaluating alternatives  
  - Formulating proposed actions  
  - Communicating results  
  - Implementing  
  - Following up                                                                         |
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<tr>
<th>Term</th>
<th>Definition</th>
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<tr>
<td>Consulting services</td>
<td>Professional services that use the practitioner’s technical skills, education, observations, experiences, and knowledge of the consulting process.</td>
</tr>
<tr>
<td>Contingent fee</td>
<td>A fee for performing any service in which the amount of the fee (or whether a fee will be paid) depends on the results of the service.</td>
</tr>
<tr>
<td>Direct financial interest</td>
<td>A direct financial interest is created when a member invests in a client entity.</td>
</tr>
<tr>
<td>Disqualifying services</td>
<td>Term used to refer to the following services, which when performed for a client prohibit the member from accepting a contingent fee or commission:</td>
</tr>
<tr>
<td></td>
<td>a. An audit or a review of a financial statement.</td>
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<tr>
<td></td>
<td>b. An examination of prospective financial information.</td>
</tr>
<tr>
<td></td>
<td>c. A compilation of a financial statement expected to be used by third parties except when the compilation report discloses a lack of independence.</td>
</tr>
<tr>
<td>Ethics Rulings</td>
<td>Part of the Code of Professional Conduct. Rulings summarize the application of rules and interpretations to a particular set of factual circumstances.</td>
</tr>
<tr>
<td>Firm</td>
<td>A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.</td>
</tr>
<tr>
<td>Former practitioner</td>
<td>A proprietor, partner, shareholder or equivalent of a firm, who leaves by resignation, termination, retirement, or sale of all or part of the practice.</td>
</tr>
<tr>
<td>Holding out as a CPA</td>
<td>Includes any action initiated by a member, whether or not in public practice, that informs others of his or her status as a CPA.</td>
</tr>
<tr>
<td>Independence in appearance</td>
<td>If there are circumstances that a reasonable person might believe are likely to impair independence, the CPA is not independent in appearance. To be recognized as independent, the auditor must be free from any obligation to or interest in the client, its management, or its owners.</td>
</tr>
<tr>
<td>Independence in fact</td>
<td>To be independent in fact (mental independence), the CPA must have integrity and objectivity. If there is evidence that independence is actually lacking, the auditor is not independent in fact.</td>
</tr>
<tr>
<td>Indirect financial interest</td>
<td>An indirect financial interest is created when a member invests in a nonclient entity that has a financial interest in a client.</td>
</tr>
<tr>
<td>Integrity</td>
<td>An element of character fundamental to professional recognition. It is the quality from which public trust derives and the benchmark against which a member must ultimately test all decisions.</td>
</tr>
<tr>
<td>Term</td>
<td>Definition</td>
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<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>Term</td>
<td>Description</td>
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<td>------------------------------------------</td>
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</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>
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