

**Professional Education Services, LP**

# **Ethics and Professional Conduct for Virginia CPAs —2021**

**#4225S**

**COURSE MATERIAL**



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## **NOTICE**

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Note: Any case studies or examples relating to any disciplinary actions taken by the Board of Accountancy have been taken directly from a BOA source (e.g. website, newsletters, notices) and were published based on the information available at the time of course development. Subsequent events, actions, withdrawals may have occurred since the publication of this course.

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# CHAPTER 1: VIRGINIA BOARD OF ACCOUNTANCY

## 2021 PRESENTATION

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### Chapter Objective

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

- Recall the Virginia Board of Accountancy 2021 topics.

**Part I: Per the Board's regulations, you are required to view the special Virginia Board of Accountancy Ethics Segment for 2021.**

In order to complete this requirement, please use the following instructions dependent on the format of course presentation you have purchased. You must complete the Board's video segment before proceeding with the remainder of this course.

**Hardcopy self-study format:**

- Please go to our website at [www.mypescpe.com](http://www.mypescpe.com). Click on the tab entitled CPE REQUIREMENTS
- Click on the state of VIRGINIA. Scroll down to LICENSE RENEWAL INFORMATION
- Click on the link entitled VA BOA Ethics Presentation 2021
- After viewing the video segment, please return to this manual to proceed with the remainder of this course

**PDF format:**

- From your user account, download the PDF TEXT and EXAM to your desktop. Open the 4225STEXT PDF
- On page 1 of CHAPTER 1 click on the following link (*you will be alerted that you are going to a website. Click OK to open the window*): <https://www.mypescpe.com/4225SvboaVIDEO.html>
- OR open your web browser and type in the web link exactly as indicated above
- After viewing the video segment, please return to this manual to proceed with the remainder of this course

**Part II: Virginia Board of Accountancy Segment Evaluation**

Per the Board's request, please use the following link to provide specific feedback regarding the Board's video segment and the new 2021 format and CPE ethics options. Thank you for your consideration and cooperation regarding this request.

<https://boa.virginia.gov/individual-cpas/cpe/vboa-approved-ethics-course/ethics-course-2021-evaluation/>

**Part III: Additional Information**

For updated and detailed information regarding your CPA license, Board policies, CPE requirements, and much more, we recommend that you regularly visit the VA Board of Accountancy website at <https://boa.virginia.gov/>.

For your convenience and review, we have included on the following pages the highlights / outline of the VBOA Segment for 2021, VBOA Policy #4 related to *Continuing Education Guidelines for CPAs*, and VBOA Policy #9 related to *Inactive Status Procedure for Approval / Denial / Appeal*.

# **WELCOME TO THE 2021 VIRGINIA BOARD OF ACCOUNTANCY SEGMENT - HIGHLIGHTS**

The 2021 VBOA Segment will include the following topics:

- Importance of CPA title
- Website redesign
- Inactive status, formally Active – CPE Exempt status
- Overall CPE requirements

## **Importance of CPA title**

- CPA stands for certified public accountant and is a credential that is synonymous with trust, integrity, high-level thinking and sound advice. You have to go the extra distance to earn and maintain the CPA credential. It is one of the most respected designations and professions in the world.
- All CPAs are tasked with following the AICPA Code of Professional Conduct. This code requires CPAs to act with integrity, objectivity, due care and competence, fully disclose any conflicts of interest (and obtain client consent if a conflict exists), maintain client confidentiality, disclose to the client any commission or referral fees, and serve the public interest when providing financial services.

## **Website redesign**

- Recently, the VBOA redesigned their website to be more user- and mobile-friendly. You can find how to annually renew a license easily in a number of places online.
- The latest feature, the 'How Do I' drop down provides information on renewing, reinstating, applying, tracking CPE, and submitting an enforcement complaint. You can also find links to our statutes, regulations and VBOA policies on the website.
- One of the biggest functional changes is the mobile capacities available on the website. The website design and content responds appropriately to every size device from a cell phone, tablet, laptop and desktop computer.

## **Inactive status, formally Active – CPE Exempt status**

- The VBOA has the Inactive status for licensees who have retired, are no longer actively employed or who have changed jobs outside the accounting or accounting-related profession.
- Audit, financial analysis, and even consultants involved in IT accounting and finance solutions would not qualify for the Inactive status. Holding a CPA is often a requirement or preferred qualification for these types of positions.
- As of January 1, 2020, the previous Active – CPE Exempt status was renamed Inactive status but the requirements to apply remain the same.
- If the licensee is not currently providing services that require a use of accounting, financial, tax or other skills that are relevant, including on a volunteer basis, to the public or to or on behalf of an employer, they may not be required to meet the VBOA's CPE requirements.
- But remember, licensees must be pre-approved by the VBOA for the Inactive status first before ceasing to take CPE and be exempt from the requirements.

- Licensees apply for this status on the VBOA website and must provide a copy of their official job title and description, as necessary. Job duties and current services must be complete. Being deceptive or misleading may result in disciplinary action by the VBOA.
- Licensees also cannot apply for the Inactive status when they have been selected for a CPE audit. If a licensee has not been approved for the status at the time of CPE audit selection and notification, the licensee is responsible for meeting all the VBOA's CPE requirements.
- Furthermore, all licensees, including those holding the Inactive status, must continue to annually renew their license. Failing to renew, even if Inactive, will result in an Expired license and require reinstatement.
- The VBOA encourages CPAs to serve their communities as volunteers by providing their knowledge and financial expertise. Licensees who hold the Inactive status can still volunteer but need to follow a few guidelines.
- If you have questions about volunteering as an Active or Inactive CPA, please check the Volunteer Services guidelines on our website at <https://boa.virginia.gov/individual-cpas/>.

### **Overall CPE requirements**

- An individual who applies for an initial license, holds a Virginia individual CPA license, or applies to have their license reinstated is required to obtain CPE. It is the intent of the VBOA that all CPE meet the requirements of VBOA regulations and assist the licensee in becoming a better overall professional.
- Active CPAs must complete the required 120 CPE hours over a rolling three-year period, with a minimum of 20 hours annually. The CPE requirement also includes completing a two-hour VBOA-approved ethics course annually, just as you are doing right now, and eight hours of A&A courses, if releasing or authorizing the release of reports.
- The VBOA accepts CPE obtained through a variety of forums, provided the licensee is able to demonstrate that learning objectives were met.
- In addition, courses do not have to cover accounting topics to be eligible CPE. A licensee can take CPE on professional development, leadership and more.
- CPAs should not submit CPE documentation during the annual license renewal process unless specifically asked to by the VBOA. However, CPE documentation must be retained and available to the CPA easily for the four calendar years preceding the current calendar year.
- Remember that CPE is tracked and documented by calendar year, not fiscal year like the license renewal deadline.
- On a monthly basis, the VBOA randomly selects licensed CPAs in Virginia for a CPE audit. Licensees will be required to visit the NASBA-sponsored CPE Audit Service to complete the CPE audit.
- In addition to the random selection process, CPAs will also be selected for a CPE audit as a component of any open investigation, enforcement case or in situations where the VBOA believes a CPE audit is warranted.
- Explain the differences of reciprocity vs. mobility and how this might affect your CPE requirements.



# **VBOA POLICY #4**

## **TITLE**

Continuing Professional Education Guidelines for CPAs

## **EFFECTIVE DATE**

August 19, 2020

## **AUTHORITY**

Code of Virginia §§ 54.1-4409.2 and 54.1-4413.2 and VBOA regulations 18VAC5-22-90 and 18VAC5-22-140

## **POLICY STATEMENT**

Specific CPE requirements of the Virginia Board of Accountancy (VBOA) are listed in the authority sections named above. This policy details the CPE guidelines approved by the VBOA.

### **General guidelines**

Persons who hold a Virginia license must obtain 120 hours of CPE during a rolling three-calendar-year reporting period. For each calendar year within the reporting period, the person must obtain a minimum of 20 hours of CPE that must include a VBOA-approved ethics course of at least 2 hours. If the person releases or authorizes the release of reports on attest services, compilation services, or financial statement preparation services during the calendar year, the person must obtain a minimum of 8 hours of CPE related to those services in that same calendar year, which are included as part of the annual minimum and reporting period minimum.

CPE requirements for persons who have been newly issued a Virginia license can be found in VBOA regulation 18VAC5-22-90(B). CPE requirements for a person wishing to reinstate a Virginia license or wishing to transition the status of their Virginia license from Inactive back to Active can be found in VBOA regulation 18VAC5-22-90(C).

The VBOA recognizes that 50 minutes of CPE participation equals one hour of CPE. Conversion of semester hours or quarter hours from an accredited college or university into hours of CPE can be found in VBOA regulations. CPE requirements may be adjusted depending upon when a person who holds a Virginia license begins or ceases to provide services to the public or to or on behalf of an employer in accordance with VBOA regulation 18VAC5-22-90. Specific questions may be addressed by contacting the VBOA. All persons who hold a Virginia license have until January 31 to complete the previous calendar year's CPE requirements.



## **VBOA-approved ethics course (beginning with the 2021 course)**

The VBOA requires that all people who hold a Virginia license complete on an annual basis a VBOA-approved ethics course of at least 2 hours, which includes the VBOA Segment as defined in VBOA Policy #2, unless the person has been granted the Inactive status for their Virginia license or the VBOA has granted a waiver of this requirement.

The VBOA-approved ethics course of at least 2 hours is a separate and distinct annual requirement from the one-time American Institute of Certified Public Accountants ethics course needed for initial licensure.

People who hold a Virginia license must complete the VBOA-approved course which includes the VBOA Segment no later than January 31 of each year to meet the previous calendar-year requirement. No sponsor may provide the annual ethics course later than January 31 for the previous calendar year.

The VBOA-approved ethics course must include the specific VBOA Segment. Licensees must complete a VBOA-approved ethics course annually.

It is the responsibility of a person who holds a Virginia license to ensure that sponsors providing the VBOA-approved ethics course are listed on the VBOA's website as an approved sponsor of this course. A person who holds a Virginia license will not be deemed to have met the annual ethics requirement if they complete an ethics course from a nonapproved sponsor.

People who hold a Virginia license must also ensure that sponsors provide a certificate of completion or some other form of documentation that includes the sponsor's name, participant's name, course/content name, date taken and hours of CPE earned.

If the person also holds the license of another state and Virginia is not his principal place of business, the ethics course taken to comply with this subsection either shall conform with the requirements prescribed by the VBOA or shall be an ethics course acceptable to the board of accountancy of another state in which the person holds a license.

## **Qualifying CPE other than the VBOA-approved ethics course**

It is the intent of the VBOA that all CPE (1) meet the requirements of VBOA regulations 18VAC5-22-90 and 18VAC5-22-140; (2) provide course content pertinent to the profession; and (3) assist the person who holds a Virginia license in becoming a better accounting professional. The VBOA accepts CPE obtained through a variety of forums, providing that the person who holds a Virginia license is able to demonstrate that learning objectives were met.

A variety of continuing professional education is acceptable, as specified in VBOA regulations.

The VBOA will determine on a case-by-case basis the acceptability of other forums for CPE not otherwise specified in regulation. Restrictions on specific forums for CPE are found in VBOA regulations. Acceptance of hours of CPE is at the discretion of the VBOA.

The VBOA has also approved that Continuing Education (CE), Continuing Education Units (CEU), Continuing Legal Education (CLE), Continuing Medical Education (CME), and Quality Assurance Service (QAS) are acceptable as hours of CPE.

With the exception of the VBOA-approved ethics course, the VBOA does not currently require people who hold a Virginia license to obtain CPE from specific or approved sponsors.

### **CPE reporting period**

The VBOA uses a rolling three calendar-year period to determine CPE compliance. This period includes the three calendar years prior to the current calendar year. For example, if asked by the VBOA to produce evidence of CPE compliance, submit such evidence for the three calendar years prior to the current calendar year.

### **CPE compliance reviews**

On a monthly basis, the VBOA randomly selects people who hold a Virginia license for CPE compliance. The VBOA will notify licensees selected for a CPE compliance review. If selected, a person will be required to submit acceptable CPE documentation to verify compliance through a means determined by the VBOA. As a function of this CPE review process, a person may be required to provide additional documentation as requested by the VBOA to support compliance.

In addition to the random selection process, people who hold a Virginia license will also be selected for a CPE compliance review as a component of any open investigation or enforcement case or in situations where the VBOA believes that a CPE compliance review is warranted.

### **CPE documentation requirements**

Required documentation can generally be satisfied by providing:

- Certificates of completion or some other form of documentation from the CPE sponsor(s) including the sponsor(s)' name, participant's name, course/content name, date taken and hours of CPE earned.
- Official transcript of the college or university for earning course credit at an accredited college or university.
- Syllabus/agenda and signed statement indicating the length of the presentation when making a presentation.
- Copy of published article, book or written material (or proof of publication) when producing written material relevant to CPAs who provide services to the public or to or on behalf of an employer.

The VBOA has restrictions on the types of documentation it regards as acceptable. The VBOA will not accept receipts, registration confirmations, canceled checks, outlines, PowerPoint presentations or sign-in sheets, etc., as valid CPE documentation.

### **Retention requirements for CPE documentation**

People who hold a Virginia license must retain CPE documentation for the four calendar years preceding the current calendar year.

## **CPE violations**

As the result of a CPE compliance review, the VBOA may find that a person who holds a Virginia license has violated the CPE requirements during the reporting period. In such cases, enforcement action may be taken and the person will generally be offered a Consent Order and be subject to disciplinary action.

A person who holds a Virginia license may also determine on their own, outside of a CPE compliance review, that they are deficient in CPE for a specific reporting period. The person should notify the VBOA immediately when it is determined that a CPE deficiency has occurred.

In accordance with VBOA regulations, depending on the facts and circumstances, the VBOA may waive all or part of the CPE requirement for one or more calendar years or grant additional time for complying with the CPE requirement, provided that the waiver or deferral is in the public interest. However, requests for a waiver or a deferral must generally be received in advance of the deadline for CPE completion. It is the policy of the VBOA that such waivers or deferrals generally be considered only in situations resulting from extreme medical hardship or active military deployment.

Requests for a waiver or deferral made under this section will be considered on a case-by-case basis. Such approvals are rare.

## **APPROVAL AND REVIEW**

This VBOA policy was reviewed on June 23, 2020.

## **SUPPRESSION**

This VBOA policy replaces VBOA Policy #4 that was approved on September 30, 2019.

## **VBOA CHAIR AT LAST REVIEW**

D. Brian Carson, CPA, CGMA, Chair

## **VBOA MEMBERS AT LAST REVIEW**

Laurie A. Warwick, CPA, Vice Chair

Matthew P. Boshier

W. Barclay Bradshaw, CPA

William R. Brown, CPA

Nadia A. Rogers, CPA

Stephanie S. Saunders, CPA

## **EXECUTIVE DIRECTOR**

Nancy J. Glynn, CPA

# **VBOA POLICY #9**

## **TITLE**

Inactive Status Procedure for Approval/Denial/Appeal

## **EFFECTIVE DATE**

March 5, 2020

## **AUTHORITY**

Code of Virginia § 54.1-4409.1(B) of the Code of Virginia and VBOA regulation 18VAC5-22-90(C)

## **POLICY STATEMENT**

A person who holds a Virginia license with the status of Inactive has a current license and has the privilege of using the CPA title. However, the person has demonstrated to the Virginia Board of Accountancy (VBOA) that they are not currently providing services, including on a volunteer basis, to the public (providing services that are subject to the guidance of the standard-setting authorities listed in the standards of conduct and practice in subsections 5 and 6 of § 54.1-4413.3) or to or on behalf of an employer (providing to an entity services that require the substantial use of accounting, financial, tax, or other skills that are relevant, as determined by the VBOA) and therefore is not required to meet the VBOA's CPE requirements.

Persons who hold an Active Virginia license must proactively apply for this status by submitting a change of license status request by completing and submitting the Inactive status application form which must be approved by the VBOA. Applicants not approved for this status are required to obtain CPE in accordance with VBOA statutes and regulations and will not be exempt from CPE requirements.

Persons currently under CPE audit may not apply for the Inactive status until the audit has been completed.

Only Active CPAs may apply for this status. Applicants whose licenses were either voluntarily surrendered, suspended, or expired and need to be reinstated must obtain 120 CPE hours, including the ethics course as prescribed by the VBOA, and follow the appropriate process, application, and fees to reinstate into the Active status. After reinstating as an Active CPA, applicants may then apply for the Inactive status.

Procedure for approval/denial/appeal of Inactive status includes:

1. Application form must be submitted to the VBOA.
2. Upon receipt of form and supporting documentation, the Executive Director or designee makes the determination to approve or deny status change.
3. If approved by the Executive Director or designee, the status is changed and the applicant is informed of the change.

4. If denied by the Executive Director or designee, the applicant is informed of denial.
5. Following initial denial of the Inactive status pursuant to #4 above, the applicant may appeal the decision and may present additional documentation to assist the VBOA in making a determination. The VBOA Chair or designee will make the final determination of status.
  - a) If approved by VBOA Chair or designee, the status is changed and the applicant is informed of the change.
  - b) If denied by VBOA Chair or designee, the applicant is informed of denial and no further appeals are available.

## **APPROVAL AND REVIEW**

This VBOA policy was reviewed on January 7, 2020.

## **SUPPRESSION**

This VBOA policy replaces Board Policy #9 that was effective on December 12, 2019.

## **VBOA CHAIR AT LAST REVIEW**

D. Brian Carson, CPA, CGMA, Chair

## **VBOA MEMBERS AT LAST REVIEW**

Laurie A. Warwick, CPA, Vice Chair

Matthew P. Boshier

W. Barclay Bradshaw, CPA

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## **EXECUTIVE DIRECTOR**

Nancy J. Glynn, CPA

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## CHAPTER 1: TEST YOUR KNOWLEDGE

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

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

1.	<p><b>Which statement is <u>true</u> regarding the Board’s “Inactive” status:</b></p> <ul style="list-style-type: none"><li><b>A.</b> the Inactive status is reserved only for those licensees who have formally retired</li><li><b>B.</b> if a licensee intends to apply for an Inactive status designation, they can stop taking CPE immediately</li><li><b>C.</b> Inactive status licensees must continue to renew their license annually</li><li><b>D.</b> licensees who hold the Inactive status can no longer volunteer their services</li></ul>
2.	<p><b>Which statement is <u>not</u> true regarding the CPE requirements for an Active licensee:</b></p> <ul style="list-style-type: none"><li><b>A.</b> the VA Board of Accountancy requires 120 hours over a rolling three-year period</li><li><b>B.</b> the VA Board of Accountancy accepts CPE obtained through a live presentation</li><li><b>C.</b> the VA Board of Accountancy only accepts CPE on accounting topics</li><li><b>D.</b> the VA Board randomly selects CPAs for a CPE audit</li></ul>



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## CHAPTER 1: SOLUTIONS AND SUGGESTED RESPONSES

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

1.	<p><b>A.</b> Incorrect. The Inactive status is indeed for licensees who have retired, but also for those that are no longer actively employed or who have changed jobs outside the accounting, finance, or accounting-related profession.</p> <p><b>B.</b> Incorrect. Before ceasing to take or meet CPE requirements, licensees must first be pre-approved by the Virginia Board of Accountancy for the Inactive status.</p> <p><b>C. CORRECT.</b> All licensees, including those holding the Inactive status, must continue to annually renew their license. Failure to do so (even if Inactive) will result in an expired license and require reinstatement.</p> <p><b>D.</b> Incorrect. The VBOA encourages CPAs to serve their communities on a volunteer basis utilize their knowledge and financial expertise. Those holding the Inactive status can still volunteer but need to follow guidelines which can be found on the VBOA's website.</p> <p><i>(Refer to the VA BOA 2021 ethics video segment.)</i></p>
2.	<p><b>A.</b> Incorrect. This is a true statement. Active CPAs must complete 120 hours over a rolling three-year period, with a minimum of 20 hours annually. The three-year period includes the calendar years prior to the current calendar year.</p> <p><b>B.</b> Incorrect. This is a true statement. The VBOA accepts CPE obtained through a variety of forums as long as the licensee is able to demonstrate that learning objectives were met. Different methods of CPE delivery include a live seminar presentation as well as self-study courses, in-house training, live and on-demand webcasts, and more.</p> <p><b>C. CORRECT.</b> CPE courses do not need to cover accounting topics to be eligible. A licensee can take courses in a variety of subject areas provided that the course content is pertinent to the professional and assists the licensee in becoming a better accounting professional. A licensee can take CPE on professional development, leadership, and more.</p> <p><b>D.</b> Incorrect. This is a true statement. On a monthly basis, the VBOA randomly selects licensed CPAs for a CPE audit. When selected, the licensee will be required to use the NASBA-sponsored CPE Audit Service to complete the audit. In addition to a random selection, CPAs will also be selected for an audit as a component of any open investigation, enforcement case, or anytime when the VBOA believes a CPE audit is warranted.</p> <p><i>(Refer to the VA BOA 2021 ethics video segment.)</i></p>

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## CHAPTER 2: INTRODUCTION TO THE STUDY OF ETHICS

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### Chapter Objective

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

- Identify the history and function of ethics.

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

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

### Observation



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

The modern professional rules of conduct that govern CPAs – like those governing attorneys and other professionals – have developed out of those schools of thought with an eye toward establishing a set of norms that benefit and promote the profession while protecting consumers. A general understanding of some of the background of this field of study is helpful to more fully understand the goal of the rules of professional conduct governing CPAs. This type of understanding is also useful in analyzing situations that may arise that do not fall squarely within the parameters of one of the specific professional rules. The ethical CPA should be able to determine the appropriate course of action regardless of the circumstances

in which he or she finds himself or herself. We will begin our discussion with a brief overview of a few of the major philosophical ethical constructs and then examine how those constructs can be used as models in guiding the behavior of CPAs.

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

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

Summary: Philosopher John Austin believed there are 2 types of laws:

- 1) Natural Laws – Laws laid down by God to govern the behavior of man;
- 2) Positive Laws – Laws that are established by men.

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

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

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

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

## **THE VALUE OF PROFESSIONAL CODES OF ETHICS**

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

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

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## CHAPTER 2: TEST YOUR KNOWLEDGE

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

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

1.	<p><b>Which of the following were the earliest to study the philosophy of ethics in Western civilization:</b></p> <ul style="list-style-type: none"><li>A. the Founding Fathers of the United States</li><li>B. medieval Christians</li><li>C. Greek philosophers such as Plato and Aristotle</li><li>D. the Roman Empire</li></ul>
2.	<p><b>What is the primary reason Austin believed that people follow rules or laws:</b></p> <ul style="list-style-type: none"><li>A. fear of sanction</li><li>B. a desire to do the moral thing</li><li>C. fear of stigmatism</li><li>D. a desire to conform to societal norms</li></ul>

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## CHAPTER 2: SOLUTIONS AND SUGGESTED RESPONSES

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

1.	<p><b>A.</b> Incorrect. The study of ethics goes back much further than the founding of the United States.</p> <p><b>B.</b> Incorrect. Although medieval Christians did study the philosophy of ethics, they were far from the first to do so in the West.</p> <p><b>C. CORRECT.</b> The study of the philosophy of ethics in Western civilization has its roots in the classical Greek philosophers of Plato and Aristotle.</p> <p><b>D.</b> Incorrect. The Roman empire debated the philosophy of ethics, but were not the earliest to do so.</p> <p><i>(See page 15 of the course material.)</i></p>
2.	<p><b>A. CORRECT.</b> Austin believed that people are motivated most by fear of sanction for non-compliance.</p> <p><b>B.</b> Incorrect. Austin believed that more people act out of fear than out of a desire to do the right thing.</p> <p><b>C.</b> Incorrect. A stigmatism can be a type of sanction. However, it is not nearly as broad as a sanction.</p> <p><b>D.</b> Incorrect. According to Austin, many people act in order to conform to societal norms. However, more act in order to avoid being punished.</p> <p><i>(See pages 16 to 17 of the course material.)</i></p>

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## CHAPTER 3: THE AICPA CODE OF PROFESSIONAL CONDUCT

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### Chapter Objective

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

- Recognize the rules of the Code of Professional Conduct.

### INTRODUCTION

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

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

### RULES

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

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

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

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

## CODIFIED CODE OF PROFESSIONAL CONDUCT

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

Part 1: Members in Public Practice

Part 2: Members in Business

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

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

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

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

1.000 Conceptual Framework for Members in Public Practice

1.100 Integrity and Objectivity

1.200 Independence

1.300 General Standards

1.400 Acts Discreditable

1.500 Fees and Other Types of Remuneration

1.600 Advertising and Other Forms of Solicitation

1.700 Confidential Information

1.800 Form of Organization and Name

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

## MEMBERS IN PUBLIC PRACTICE

### 1.000 INTRODUCTION

**.01** Part 1 of the Code of Professional Conduct (the code) applies to members in public practice. Accordingly, when the term member is used in part 1 of the code, the requirements apply only to members in public practice. When a member in public practice is also a member in business (for example, serves as a member of an entity's board of directors), the member should also consult part 2 of the code, which applies to a member in business.

**.02** Government auditors within a government audit organization who audit federal, state, or local governments or component units thereof, that are structurally located within the government audit organization, are considered in public practice with respect to those entities provided the head of the government audit organization meets at least one of the following criteria:

- a. Is directly elected by voters of the government entity with respect to which attest engagements are performed
- b. Is appointed by a legislative body and is subject to removal by a legislative body
- c. Is appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

### 1.000.010 CONCEPTUAL FRAMEWORK FOR MEMBERS IN PUBLIC PRACTICE

#### Introduction

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

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

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



## Definitions Used in Applying the Conceptual Framework

**.04** Acceptable level. A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a member's compliance with the rules is not compromised.

**.05** Safeguards. Actions or other measures that may eliminate a threat or reduce a threat to an acceptable level.

**.06** Threats. Relationships or circumstances that could compromise a member's compliance with the rules.

## Conceptual Framework Approach

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

a. Identify threats. The relationships or circumstances that a member encounters in various engagements and work assignments will often create different threats to complying with the rules. When a member encounters a relationship or circumstance that is not specifically addressed by a rule or an interpretation, under this approach, the member should determine whether the relationship or circumstance creates one or more threats, such as those identified in paragraphs .10–.16 that follow. The existence of a threat does not mean that the member is in violation of the rules; however, the member should evaluate the significance of the threat.

b. Evaluate the significance of a threat. In evaluating the significance of an identified threat, the member should determine whether a threat is at an acceptable level. A threat is at an acceptable level when a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the threat would not compromise the member's compliance with the rules. Members should consider both qualitative and quantitative factors when evaluating the significance of a threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. If the member evaluates the threat and concludes that a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the threat does not compromise a member's compliance with the rules, the threat is at an acceptable level, and the member is not required to evaluate the threat any further under this conceptual framework approach.

c. Identify and apply safeguards. If, in evaluating the significance of an identified threat, the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. The member

should apply judgment in determining the nature of the safeguards to be applied because the effectiveness of safeguards will vary, depending on the circumstances. When identifying appropriate safeguards to apply, one safeguard may eliminate or reduce multiple threats. In some cases, the member should apply multiple safeguards to eliminate or reduce one threat to an acceptable level. In other cases, an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member will be unable to implement effective safeguards. Under such circumstances, providing the specific professional services would compromise the member's compliance with the rules, and the member should determine whether to decline or discontinue the professional services or resign from the engagement.

## Threats

**.08** Many threats fall into one or more of the following seven broad categories: adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.

**.09** Examples of threats associated with a specific relationship or circumstance are identified in the interpretations of the code. Paragraphs .10–.16 of this section define and provide examples, which are not all inclusive, of each of these threat categories.

**.10** Adverse interest threat. The threat that a member will not act with objectivity because the member's interests are opposed to the client's interests. Examples of adverse interest threats include the following:

- a. The client has expressed an intention to commence litigation against the member.
- b. A client or officer, director, or significant shareholder of the client participates in litigation against the firm.
- c. A subrogee asserts a claim against the firm for recovery of insurance payments made to the client.
- d. A class action lawsuit is filed against the client and its officers and directors and the firm and its professional accountants.

**.11** Advocacy threat. The threat that a member will promote a client's interests or position to the point that his or her objectivity or independence is compromised. Examples of advocacy threats include the following:

- a. A member provides forensic accounting services to a client in litigation or a dispute with third parties.
- b. A firm acts as an investment adviser for an officer, a director, or a 10 percent shareholder of a client.
- c. A firm underwrites or promotes a client's shares.
- d. A firm acts as a registered agent for a client.
- e. A member endorses a client's services or products.

**.12 Familiarity threat.** The threat that, due to a long or close relationship with a client, a member will become too sympathetic to the client's interests or too accepting of the client's work or product. Examples of familiarity threats include the following:

- a. A member's immediate family or close relative is employed by the client.
- b. A member's close friend is employed by the client.
- c. A former partner or professional employee joins the client in a key position and has knowledge of the firm's policies and practices for the professional services engagement.
- d. Senior personnel have a long association with a client.
- e. A member has a significant close business relationship with an officer, a director, or a 10 percent shareholder of a client.

**.13 Management participation threat.** The threat that a member will take on the role of client management or otherwise assume management responsibilities, such may occur during an engagement to provide nonattest services.

**.14 Self-interest threat.** The threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client. Examples of self-interest threats include the following:

- a. The member has a financial interest in a client, and the outcome of a professional services engagement may affect the fair value of that financial interest.
- b. The member's spouse enters into employment negotiations with the client.
- c. A firm enters into a contingent fee arrangement for a tax refund claim that is not a predetermined fee.
- d. Excessive reliance exists on revenue from a single client.

**.15 Self-review threat.** The threat that a member will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the member or an individual in the member's firm and that the member will rely on that service in forming a judgment as part of another service. Examples of self-review threats include the following:

- a. The member relies on the work product of the member's firm.
- b. The member performs bookkeeping services for a client.
- c. A partner in the member's office was associated with the client as an employee, an officer, a director, or a contractor.

**.16 Undue influence threat.** The threat that a member will subordinate his or her judgment to an individual associated with a client or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member.

Examples of undue influence threats include the following:

- a. The firm is threatened with dismissal from a client engagement.
- b. The client indicates that it will not award additional engagements to the firm if the firm continues to disagree with the client on an accounting or tax matter.
- c. An individual associated with a client or any relevant third party threatens to withdraw or terminate a professional service unless the member reaches certain judgments or conclusions.

## **Safeguards**

**.17** Safeguards may partially or completely eliminate a threat or diminish the potential influence of a threat. The nature and extent of the safeguards applied will depend on many factors. To be effective, safeguards should eliminate the threat or reduce it to an acceptable level.

**.18** Safeguards that may eliminate a threat or reduce it to an acceptable level fall into three broad categories:

- a. Safeguards created by the profession, legislation, or regulation.
- b. Safeguards implemented by the client. It is not possible to rely solely on safeguards implemented by the client to eliminate or reduce significant threats to an acceptable level.
- c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements.

**.19** The effectiveness of a safeguard depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of threats
- c. Whether the safeguard is suitably designed to meet its objectives
- d. The party(ies) who will be subject to the safeguard
- e. How the safeguard is applied
- f. The consistency with which the safeguard is applied
- g. Who applies the safeguard
- h. How the safeguard interacts with a safeguard from another category
- i. Whether the client is a public interest entity

**.20** Examples of safeguards within each category are presented in the following paragraphs. Because these are only examples and are not intended to be all inclusive, it is possible that threats may be sufficiently mitigated through the application of other safeguards not specifically identified herein.

**.21** The following are examples of safeguards created by the profession, legislation, or regulation:

- a. Education and training requirements on independence and ethics rules
- b. Continuing education requirements on independence and ethics
- c. Professional standards and the threat of discipline
- d. External review of a firm's quality control system
- e. Legislation establishing prohibitions and requirements for a firm or a firm's professional employees
- f. Competency and experience requirements for professional licensure
- g. Professional resources, such as hotlines, for consultation on ethical issues

**.22** Examples of safeguards implemented by the client that would operate in combination with other safeguards are as follows:

- a. The client has personnel with suitable skill, knowledge, or experience who make managerial decisions about the delivery of professional services and makes use of third-party resources for consultation as needed.
- b. The tone at the top emphasizes the client's commitment to fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.
- c. Policies and procedures are in place to achieve fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.
- d. Policies and procedures are in place to address ethical conduct.
- e. A governance structure, such as an active audit committee, is in place to ensure appropriate decision making, oversight, and communications regarding a firm's services.
- f. Policies are in place that bar the entity from hiring a firm to provide services that do not serve the public interest or that would cause the firm's independence or objectivity to be considered impaired.

**.23** The following are examples of safeguards implemented by the firm:

- a. Firm leadership that stresses the importance of complying with the rules and the expectation that engagement teams will act in the public interest.
- b. Policies and procedures that are designed to implement and monitor engagement quality control.
- c. Documented policies regarding the identification of threats to compliance with the rules, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate identified threats or reduce them to an acceptable level.

- d. Internal policies and procedures that are designed to monitor compliance with the firm's policies and procedures.
- e. Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and the firm's clients.
- f. The use of different partners, partner equivalents, and engagement teams from different offices or that report to different supervisors.
- g. Training on, and timely communication of, a firm's policies and procedures and any changes to them for all partners and professional staff.
- h. Policies and procedures that are designed to monitor the firm's, partner's, or partner equivalent's reliance on revenue from a single client and that, if necessary, trigger action to address excessive reliance.
- i. Designation of someone from senior management as the person responsible for overseeing the adequate functioning of the firm's quality control system.
- j. A means for informing partners and professional staff of attest clients and related entities from which they must be independent.
- k. A disciplinary mechanism that is designed to promote compliance with policies and procedures.
- l. Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution.
- m. Policies and procedures relating to independence and ethics communications with audit committees or others charged with client governance.
- n. Discussion of independence and ethics issues with the audit committee or others responsible for the client's governance.
- o. Disclosures to the audit committee or others responsible for the client's governance regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged.
- p. The involvement of another professional accountant who (a) reviews the work that is done for a client or (b) otherwise advises the engagement team. This individual could be someone from outside the firm or someone from within the firm who is not otherwise associated with the engagement.
- q. Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant.
- r. Rotation of senior personnel who are part of the engagement team.

- s. Policies and procedures that are designed to ensure that members of the engagement team do not make or assume responsibility for management decisions for the client.
- t. The involvement of another firm to perform part of the engagement.
- u. Having another firm to reperform a nonattest service to the extent necessary for it to take responsibility for that service.
- v. The removal of an individual from an attest engagement team when that individual's financial interests or relationships pose a threat to independence or objectivity.
- w. A consultation function that is staffed with experts in accounting, auditing, independence, ethics, and reporting matters who can help engagement teams
  - i. assess issues when guidance is unclear or when the issues are highly technical or require a great deal of judgment; and
  - ii. resist undue pressure from a client when the engagement team disagrees with the client about such issues.
- x. Client acceptance and continuation policies that are designed to prevent association with clients that pose a threat that is not at an acceptable level to the member's compliance with the rules.
- y. Policies that preclude audit partners or partner equivalents from being directly compensated for selling nonattest services to the attest client.
- z. Policies and procedures addressing ethical conduct and compliance with laws and regulations.

## **1.000.020 ETHICAL CONFLICTS**

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

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

For example, a member suspects a fraud may have occurred, but reporting the suspected fraud would violate the member's responsibility to maintain client confidentiality.

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

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



**.03** The member should also be prepared to justify any departures that the member believes were appropriate in applying the relevant rules and law. If the member was unable to resolve the conflict in a way that permitted compliance with the applicable rules and law, the member may have to address the consequences of any violations.

**.04** Before pursuing a course of action, the member should consider consulting with appropriate persons within the firm or the organization that employs the member.

**.05** If a member decides not to consult with appropriate persons within the firm or the organization that employs the member and the conflict remains unresolved after pursuing the selected course of action, the member should consider either consulting with other individuals for help in reaching a resolution or obtaining advice from an appropriate professional body or legal counsel. The member also should consider documenting the substance of the issue, the parties with whom the issue was discussed, details of any discussions held, and any decisions made concerning the issue.

**.06** If the ethical conflict remains unresolved, the member will in all likelihood be in violation of one or more rules if he or she remains associated with the matter creating the conflict. Accordingly, the member should consider his or her continuing relationship with the engagement team, specific assignment, client, firm, or employer.

## **1.100 INTEGRITY AND OBJECTIVITY**

### **1.100.001 INTEGRITY AND OBJECTIVITY RULE**

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

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

### **1.100.005 APPLICATION OF THE CONCEPTUAL FRAMEWORK FOR MEMBERS IN PUBLIC PRACTICE AND ETHICAL CONFLICTS**

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

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

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

## **1.110 CONFLICTS OF INTEREST**

### **1.110.010 CONFLICTS OF INTEREST FOR MEMBERS IN PUBLIC PRACTICE**

**.01** A member or his or her firm may be faced with a conflict of interest when performing a professional service. In determining whether a professional service, relationship or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

**.02** A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001]. For example, threats may be created when

- a. the member or the member's firm provides a professional service related to a particular matter involving two or more clients whose interests with respect to that matter are in conflict, or
- b. the interests of the member or the member's firm with respect to a particular matter and the interests of the client for whom the member or the member's firm provides a professional service related to that matter are in conflict.

**.03** Certain professional engagements, such as audits, reviews and other attest services require independence. Independence impairments under the "Independence Rule" [1.200.001], its interpretations, and rulings cannot be eliminated by the safeguards provided in this interpretation or by disclosure and consent.

**.04** The following are examples of situations in which conflicts of interest may arise:

- a. Providing corporate finance services to a client seeking to acquire an audit client of the firm, when the firm has obtained confidential information during the course of the audit that may be relevant to the transaction
- b. Advising two clients at the same time who are competing to acquire the same company when the advice might be relevant to the parties' competitive positions
- c. Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction
- d. Preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets
- e. Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership
- f. Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement

- g. Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest in the business
- h. Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client
- i. Advising a client on the acquisition of a business which the firm is also interested in acquiring
- j. Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service
- k. Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm
- l. Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests
- m. Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement
- n. A client asks the member to provide tax or personal financial planning services to its executives, and the services could result in the member recommending to the executives actions that may be adverse to the company
- o. A member serves as a director or an officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities receive funds. Some of those charities are clients of the member's firm
- p. A member who is an officer, a director, or a shareholder of an entity has significant influence over the entity, and that entity has a loan to or from a client of the firm

## Identification of a Conflict of Interest

**.05** Before accepting a new client relationship, engagement, or business relationship, a member should take reasonable steps to identify circumstances that might create a conflict of interest including identification of

- a. the nature of the relevant interests and relationships between the parties involved, and
- b. the nature of the service and its implication for relevant parties.

**.06** The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a member is asked to conduct an engagement for a client in a situation that may become adversarial with respect to another client or the member or member's firm, even though the parties who engage the member may not initially be involved in a dispute. A member should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

**.07** For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a member in identifying actual or potential conflicts of interest that may create significant threats to compliance with the “Integrity and Objectivity Rule” [1.100.001] prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example clients or potential clients. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a member being able to apply safeguards to eliminate or reduce significant threats to an acceptable level. The process to identify actual or potential conflicts of interest will depend on such factors as

- a. the nature of the professional services provided,
- b. the size of the firm,
- c. the size and nature of the client base, and
- d. the structure of the firm, for example the number and geographic location of offices.

**.08** If the firm is a member of a network, the member is not required to take specific steps to identify conflicts of interest of other network firms; however, if the member knows or has reason to believe that such conflicts of interest may exist or might arise due to interests and relationships of a network firm, the member should evaluate the significance of the threat created by such conflicts of interest as described below.

### **Evaluation of a Conflict of Interest**

**.09** When an actual conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both qualitative and quantitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. In evaluating the significance of an identified threat, members should consider both of the following:

- a. The significance of relevant interests or relationships.
- b. The significance of the threats created by performing the professional service or services. In general, the more direct the connection between the professional service and the matter on which the parties’ interests are in conflict, the more significant the threat to compliance with the rule will be.

**.10** If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

- a. Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include

- i. using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
  - ii. creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm;
  - iii. establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and the physical and electronic separation of confidential information.
- b. Regularly reviewing the application of safeguards by a senior individual not involved with the client engagement or engagements.
- c. Having a member of the firm who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
- d. Consulting with third parties, such as a professional body, legal counsel, or another professional accountant.

**.11** In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

### **Disclosure of a Conflict of Interest and Consent**

**.12** When a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional services. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

**.13** Disclosure and consent may take different forms. The following are examples:

- a. General disclosure to clients of circumstances in which the member, in keeping with common commercial practice, does not provide services exclusively for any one client (for example, in a particular service in a particular market sector) in order for the client to provide general consent accordingly. Such disclosure might be made in a member's standard terms and conditions for the engagement.
- b. Specific disclosure to affected clients of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the client to make an informed decision with respect to the matter and to provide specific consent.

**.14** The member should determine whether the nature and significance of the conflict of interest is such that specific disclosure and specific consent are necessary, as opposed to general disclosure and general consent. For this purpose, the member should exercise professional judgment in evaluating the circumstances that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

**.15** When a member has requested specific consent from a client and that consent has been refused by the client, the member should (a) decline to perform or discontinue professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level, such that consent can be obtained, after applying any additional safeguards, if necessary.

**.16** The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

**.17** When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a member should remain alert to the requirements of the “Confidential Client Information Rule” [1.700.001] and the “Confidential Information Obtained From Employment or Volunteer Activities” interpretation [1.400.070] of the “Acts Discreditable Rule” [1.400.001]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct.

**.18** When practicing before the IRS or other taxing authorities, members should ensure compliance with any requirements that are more restrictive. For example, Treasury Department Circular No. 230, Regulations Governing Practice before the Internal Revenue Service, provides more restrictive requirements concerning written consent by the client when a conflict of interest exists.

## Independent Contractors: Q&A

**Question:** Would independence be impaired if a CPA firm retained an independent contractor (as defined by IRS regulations and other federal regulatory guidance such as case law and revenue rulings) on a part-time basis that is employed by or associated with an attest client in a key position?

**Answer:** Yes. Independence would be impaired if an independent contractor retained by the firm was simultaneously employed by or associated with an attest client in a key position. However, if the independent contractor is employed by or associated with the attest client in a non-key position, a member should consider the following criteria when determining if independence (in fact and appearance) is impaired:

- a. Location of the firm office where the independent contractor will work in relation to the location of the office providing services to the attest client.
- b. Whether the independent contractor performs services for other firms or entities or solely to the member's firm. Factors to consider include but are not limited to:
  1. The percentage of income the individual derives from the member's firm in relation to the individual's total "self-employed" or earned income.
  2. The percentage of income the individual derives from the client entity in relation to the individual's total earned income.
  3. The amount of time the individual devotes to the member's firm versus time devoted to the attest client.
  4. The amount of time the individual devotes to the member's firm versus time devoted to other firms or entities.

In situations in which the threats to independence (in fact or appearance) are deemed not significant, the member or the member's firm should consider the potential conflict of interest arising from such a relationship as set forth in the "Conflicts of Interest for Members in Public Practice" interpretation (ET sec. 1.110.010) under "Integrity and Objectivity Rule". If threats are deemed significant, the member should consider whether safeguards are available to eliminate or reduce them to an acceptable level. If no safeguards could eliminate or reduce threats to an acceptable level, independence would be considered impaired.



## 1.120 GIFTS AND ENTERTAINMENT

### 1.120.010 OFFERING OR ACCEPTING GIFTS OR ENTERTAINMENT

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

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

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

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

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

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

**.05** Threats to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an acceptable level and could not be reduced to an acceptable level through the application of safeguards if a member offers to a client or accepts gifts or entertainment from a client that is not reasonable in the circumstances. The member would be presumed to lack objectivity in violation of the "Integrity and Objectivity Rule" under these circumstances.

**.06** Refer to the "Offering or Accepting Gifts or Entertainment" interpretation [1.285.010] of the "Independence Rule" [1.200.001] for additional guidance.



## Campaign Contributions: Q&A

**Question:** May a member make a political contribution to the campaign of an individual that is associated with an attest client in a key position or holds a financial interest in the attest client that is material and/or enables the individual to exercise significant influence over the attest client without impairing independence or violating any other rule of conduct?

**Answer:** Yes. A member would not impair independence or be in violation of any other rule of conduct provided the political contribution is not made with the intention of influencing the procurement of professional services or in contravention of federal or state laws or regulations. Related Guidance: “Offering or Accepting Gifts or Entertainment” interpretation (ET sec. 1.285.010) under the “Independence Rule” and “Offering or Accepting Gifts or Entertainment” interpretation (ET sec. 1.120.010) under the “Integrity and Objectivity Rule” (ET sec. 1.100.001) [August 2012]

### 1.130 PREPARING AND REPORTING INFORMATION

#### 1.130.010 KNOWING MISREPRESENTATIONS IN THE PREPARATION OF FINANCIAL STATEMENTS OR RECORDS

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

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

#### 1.130.020 SUBORDINATION OF JUDGMENT

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

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

**.03** A member should evaluate the significance of any threats to determine if they are at an acceptable level. Threats are at an acceptable level if the member concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If threats are not at an acceptable level, the member should apply the safeguards in paragraphs .06–.08 to eliminate or reduce the threat(s) to an acceptable level so that the member does not subordinate his or her judgment.

**.04** In evaluating the significance of any identified threats, the member should determine, after appropriate research or consultation, whether the result of the position taken by the supervisor or other person

- a. fails to comply with professional standards, when applicable;
- b. creates a material misrepresentation of fact; or
- c. may violate applicable laws or regulations.

**.05** If the member concludes that threats are at an acceptable level the member should discuss his or her conclusions with the person taking the position. No further action would be needed under this interpretation.

**.06** If the member concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then threats would not be at an acceptable level. In such circumstances, the member should discuss his or her concerns with the supervisor.

**.07** If the difference of opinion is not resolved after discussing the concerns with the supervisor, the member should discuss his or her concerns with the appropriate higher level(s) of management within the member's organization (for example, the supervisor's immediate superior, senior management, and those charged with governance).

**.08** If after discussing the concerns with the supervisor and appropriate higher level(s) of management within the member's organization, the member concludes that appropriate action was not taken, then the member should consider, in no specific order, the following safeguards to ensure that threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001] are eliminated or reduced to an acceptable level:

- a. Determine whether the organization's internal policies and procedures have any additional requirements for reporting differences of opinion.
- b. Determine whether he or she is responsible for communicating to third parties, such as regulatory authorities or the organization's (former organization's) external accountant. In considering such communications, the member should be cognizant of his or her obligations under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] of the "Acts Discreditable Rule" [1.400.001].
- c. Consult with his or her legal counsel regarding his or her responsibilities.
- d. Document his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

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

**.10** Nothing in this interpretation precludes a member from resigning from the organization at any time. However, resignation may not relieve the member of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

**.11** A member should use professional judgment and apply similar safeguards, as appropriate, to other situations involving a difference of opinion as described in this interpretation so that the member does not subordinate his or her judgment.

## **1.200 INDEPENDENCE**

### **1.200.001 INDEPENDENCE RULE**

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

#### **Interpretations Under the Independence Rule**

### **1.200.005 APPLICATION OF THE CONCEPTUAL FRAMEWORK FOR INDEPENDENCE AND ETHICAL CONFLICTS**

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

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

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

## Observation



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

### 1.210 Conceptual Framework Approach

#### 1.210.010 CONCEPTUAL FRAMEWORK FOR INDEPENDENCE

##### Introduction

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

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

##### Definitions Used in Applying the Conceptual Framework for Independence

**.03** Acceptable level. A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a member's independence is not impaired.

**.04** Impair(ed). In connection with independence, to effectively extinguish independence. When a member's independence is impaired, the member is not independent.

**.05** Safeguards. Actions or other measures that may eliminate a threat or reduce a threat to an acceptable level.

**.06** Threats. Relationships or circumstances that could impair independence.

## **Conceptual Framework Approach**

**.07** The conceptual framework approach entails identifying threats and evaluating the threat that the member would not be independent or would be perceived by a reasonable and informed third party who is aware of the relevant information as not being independent. The member must eliminate or reduce that threat to an acceptable level to conclude that the member is independent. Threats are at an acceptable level either because of the types of threats and their potential effect or because safeguards have eliminated or reduced the threat, so that a reasonable and informed third party who is aware of the relevant information would perceive that the member's professional judgment is not compromised.

**.08** Refer to paragraph .07 of the "Conceptual Framework for Members in Public Practice" [1.000.010.07] for a detailed description of the conceptual framework approach.

## **Documentation**

**.09** When the member applies safeguards to eliminate or reduce significant threats to an acceptable level, as described in paragraph .07c of the "Conceptual Framework for Members in Public Practice" [1.000.010.07], the member should document the identified threats and safeguards applied. Failure to prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001] rather than the "Independence Rule" [1.200.001] if the member can demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

## **Threats**

**.10** Many different relationships or circumstances (or combinations of relationships or circumstances) can create threats to compliance with the "Independence Rule" [1.200.001]. It is impossible to identify every relationship or circumstance that creates a threat. Many threats fall into one or more of the following seven broad categories: adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.

**.11** Examples of threats associated with a specific relationship or circumstance are identified in the interpretations of the code. Paragraphs .12–.18 in this section define and provide examples, which are not all inclusive, of each of these threat categories. In certain circumstances, the code specifies that because of the type of threat and its potential effect, either no safeguards can eliminate or reduce the threat to an acceptable level, or a member would need to apply specific safeguards to eliminate or reduce an independence threat to an acceptable level. When independence interpretations in the code address one of these examples, a specific reference to the independence interpretation is provided in brackets after that example. If an example does not contain a specific reference to an independence interpretation, a member should use this "Conceptual Framework for Independence" interpretation to evaluate whether a threat is significant.

**.12** Adverse interest threat. The threat that a member will not act with objectivity because the member's interests are in opposition to the interests of an attest client. An example is either the attest client or

the member commencing litigation against the other or expressing the intent to commence litigation. [1.290.010]

**.13 Advocacy threat.** The threat that a member will promote an attest client's interests or position to the point that his or her independence is compromised. Examples of advocacy threats include the following:

- a. A member promotes the attest client's securities as part of an initial public offering. [1.295.130]
- b. A member provides expert witness services to an attest client. [1.295.140]
- c. A member represents an attest client in U.S. tax court or other public forum. [1.295.160]

**.14 Familiarity threat.** The threat that, because of a long or close relationship with an attest client, a member will become too sympathetic to the attest client's interests or too accepting of the attest client's work or product. Examples of familiarity threats include the following:

- a. A member of the attest engagement team has an immediate family member or close relative in a key position at the attest client, such as the attest client's CEO. [1.270.020 and 1.270.100]
- b. A partner or partner equivalent of the firm has been a member of the attest engagement team for a prolonged period.
- c. A member of the firm has recently been a director or an officer of the attest client. [1.277.010]
- d. A member of the attest engagement team has a close friend who is in a key position at the attest client.

**.15 Management participation threat.** The threat that a member will take on the role of attest client management or otherwise assume management responsibilities for an attest client. Examples of management participation threats include the following:

- a. A member serves as an officer or a director of the attest client. [1.275.005]
- b. A member accepts responsibility for designing, implementing, or maintaining internal controls for the attest client. [1.295.030]
- c. A member hires, supervises, or terminates the attest client's employees. [1.295.135]

**.16 Self-interest threat.** The threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, an attest client or persons associated with the attest client. Examples of self-interest threats include the following:

- a. A member has a direct financial interest or material indirect financial interest in the attest client. [1.240.010]

b. A member has a loan from the attest client, an officer or a director of the attest client, or an individual who owns 10 percent or more of the attest client's outstanding equity securities. [1.260.010]

c. A member or his or her firm relies excessively on revenue from a single attest client.

d. A member or member's firm has a material joint venture or other material joint business arrangement with the attest client. [1.265]

**.17 Self-review threat.** The threat that a member will not appropriately evaluate the results of a previous judgment made, or service performed or supervised by the member or an individual in the member's firm and that the member will rely on that service in forming a judgment as part of an attest engagement. Certain self-review threats, such as preparing source documents used to generate the attest client's financial statements [1.295.120], pose such a significant self-review threat that no safeguards can eliminate or reduce the threats to an acceptable level.

**.18 Undue influence threat.** The threat that a member will subordinate his or her judgment to that of an individual associated with an attest client or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. Examples of undue influence threats include the following:

a. Management threatens to replace the member or member's firm over a disagreement on the application of an accounting principle.

b. Management pressures the member to reduce necessary audit procedures in order to reduce audit fees.

c. The member receives a gift from the attest client, its management, or its significant shareholders. [1.285.010]

## **Safeguards**

**.19 Safeguards** may partially or completely eliminate a threat or diminish the potential influence of a threat. The nature and extent of the safeguards applied will depend on many factors, including the size of the firm and whether the attest client is a public interest entity. To be effective, safeguards should eliminate the threat or reduce it to an acceptable level.

**.20** The following are three broad categories of safeguards:

a. Safeguards created by the profession, legislation, or regulation.

b. Safeguards implemented by the attest client. It is not possible to rely solely on safeguards implemented by the attest client to eliminate or reduce significant threats to an acceptable level.

c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements.



**.21** The effectiveness of a safeguard depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of threats
- c. Whether the safeguard is suitably designed to meet its objectives
- d. The party(ies) that will be subject to the safeguard
- e. How the safeguard is applied
- f. The consistency with which the safeguard is applied
- g. Who applies the safeguard
- h. How the safeguard interacts with a safeguard from another category
- i. Whether the attest client is a public interest entity

**.22** Examples of various safeguards within each category are presented in paragraphs .21–.23 of the “Conceptual Framework for Members in Public Practice” [1.000.010]. The examples presented in these paragraphs are not intended to be all inclusive. In addition, threats may be sufficiently mitigated through the application of other safeguards not specifically identified in these paragraphs.

## **1.230 FEES**

### **1.230.010 UNPAID FEES**

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

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

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

## **1.240 FINANCIAL INTERESTS**

### **1.240.010 OVERVIEW OF FINANCIAL INTERESTS**

**.01** If a covered member had or was committed to acquire any direct financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member’s compliance with the “Independence Rule” [1.200.001] would not be at an acceptable level and could not



be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

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

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

## **1.300 GENERAL STANDARDS**

### **1.300.001 GENERAL STANDARDS RULE**

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

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

## Pro Bono / Below Cost Fees: Q&A

**Question:** May a member perform professional services for a client for no fee or for a fee that is below cost without impairing independence or violating any other rule of conduct?

**Answer:** Yes. However, regardless of what fee is charged, members are required to comply with all professional standards that are applicable to the services performed. For example, a member must comply with the “General Standards Rule” (ET sec. 1.300.001), which requires members to

- only undertake those professional services that the member or the member’s firm can reasonably expect to be completed with professional competence.
- exercise due professional care in the performance of professional services.
- adequately plan and supervise the performance of professional services.
- obtain relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

The member’s state board(s) of accountancy may have rules that are more restrictive than provided in the above guidance. Accordingly, members should consult with their state board(s) of accountancy for guidance.

Professional services performed for a client for no fee or a fee below cost would not be considered a gift for purposes of applying the “Gifts and Entertainment” subtopic (ET sec. 1.120.010) of the “Integrity and Objectivity Rule” and the “Gifts and Entertainment” subtopic (ET sec. 1.285.010) of the “Independence Rule.”

### 1.300.010 COMPETENCE

**.01** Competence, in this context, means that the member or member’s staff possess the appropriate technical qualifications to perform professional services and that the member, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession’s standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of professional services.

**.02** A member’s agreement to perform professional services implies that the member has the necessary competence to complete those services according to professional standards and to apply the member’s knowledge and skill with reasonable care and diligence. However, the member does not assume a responsibility for infallibility of knowledge or judgment.

**.03** The member may have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing professional services involves performing additional research or consulting with others to gain sufficient competence.

**.04** If a member is unable to gain sufficient competence, the member should suggest, in fairness to the client and public, the engagement of a competent person to perform the needed professional service, either independently or as an associate.

## **1.310 COMPLIANCE WITH STANDARDS**

### **1.310.001 COMPLIANCE WITH STANDARDS RULE**

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

## **1.320 ACCOUNTING PRINCIPLES**

### **1.320.001 ACCOUNTING PRINCIPLES RULE**

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

## **1.400 ACTS DISCREDITABLE**

### **1.400.001 ACTS DISCREDITABLE RULE**

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

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

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

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

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

#### **1.400.090 FALSE, MISLEADING, OR DECEPTIVE ACTS IN PROMOTING OR MARKETING PROFESSIONAL SERVICES**

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

**.02** Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body.

#### **1.500 FEES AND OTHER TYPES OF REMUNERATION**

##### **1.510 CONTINGENT FEES**

##### **1.510.001 CONTINGENT FEES RULE**

**.01** A member in public practice shall not

- a. Perform for a contingent fee any professional services for, or receive such a fee from a client for whom the member or the member’s firm performs,

- i. an audit or review of a financial statement; or
  - ii. a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
  - iii. an examination of prospective financial information; or
- b. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

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

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

### Contingent Fees: Q&A

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

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

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

### Note



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

## Observation



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

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

The period of prohibition includes the date covered by the financial statements and the period during which the attestation service (and compilation service, as described above) is performed. For example, if the CPA is auditing a client's financial statements for the year ended December 31, 2020, and the date of the auditor's report is March 12, 2021, no services could be performed on a contingent fee basis by the auditor for the period from January 1, 2020, through March 12, 2021.

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

### 1.520 COMMISSIONS AND REFERRAL FEES

#### 1.520.001 COMMISSIONS AND REFERRAL FEES RULE

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

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

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

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

**.04** Referral fees. Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client. [Prior reference: paragraph .01 of ET section 503]

### **Disclosure of Commissions: Q&A**

**Question:** When is a member required to disclose to a client that a commission will be received under the “Commissions and Referral Fees Rule” (ET sec. 1.520.001)?

**Answer:** A member should disclose that a commission would be received at the time the referral is being made so that the client can decide whether to act on the recommendation.

## **1.600 ADVERTISING AND OTHER FORMS OF SOLICITATION**

### **1.600.001 ADVERTISING AND OTHER FORMS OF SOLICITATION RULE**

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

## **1.700 CONFIDENTIAL INFORMATION**

### **1.700.001 CONFIDENTIAL CLIENT INFORMATION RULE**

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

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



that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

### Confidential Client Information: Q&A

**Question:** 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?

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

## 1.800 Form of Organization and Name

### 1.800.001 FORM OF ORGANIZATION AND NAME RULE

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

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

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

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

### Organization Name: Q&A

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

**Answer:** 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.

### Observation



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



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

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

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

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

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## CHAPTER 3: TEST YOUR KNOWLEDGE

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

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

1.	<p><b>Which of the following is an example of a safeguard created by a profession, legislation, or regulation:</b></p> <ul style="list-style-type: none"><li>A. professional standards and the threat of discipline</li><li>B. well-trained personnel to make managerial decisions about professional services</li><li>C. strong firm leadership</li><li>D. an active audit committee to ensure appropriate decision making regarding a firm's services</li></ul>
2.	<p><b>Which of the following is true regarding a CPA accepting an engagement under 1.300.010:</b></p> <ul style="list-style-type: none"><li>A. a CPA must accept any engagement in which the CPA can meet the expectations of the client</li><li>B. a CPA may accept an engagement only if, at the time of acceptance, the CPA possesses sufficient professional competence to complete the engagement</li><li>C. 1.300.010 allows a CPA to accept an engagement in which the CPA lacks professional competence provided the CPA can obtain the necessary competence prior to completing the engagement</li><li>D. 1.300.010 generally prohibits CPAs from representing taxpayers before the Internal Revenue Service unless the CPA has also earned the Enrolled Agent designation</li></ul>

3.	<p><b>The AICPA allows a CPA firm to be owned by non-CPAs if the form of ownership is sanctioned by the particular state, and if certain guidelines are observed. Which of the following guidelines <u>must</u> be met:</b></p> <ul style="list-style-type: none"><li><b>A.</b> 51% of the ownership must be held by CPAs</li><li><b>B.</b> a non-CPA owner must be actively engaged in providing services to the firm's clients</li><li><b>C.</b> a non-CPA owner may not hold him or herself out as a CPA</li><li><b>D.</b> all of the above</li></ul>
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## CHAPTER 3: SOLUTIONS AND SUGGESTED RESPONSES

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

1.	<p><b>A. CORRECT.</b> A potential safeguard to minimize a threat that is created by the profession, legislation, or regulation, is the establishment of professional standards and the threat of discipline.</p> <p><b>B.</b> Incorrect. Well trained personnel to make managerial decisions about professional services is a safeguard implemented by the client.</p> <p><b>C.</b> Incorrect. A safeguard implemented by the firm would include strong firm leadership that stresses the importance of complying with the rules.</p> <p><b>D.</b> Incorrect. An active audit committee, put in place to ensure appropriate decision making, would be a safeguard established by the client.</p> <p><i>(See page 30 of the course material.)</i></p>
2.	<p><b>A.</b> Incorrect. A CPA is not required to accept an engagement simply because they can meet the client's expectations.</p> <p><b>B.</b> Incorrect. A CPA may accept an engagement, even if at the time of acceptance they do not have the required professional competence, as long as they seek out the requisite knowledge by performing additional research or consulting with others.</p> <p><b>C. CORRECT.</b> 1.300.010 allows a CPA to accept an engagement that he or she lacks professional competence in, as long as the CPA can obtain the necessary competence prior to completing the engagement.</p> <p><b>D.</b> Incorrect. 1.300.010 does not require that only Enrolled Agents represent taxpayers before the Internal Revenue Service.</p> <p><i>(See page 50 of the course material.)</i></p>

3.	<p><b>A.</b> Incorrect. The AICPA allows for non-CPA ownership of CPA firms as long as 51% of the ownership (as measured by financial interest and voting rights) is held by CPAs. However, this is not the only correct selection.</p> <p><b>B.</b> Incorrect. One of the prerequisites for non-CPA ownership of a CPA firm is that non-CPA owners must be actively engaged in providing services to the firm's clients, but this is not the only selection that is correct.</p> <p><b>C.</b> Incorrect. The AICPA allows for non-CPA ownership of a CPA firm assuming that the non-CPA owner does not hold him or herself out as a CPA. However, this is not the only selection that is correct.</p> <p><b>D.</b> <b>CORRECT</b>. The AICPA allows for non-CPA ownership of a CPA firm as long as CPAs own a minimum of 51%, the non-CPA owner is actively engaged in providing services to the clients, and non-CPAs do not hold themselves out as CPAs.</p> <p><i>(See page 57 of the course material.)</i></p>
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## GLOSSARY

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

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

**Close relative** - Close relatives are the member's nondependent children (including grandchildren and stepchildren), brothers and sisters, grandparents, parents, and parents-in-law. Spouses of any of the above are also close relatives. The SEC definition of close relatives expands the above to include a spouse's brothers and sisters and their spouses.

**Code of Professional Conduct (the Code)** - The Code was adopted by the membership of the AICPA to provide guidance and rules to all members on various ethics requirements. The Code consists of: 1) Principles, 2) Rules, 3) Interpretations, and 4) Ethics Rulings.

**Conflict of interest** - A conflict of interest may occur if a member performs a professional service for a client or employer, and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity.

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

**Contingent fee** - A fee for performing any service in which the amount of the fee (or whether a fee will be paid) depends on the results of the service.

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

**Firm** - A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.

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

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

**Independence in fact** - To be independent in fact (mental independence), the CPA must have integrity and objectivity. If there is evidence that independence is actually lacking, the auditor is not independent in fact.

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

**Integrity** - An element of character fundamental to professional recognition. It is the quality from which public trust derives and the benchmark against which a member must ultimately test all decisions.

**Member** - In its broadest sense, “member” is a term used to describe a member, associate member, or international associate of the AICPA. All members must adhere to the AICPA’s Code of Professional Conduct. For the purposes of applying the independence rules, the term “member” identifies the people in a CPA firm and their spouses, dependents, and cohabitants who are subject to the independence requirements.

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

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

**Practice of public accounting** - According to the Code of Professional Conduct, the practice of public accounting consists of the performance for a client, by a member or a member’s firm, while holding out as CPAs, of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements on Standards for Tax Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements. However, a member or member’s firm, while holding out as CPAs, is not considered to be in the practice of public accounting if the member or the member’s firm does not perform, for any client, any of the professional services described in the preceding paragraph.

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

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

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

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

**Unpaid fees** - Fees for: 1) audit, and 2) other professional services that relate to certain prior periods that are delinquent as of the date the current year’s audit engagement begins, if the client is an SEC registrant, or the date the audit report is issued for non-SEC clients (i.e., AICPA rule).



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