Ethics for California

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Course CPE Information

Course Expiration Date
Per AICPA and NASBA Standards (S9-06), QAS Self-Study courses must include an expiration date that is ***no longer than one year from the date of purchase or enrollment***.

Field of Study
Regulatory Ethics. Some state boards may count credits under different categories—check with your state board for more information.

Course Level
Overview

Prerequisites
There are no prerequisites.

Advance Preparation
None.

Course Description
This is an ethics course for California covering standards of professional conduct and business practices adhered to by accountants such as CPAs in order to enhance their profession and maximize idealism, justice and fairness when dealing with the public, clients and other members of their profession. It also presents an approach --the threats and safeguards approach –to coping with ethical dilemmas. The Sarbanes-Oxley Act and its impact on business ethics, new internal control requirements, and the CPA’s responsibilities are summarized. Finally, a brief discussion of the AICPA’s Standards for Tax Service and the IMA’s Statement of Ethical Professional Practice are included.

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Instructional Design

This Self-Study course is designed to lead you through a learning process using instructional methods that will help you achieve the stated learning objectives. You will be provided with course objectives and presented with comprehensive information and facts demonstrated in exhibits and/or case studies. Review questions will allow you to check your understanding of the material, and a qualified assessment will test your mastery of the course.

Please familiarize yourself with the following instructional features to ensure your success in achieving the learning objectives.

Course CPE Information

The preceding section, "Course CPE Information," details important information regarding CPE. If you skipped over that section, please go back and review the information now to ensure you are prepared to complete this course successfully.

Table of Contents

The table of contents allows you to quickly navigate to specific sections of the course.

Learning Objectives and Content

Learning objectives clearly define the knowledge, skills, or abilities you will gain by completing the course. Throughout the course content, you will find various instructional methods to help you achieve the learning objectives, such as examples, case studies, charts, diagrams, and explanations. Please pay special attention to these instructional methods, as they will help you achieve the stated learning objectives.

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

Glossary

The glossary defines key terms. Please review the definition of any words you are not familiar with.

Index

The index allows you to quickly locate key terms or concepts as you progress through the instructional material.

Qualified Assessment

Qualified Assessment measure (1) the extent to which the learning objectives have been met and (2) that you have gained the knowledge, skills, or abilities clearly defined by the learning objectives for each section of the course. Unless otherwise noted, you are required to earn a minimum score of 70% to pass a course. If you do not pass on your first attempt, please review the learning objectives, instructional materials, and review questions and answers before attempting to retake the qualified assessment to ensure all learning objectives have been successfully completed.

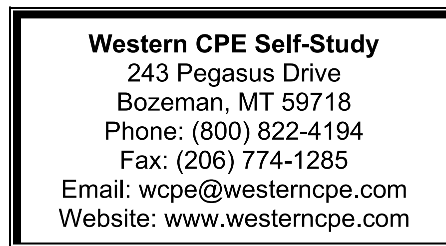
Answer Sheet

Feel free to fill the Answer Sheet out as you go over the course. To enter your answers online, follow these steps:

1. Go to www.westerncpe.com.
2. Log in with your username and password.
3. At the top right side of your screen, hover over "My Account" and click "My CPE."
4. Click on the big orange button that says "View All Courses."
5. Click on the appropriate course title.
6. Click on the blue wording that says "Qualified Assessment."
7. Click on "Attempt assessment now."

Evaluation

Upon successful completion of your online assessment, we ask that you complete an online course evaluation. Your feedback is a vital component in our future course development.



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Chapter 1 – Ethics and Ethical Reasoning

Learning Objectives

After studying this chapter, you will be able to:

- Recognize ethical reasoning used by accountants.

Ethics is the "science of morals". A moral is an accepted rule or standard of human behavior. The understanding of "accepted" is "accepted by society", and accepted only insofar as the behavior in question being behavior that affects others in the society, even if only indirectly. The implication of this definition is therefore that private actions that have no impact on others are a matter for personal morality, which is not of business or organizational concern.

However, the distinction between personal morality and business morality may not always be so clearly defined. This is because individuals bring personal values to their jobs and to the real or perceived problems of moral choice that confront them at work. Moral choices sometimes must be made because of tensions within individuals, between individuals, or between individuals and what they believe to be the values that drive their organizations.

Furthermore, business organizations do not operate in a social vacuum. Because of the ways business organizations can and do affect the lives and livelihoods of society at large, some would argue that business organizations are kind of "moral agents" in society. Therefore managers and general public alike often wrestle with defining exactly what constitutes the ethical way of doing business, and what constitutes proper constraints on individual self-interests, and by whom shall these constraints be imposed.

A further complexity results from the fact that businesses are increasingly becoming global in nature. Different countries have or seem to have vastly different customs and values. Understanding and assessing whether and how these different cultural and ethical conflicts should be taken into account is often most difficult.

Attitudes toward ethics

Amoral:	Condone any actions that contribute to the corporate aim. Getting away with it is the key. No set of values other than greed.
Legalistic:	Obey the letter of the law but not the spirit of it, especially if it conflicts with profits. Ethics ignored until it becomes a problem.
Responsive:	Take the view that there is something to gain from ethical behavior. Using ethics as a tool to attain corporate aim.
Emerging:	Ethical values becoming part of the culture. Codes of ethics being action documents, and likely to contain statements reflecting core value.
Ethical:	Total ethical profile. Everything done is ethical, and the right thing

	always done by everyone. The ideal.

In general, a key focus of ethics is the concept of integrity (or honesty). Integrity in broad terms will imply that no business-persons in the course of their business functions should be party to the falsification of any facts or information or make any statement which knowingly is misleading, false or deceptive in a material particular.

Another major focus of ethics is professional competence and due care, which implies that business professionals should always perform their functions in accordance with law and regulations. In other words, business transactions and professional functions should not be undertaken unless one possesses the required competence and technical skills.

A more controversial focus is the area of freedom from conflicts of interests. The preferred position of many is that one should always avoid concurrent involvement in any business, occupation or activity, which might result in the compromising of integrity, objectivity and independence of decision making.

In defining law and ethics and their relationship to each other, it is necessary to distinguish between moral and legal rights and duties. Morally, a person's rights consist of claims that he can justly make to the conditions of well-being; his duties consist of what he can justly contribute to well-being. Legal rights and duties - that is, claims and obligations enforceable at law - may or may not be fully in harmony with prevalent moral opinion systems in which law and ethics and religion are closely interwoven. The impact of moral opinion on law varies with the type of political structure and influence of public opinion.

In free societies, the ultimate justification of law is that it serves moral ends. However, the dependence of law on moral principles must not be taken to imply that there is a set of moral principles, which can be lain down for guidance. However, most free societies are coming to be more or less consistent in principles that draw the line between law and morals. The task of ethics becomes two-fold: to bring out what is involved in the notion of a principle or norm of action and to recognize ideals that serve as agencies of guidance and control.

A number of consistent principles recognized in modern society are the individual, responsibility and equity. The end of law is to secure the greatest possible general individual self-assertion. In the Judeo-Christian ethic, responsibility is a given: the best ordering of human society in which the individual may come to full manhood and satisfying existence. On the basis of equitable doctrine, we can say confidently that morality is inseparable from the legal order; that right and wrong is part of the legal order.

Ethical Reasoning and Accountants

The largest part of the prior research projects which have been done on ethical issues in accounting have generally avoided theoretical discussions about "right and wrong" or "good and bad" choices. Instead, they have focused on determining whether or not accountants are abiding by the rules of professional conduct. There are basically two principles used to resolve ethical dilemmas, related to CPAs, which are utilitarianism and rule deontology.

Utilitarianism (Teleological ethics)	The promotion that the best long-term interest of everyone concerned should be the moral standard: one should take those actions that lead to the greatest balance of good versus bad consequences.
Deontology (Kantian ethics)	It deals with the concept of duty and the rightness of acts. It emphasizes maxims, duties, rules, and principles that are so important that they should be followed whatever the consequences.

In utilitarian, the focus is based on the consequences of an action rather than abiding by rules. Deontology, on the other hand, focuses on just the opposite. Under Deontology principles, an accountant would be more concerned with abiding by rules of professional conduct no matter what the consequences.

For example, a 2008 study published in *The CPA Journal* attempted to determine how accountants, specifically auditors, used ethical reasoning when confronted with issues related to client confidentiality. Rule 1.700, Confidential Client Information, of the AICPA' Code of Professional Conduct states that a member in public practice cannot disclose confidential client information without the client's consent. However, this Rule does not affect a CPA's obligations:

1. To comply with a validly issued and enforceable subpoena or summons or with applicable laws and regulations
2. To discharge his/her professional obligations properly under Rules 1.310 and 1.320
3. To cooperate in a review of the CPA's professional practice under AICPA or state CPA society or board of accountancy authorization
4. To initiate a complaint with or respond to any inquiry made by the professional ethics division, trial board of the AICPA, or an investigative or disciplinary body of a state society or board of accountancy

In the study, a survey consisting of three different circumstances was sent to 100 randomly selected CPA's. Each CPA was asked to respond to each circumstance described using the following guide:

1. To inform or not inform a third party of confidential client information, and
2. To indicate which response given in 1) was considered "good ethical behavior" if the Code was disregarded. Respondents were also asked to provide justification for their answers.

The following are the circumstances they were given:

"**Scenario 1**: James Corporation employs the regional CPA firm of Green and Cash to audit its financial statements. The firm has been asked to prepare quarterly financial statements. Bob Ethics, a staff accountant, was assigned to do the work. During the course of preparing the statements, Bob discovered that James Corporation materially understated net income on last year's tax return. Bob informed his supervisor about this and the client is asked to prepare an amended tax return. The client, however, refused to take corrective action.

Scenario 2: Johnson Manufacturing Corporation is a publicly owned company that manufactures equipment used by hospitals and medical laboratories. The company is audited by the national accounting firm of Adams & Pitre. One day, John, the senior in charge of the engagement overheard a conversation between two managers indicating that although they met inspection standards, they were aware of a defect in a particular piece of equipment, but they had not notified any of their customers because they felt the probability of malfunction was low. John takes this information to the controller and is told not to include it in the audit report. He then takes it to the manager on the engagement. The manager informs University Hospital, one of its clients, and also a major customer of Johnson Manufacturing Corporation, not to purchase any more equipment from Johnson. Johnson sues Adams & Pitre for violating the confidentiality rule.

Scenario 3: William Johnson, a CPA, served as a director of Last National Bank for a year. As a director, William may be held liable for damages if he fails to use care and prudence in administering bank affairs and such action causes the bank to suffer a financial loss. In the course of an audit, William discovered a seriously weakened financial position in a client who has a large loan at Last National Bank. Disclosure of this condition to the other bank directors would minimize the bank's loss, however, since the audit has not been completed, this would represent a violation of Rule 1.700 of the Code.[1]"

According to the study, the following were the results, conclusions and implications:

"**Scenario 1:** Given a Code, most (78%) respondents would not inform the IRS. This is in agreement with the rule of conduct. Although the variability increased, most CPAs (70%) in this situation would make the same decision without a Code. This is consistent with the justification given that most CPAs perceived themselves to be an advocate of the client in a tax engagement. There was no perceived conflict in the rule of conduct and what most accountants perceived as good ethical behavior.

Scenario 2: Most CPAs (78%) responding in this situation would adhere to the Code and not inform one client of information discovered while auditing another client. A large percentage (52%) of respondents, however, indicated that informing would be the "best ethical behavior." In most instances, "potential safety concerns" were cited as the justification for considering informing as the "best ethical behavior." Thus, there appears to be some conflict in adhering to the Code and the moral value of some CPAs.

Scenario 3: Given a Code, a majority (78%) of CPAs would not inform, which is in agreement with the Code. A lesser percentage (53%), however, feels this is the best ethical behavior.

Conclusions and Implications

The findings of this study indicate that CPAs usually adhere to the Code (rule deontology) in resolving issues involving confidentiality. However, such decisions are not always in accord with what they perceive as "good ethical behavior." The broad principles of the Code indicate that ethical conduct, in the truest sense, means more than abiding by a letter of a rule. It means accepting a responsibility to do what is honorable or doing that which promotes the greatest good

[1] "Ethical reasoning in confidentiality decisions," by Barbara L. Adams, Fannie L. Malone, and Woodrow James, Jr., *The CPA Journal*, July 2008

to the greatest number of people, even if it results in some personal sacrifice. Somehow, the profession needs to emphasize the "greatest good" criterion more strongly in applying the rules of conduct.

Ethical Dilemmas in Accounting

Deciding how to handle ethical dilemmas is an important part of the accounting profession. Individuals in the accounting profession have a considerable responsibility to the general public. Accountants provide information about companies that allow the public to make investment decisions for retirement, a child's education and major purchases such as a home. For the public to rely on the information provided, there must be a level of confidence in the knowledge and behavior of accountants. Ethical behavior is necessary in the accounting profession to prevent fraudulent activities and to gain public trust.

The main reason for ethical guidelines is not to provide an exact solution to every problem, but to aid in the decision-making process. An established set of guidelines provides an accounting professional with a compass to direct him toward ethical behavior. Specific responsibilities of the accounting profession are expressed in the various codes of ethics established by the major organizations such as the American Institute of CPAs. The AICPA Code of Professional Conduct outlines an accountant's responsibilities towards the public interest and emphasizes integrity, objectivity and due care.

The effects of ethical behavior in accounting are far reaching in the economy. Every business entity has an accounting professional provide information at some point in the organization's life cycle. Many accounting professionals are tempted to alter financial results and often rationalize the behavior by calling it creative or aggressive accounting. Aggressive accounting is the process of employing questionable accounting methods to boost results. An accountant may record revenues and expenses in an incorrect manner or omit expenses altogether. Repeated incidences of aggressive accounting are a result of the lack of ethical behavior.

Example

A common example of an ethical dilemma involves management instructing a subordinate employee to record a transaction in an incorrect manner. For instance, a company with a Dec. 31 year-end calendar year, signs contracts with consumers to perform services. The contracts are usually signed Dec. 1 and are a year in length. Accounting principles require the company to record the revenue for the contract for one month only, the month of December. The remainder of the revenue is recognized on next year's financial statements. However, management instructs an employee to record the entire amount of the contract in December to boost revenues for the current year end. Management receives a bonus for the boosted revenue and the subordinate receives recognition in an upcoming performance review.

Solutions

Unfortunately, ethical dilemmas, such as the example provided, are common. To help curb the desire to practice aggressive accounting and ignore ethical behavior, a number of organizations require accounting professionals to complete continuing professional education courses on ethics. In addition, a number of companies establish whistleblower hotlines to encourage employees to demonstrate honesty and integrity in the workplace.

Perceptions of Ethics across Different Professions

Gallup polls individual about their perceptions of the honesty and ethical standards of people in these different fields. Below are the results for 2018. Accountants rate fairly well with 42% of people thinking accountants have either very high or high ethical standards. The numbers have been fairly consistent for accountants, but hit a low after the Enron and Worldcom scandals in the early 2000's.

	Very high	**High**	**Average**	**Low**	**Very low**	**No opinion**
	%	%	%	%	%	%
Nurses	28	56	15	2	*	*
Medical doctors	15	52	25	6	2	1
Pharmacists	14	52	28	4	1	1
High school teachers	17	43	29	8	2	1
Police officers	15	39	32	9	4	1
Accountants	**5**	**37**	**48**	**6**	**1**	**3**
Funeral directors	8	31	42	8	2	7
Clergy	8	29	43	12	3	5
Journalists	7	26	31	21	13	2
Building contractors	4	25	49	17	3	1
Bankers	3	24	50	17	4	1
Real estate agents	2	23	54	15	4	3
Labor union leaders	4	17	42	23	8	5
Lawyers	3	16	51	21	7	1
Business executives	3	14	49	26	6	3
Stockbrokers	2	12	48	26	6	6
Advertising practitioners	1	12	46	29	8	4
Telemarketers	1	8	32	33	23	2
Members of Congress	2	6	33	38	20	2
Car salespeople	1	7	47	33	11	2

Quotes on Ethics and Integrity

There's strong data that, within companies, the No. 1 reason for ethical violations is the pressure to meet expectations, sometimes unrealistic expectations. (Stephen Covey)

There is a need for financial reform along ethical lines that would produce in its turn an economic reform to benefit everyone. This would nevertheless require a courageous change of attitude on the part of political leaders. (Pope Francis)

Honesty and integrity are by far the most important assets of an entrepreneur. (Zig Ziglar)

Compromise on ethical conduct is not an option. (Rex Tillerson)

The supreme quality for leadership is unquestionably integrity. Without it, no real success is possible, no matter whether it is on a section gang, a football field, in an army, or in an office. (Dwight D. Eisenhower)

With integrity, you have nothing to fear, since you have nothing to hide. With integrity, you will do the right thing, so you will have no guilt. (Zig Ziglar)

Real integrity is doing the right thing, knowing that nobody's going to know whether you did it or not. (Oprah Winfrey)

If you don't have integrity, you have nothing. You can't buy it. You can have all the money in the world, but if you are not a moral and ethical person, you really have nothing. (Henry Kravis)
Moral authority comes from following universal and timeless principles like honesty, integrity, treating people with respect. (Stephen Covey)

Ethics is knowing the difference between what you have a right to do and what is right to do. (Potter Stewart)

Ethics and equity and the principles of justices do not change with the calendar. (D. H. Lawrence)

A man without ethics is a wild beast loosed upon this world. (Albert Camus)

It is curious that physical courage should be so common in the world and moral courage so rare. (Mark Twain)

In just about every area of society, there's nothing more important than ethics. (Henry Paulson)

To educate a man in mind and not in morals is to educate a menace to society. (Theodore Roosevelt)

Chapter 1 Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

1. All of the following would be considered ethical behavior EXCEPT:

   A. Integrity
   B. The need to get ahead at any cost
   C. Professional competence and due care
   D. Freedom from conflicts of interest

Chapter 2 – AICPA Code of Professional Conduct

Learning Objectives

After studying this chapter, you will be able to:

- Identify different principles and rules of the AICPA *Code of Professional Conduct.*
- Identify independence and objectivity issues.
- Recognize ethical standards and violations.

This chapter covers the AICPA's *Code* of *Professional Conduct*. It presents a condensed but comprehensive summary of the AICPA Code of Conduct, along with summaries of AICPA Ethics Interpretations for the 11 Rules of Conduct. It also explains the *threats and safeguards approach* to resolve ethical dilemmas faced by accountants. The final section illustrates some cases of ethics violations.

AICPA's Code of Professional Conduct

AICPA's *Code of Professional Conduct* consists of four sections:
Preamble: Applicable to All Members
Part 1: Members in Public Practice
Part 2: Members in Business
Part 3: Other Members

Members in business (not public practice), should review Part 2 of the AICPA code for the subset of requirements.
The code includes the following:

- *Principles.* The 6 principles establish ideal standards of ethical conduct stated in philosophical terms. They express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage. There are *six* principles that are goal-oriented but *nonbinding*.
- *Rules of conduct.* These rules are the minimum standards of ethical conduct stated as specific rules. There are *eleven* rules of conducts that are *enforceable (binding)*.
- *Interpretations.* Interpretations of rules are intended to clarify the rules of conduct. They are not officially enforceable, but a practitioner must justify any departure.

Summaries of the Six Principles

Exhibit 1 - The Six Principles

		The Six Principles
1	0.300.020	Responsibilities
2	0.300.030	The Public Interest
3	0.300.040	Integrity
4	0.300.050	Objectivity and Independence
5	0.300.060	Due Care
6	0.300.070	Scope and Nature of Services

The first five of these principles are applicable to all members of the AICPA, regardless of whether they practice in a CPA firm, work as accountants in business or government, are involved in some other aspect of business, or are in education. One exception is independence. It applies only to members in public practice, and then only when they are providing attestation services such as audits. The sixth principle, scope and nature of services, applies only to members in public practice. That principle addresses whether a practitioner should provide a certain service, such as providing personnel consulting when an audit client is hiring a chief information officer (CIO) for the client's IT function. Providing such a service can create a loss of independence if the CPA firm recommends a CIO who is hired and performs incompetently.

Responsibilities. In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance.

The Public Interest. Members should act to benefit the public interest, honor the public trust, and demonstrate commitment to professionalism. The AICPA adopted the ethical standards because a distinguishing mark of a profession is an acceptance of responsibility to the public.

Integrity. Members should perform all professional responsibilities with the highest sense of integrity to maintain public confidence. Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should never be subordinated to personal gain and advantage.

Objectivity and Independence. A member should maintain objectivity and be free of conflicts of interest. A member in public practice should be independent in fact and appearance when providing attestation services. Objectivity is a state of mind, a quality that lends itself to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

Independence of mind is the state of mind that permits the performance of *an attest service* without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

Independence in fact is the member's ability to take an unbiased viewpoint in the performance of professional services. *Independence in appearance* is the avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.

Due Care. A member should follow the profession's technical and ethical standards, strive for improved competence and quality services, and discharge professional responsibility to the best of the member's ability. Members must adequately plan and supervise any activity for which they are responsible.

Scope and Nature of Services. A member in public practice should follow the Principles of the *Code of Professional Conduct* in determining the nature and scope of services.

Conceptual Framework – Threats and Safeguards Approach

The threats and safeguards approach can help members comply with the rules in situations not explicitly addressed in the code. It is an approach that the AICPA's Professional Ethics Executive Committee also uses when developing the code's interpretations and rulings.
The threats and safeguards approach identifies threats to compliance with the rules and evaluates the significance of those threats. If a threat is not at an acceptable level, members should determine whether safeguards can eliminate or reduce the threat to an acceptable level and, if so, apply such safeguards or, if not, avoid the situation that creates the threat. Members should evaluate in-the-aggregate a situation with multiple threats since the cumulative effect could be at an unacceptable level.
Keep in mind the following definition when reviewing the Conceptual Framework:

- **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.
- **Safeguards**. Actions or other measures that may eliminate a threat or reduce a threat to an acceptable level.
- **Threats**. Relationships or circumstances that could compromise a member's compliance with the rules.

Step 1 - Identify threats.
Members often face risks of encountering relationships or circumstances that could compromise compliance with the roles (in other words, threats) in their duties or work environments.
Seven threat categories are identified to help members identify and develop sensitivity to potential threats:

1. *Self-review threat.* The threat that a member will not appropriately evaluate the results of prior services performed by the member himself or herself, or by an individual in the member's firm or employing organization.
2. *Advocacy threat.* The threat that a member will promote a client or employer's position to the point that his or her objectivity is compromised.

3. *Adverse interest threat.* The threat that a member will not be objective because his or her interests are in opposition to those of a client or employer.
4. *Familiarity threat*. The threat that because of a long or close relationship with a client or employer, a member will become too sympathetic to their interests or too accepting of their work.
5. *Undue influence threat.* The threat that a member will subordinate his or her judgment to that of an individual associated with a client, employer or other relevant third party because of the individual's (1) reputation or expertise, (2) aggressive or dominant personality, or (3) attempts to coerce or exercise excessive influence over the member.
6. *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.
7. *Self-interest threat.* The threat that a member will act in a manner that is adverse to the interests of his or her firm, employer, client or the public, as a result of the member or his or her close family member's financial interest in or other relationship with a client or the employer.

Examples of Threats to Compliance with AICPA Rules of Conduct

Adverse Interest Threat

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.

Advocacy Threat

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.

Familiarity Threat

a. A member's immediate family or close relative is employed by the client.

b. 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.

c. Senior personnel have a long association with a client.

d. A member has a significant close business relationship with an officer, a director, or a 10 percent shareholder of a client.

Self-Interest Threat

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.

Self-Review Threat

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.
Undue Influence Threat
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.

Step 2 - Evaluate the significance of a threat.
The existence of a threat does not necessarily mean noncompliance with the rules; rather, members should evaluate a threat's significance by considering whether a reasonable and informed third party, weighing all quantitative and qualitative facts and circumstances, would likely conclude that the threat would compromise the member's compliance with the rules. If this evaluation finds that the threat would not compromise a member's compliance, the threat is at an acceptable level, requiring no further evaluation under the guide. If the evaluation finds the threat at an unacceptable level, the member should identify and apply appropriate safeguards.

Step 3 - Identify and apply safeguards.
Safeguards are controls that mitigate or eliminate threats to independence. Required or prohibited actions and internal control measures can serve as safeguards to eliminate or reduce threats to acceptable levels. The profession, legislation and public regulations create some safeguards for all members. Employers may implement other safeguards in the specific work environment. Members in public practice also may consider their client's safeguards when evaluating the significance of a threat.
Examples of safeguards and associated threats they might reduce are:

1. Peer reviews (actions required by the profession) that consider appropriate reliance on external evidence in attest engagements reduce undue influence threats.
2. Periodic rotations of senior members on an attest engagement (actions required by Sarbanes-Oxley legislation or a firm's internal controls) reduce familiarity threats.
3. Limitations of services to clients whose billings would be significant to the firm (actions prohibited by a firm's internal controls) reduce undue influence and self-interest threats.
4. Avoiding joint ventures with a client (actions prohibited in a firm's internal controls) reduces advocacy and self-interest threats.
5. Corporate governances that restrict certain services by the corporation's external auditors (actions prohibited by the client's internal controls) reduce self-review threats.
6. Corporate policies that stress ethical behavior and provide channels to discuss ethical issues without fear of retribution (workplace internal controls, "tone at the top") reduce undue influence threats.

Determining which safeguard to apply requires judgment, since a safeguard's effectiveness can vary from one environment to another. Members should analyze a particular situation's facts and circumstances, identify significant threats and then design safeguards, considering:

- The safeguard's objective.
- Parties who will be subject to the safeguard.
- How the safeguard will be applied (for example, uniformly, consistently, objectively).
- Who will apply the safeguard (for example, a third party, a supervisor, a computer).

A threat is reduced to an acceptable level if, after applying safeguards, a reasonable and informed third party would likely conclude that compliance with the rules is not compromised.

Step 4 - Evaluate the Effectiveness of Safeguards.
If the member concludes that threats are at an acceptable level after applying the identified safeguards, then the member may proceed with the attest service. However, a threat may be so significant that no safeguard can eliminate or reduce it to an acceptable level. If so, providing the specific professional or employee service will likely cause noncompliance with the rules. While declining or discontinuing the service would prevent a rules violation, the member should also consider the stronger response of resigning from the client or employment position.

Step 5 - Document Threats and Safeguards.
When safeguards are applied to eliminate or reduce significant threats to an acceptable level, the identified threats and safeguards applied should be documented.

Applying Threats and Safeguards Approach to Ethics Violation Cases
Case 1: Company controller Davidson, CPA, prepared his employer’s financial statements knowing that they misstated revenues. The company's CEO, who could fire Davidson at will, "strongly urged" Davidson to record sales at full invoice prices despite customers' rights to return merchandise long after a normal return period, and historical experience has shown a substantial number of late returns. Davidson's brother-in-law, a company in-house lawyer, wrote the sales contracts and assured Davidson that recording the full sales amounts was appropriate. After investigating the misstatement, the Illinois Department of Financial and Professional Regulation revoked Davidson's CPA certificate for "negligence in the preparation of financial statements" and "subordination of judgment" even though he was not in public practice.

Solution: CPA Davidson, whose boss urged him to record transactions contrary to GAAP and whose brother-in-law analyzed GAAP for him, should have referred to subordination interpretation that prescribes potentially confrontational actions when a member's interpretation of GAAP differs from those of his or her supervisors. However, with the "threats and safeguards" approach, the unwelcomed need to invoke the subordination Interpretation might have been avoided, as in this scenario: Davidson recognized the CEO's authority to fire him at-will as an *undue influence threat* and his brother-in-law's legal counsel as a *familiarity threat*. Davidson wrote a memo to his files discussing both threats and his belief that a reasonable and informed third party, weighing all the facts and circumstances, would likely conclude that the threats--separately and in the aggregate--compromise his compliance with rules Integrity and Objectivity, General Standards and Accounting Principles.

He considered actions or policies that might reduce the two threats to acceptable levels and wrote to the company's audit committee suggesting safeguards to protect his objectivity: (1) an officer's employment termination should require a due process hearing before an independent arbitrator, allowing the officer to respond to allegations; and (2) staff preparing financial statements cannot be related to staff generating transactions or related documents. The audit committee adopted the due process personnel policy and assigned Davidson's brother-in-law to other legal matters. Davidson properly deferred revenue recognition on the dubious sales in accordance with the provisions of ASC 605-15-25-1, *Revenue Recognition: Products*.

Case 2: The California Board of Accountancy disciplined Norman & Co., CPAs, (the firm's name and other facts have been modified) when it audited a bank's financial statements while the firm's consulting group concurrently sold the client's debt consolidation services. The Board of Accountancy imposed a three-year CPA license probation plus frequent and costly peer reviews.

Solution: Two audit team members familiar with the AICPA's threats and safeguards approach knew that the firm's consulting group was negotiating a client-firm joint marketing venture and wrote memos identifying a *self-review threat, advocacy threat, self-interest threat* and independence issues. Their memo labeled the threats severe and urgent. The lead partner found that no safeguards could adequately reduce the threats to acceptable levels, and the firm immediately withdrew from the nonaudit activities.

Ethical Conflicts Unrelated to Threats

Members may confront ethical conflicts due to internal or external work-environment pressures or conflicts within professional standards unrelated to threats described above. For example, a member may encounter a fraud and feel ethically bound to report it; but reporting the fraud could breach mandates to maintain client confidentiality. To resolve such ethical conflicts and comply with the rules, the guide recommends that members:

1. Recognize and consider all relevant facts and circumstances, including applicable rules, laws or regulations,
2. Consider the ethical issues involved,
3. Consider established internal procedures, and then
4. Formulate alternative courses of action.

After weighing the consequences of each course of action, the member should select the course that best enables compliance with the rules. Before pursuing the selected course of action, the member may want to consult with legal counsel, applicable professional bodies and appropriate firm or employer personnel.

If the conflict remains unresolved after pursuing the selected course of action, the member should consider further consultation with those advisers to review the process and reach a different resolution. Members may be well-advised to document the ethical conflict's substance, details of discussions and suggested decisions.

What if there is no effective resolution?

If, after exhausting all reasonable possibilities, the ethical conflict remains unresolved, members will probably not be in compliance with the rules if they remain associated with the matter

creating the conflict. In this case, members should consider withdrawing from the engagement team or specific assignment, and perhaps consider the stronger response of resigning from the client or employment position.

Summaries of the Eleven Rules of Conduct

Exhibit 2 - The Eleven Rules of Conduct

		The Eleven Rules of Conduct
1	1.100, 2.100	Integrity and Objectivity
2	1.200	Independence
3	1.300, 2.300	General Standards
4	1.310, 2.310	Compliance with Standards
5	1.320, 2.320	Accounting Principles
6	1.400, 2.400	Acts Discreditable
7	1.510	Contingent Fees
8	1.520	Commissions and Referral Fees
9	1.600	Advertising and Other Forms of Solicitation
10	1.700	Confidential Client Information
11	1.800	Form of Organization and Name

NOTE: Rules in Chapter 1 (1.xxx) are applicable to members in public practice and Chapter 2 rules (2.xxx) are applicable to members in business.

1.100 - Integrity and Objectivity Rule

All members must maintain objectivity and integrity, be free of conflicts of interest, not knowingly misrepresent facts, and not subordinate his/her judgment to others when performing professional services.

Interpretations

1.110 Conflicts of Interest

CPAs 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, the CPA 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.

A conflict of interest creates adverse interest and self-interest threats to compliance with the "Integrity and Objectivity Rule". For example, threats may be created when

a. the CPA or the CPA'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 CPA or the CPA's firm with respect to a particular matter and the interests of the client who receives a professional service related to that matter are in conflict.

Certain professional engagements, such as audits, reviews and other attest services require independence. Any independence impairments under the "Independence Rule" [1.200], its interpretations, and rulings cannot be eliminated by the safeguards or by disclosure and consent.

When a conflict of interest exists, the Integrity and Objectivity rule will not prohibit the service if disclosure is made to and permission is obtained from the appropriate parties. The CPA should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their permission to perform the professional services. The CPA should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

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 CPA is unable to implement effective safeguards, the CPA 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.

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 CPA 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 CPA's firm.
p. A CPA 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.

1.120 Gifts and Entertainment
When a CPA offers to a client or accepts gifts or entertainment from a client, self-interest, familiarity, or undue influence threats may exist. However, occasionally going to lunch or dinner with a vendor or a client should not create any significant threats.
A CPA would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

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

Threats are at an acceptable level when gifts or entertainment are reasonable in the circumstances. If the gift or entertainment is not reasonable, the CPA would be presumed to lack objectivity in violation of the "Integrity and Objectivity Rule".

Situation: Jim, a CPA, works for Allen & Partners, a large CPA firm. Recently, he has been receiving several invitations to sporting event and lunches from an audit client, Williams Enterprises. Should Jim be concerned with any threats to independence or objectivity associated with these invitations?
Answer: Perhaps. Jim should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Receiving invitations is one thing; the frequency of accepting them is another. Examples of relevant facts and circumstances include the following:

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 attest clients also participated in the entertainment

g. The individuals from the attest client's and Jim's firm who participated in the entertainment

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

1.130 Preparing and Reporting Information

Knowing Misrepresentations in the Preparation of Financial Statements or Records

Threats to compliance with the "Integrity and Objectivity Rule" would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards and the CPA would be considered to have knowingly misrepresented facts in violation of the "Integrity and Objectivity Rule," if the CPA:

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.

Enron Case Study

Enron Corporation was an American company based in Houston, Texas. It was founded in 1985 as a merger between Houston Natural Gas and InterNorth. In 2000, Enron employed approximately 29,000 staff and was a major electricity, natural gas, communications and services company, and claimed a revenue of nearly $101 billion. Fortune had named Enron "America's Most Innovative Company" for six consecutive years.

During 2001, a discovery of irregular accounting procedures bordering on fraud perpetrated throughout the 1990s were made involving Enron and its accounting company Arthur Andersen By the end of 2001, it became apparent that Enron's reported financial condition were created by a well-organized accounting fraud.

Enron used a variety of deceptive fraudulent accounting practices to hide fraud in its financial statements. The company created Special Purpose Entities to coverup large liabilities on Enron's financial statements. The SPEs made Enron appear more profitable than it actually was. Eventually, the fraud created a dangerous domino effect where each quarter executives had to develop more and more financial deception in order to create the illusion of billions of dollars in profits while the company was actually losing money.

The deception helped drive up the stock price. In addition, the executives used insider information to trade millions of dollars' worth of Enron stock. The Enron executive team knew that offshore accounts were hiding significant Enron losses, but investors outside the company did not.

Chief Financial Officer Andrew Fastow directed the team which created the off-books companies, and manipulated the deals to provide himself, his family, and his friends with hundreds of millions of dollars in guaranteed revenue, at the expense of the corporation for which he worked and its stockholders.

Enron share prices decreased from US $90.56 during the summer of 2000, to just pennies by December 2001, when Enron was forced to file for bankruptcy. In addition, the scandal caused the dissolution of Arthur Andersen, which at the time was one of the world's largest accounting firms. Arthur Andersen was found guilty of obstruction of justice during 2002 for destroying audit documents from Enron. Since the SEC is not allowed to accept audits from convicted felons, Andersen was forced to stop auditing public companies.

Fastow served a six-year prison sentence for charges related to these acts. His wife also worked at Enron, as an assistant treasurer, and she pleaded guilty to conspiracy to commit wire fraud, money laundering conspiracy and filing fraudulent income tax returns, and served jail time.

Subordination of Judgment
The “Integrity and Objectivity Rule” prohibits a CPA 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.
There is an old saying that "the boss is not always right but (s)he is always the boss." What must a member do when (s)he disagrees with the boss relative to an accounting matter? If a member and his/her supervisor have a dispute about statement preparation or recording of transactions, the member should do nothing if the supervisor’s position is an acceptable alternative and does not materially misrepresent the facts.

1. If the member concludes that a material misstatement would result, (s)he should consult the appropriate higher level(s) of management and should consider documenting relevant matters.
2. If, after such discussions, the member concludes that action was not taken, (s)he should consider the continuing relationship with the employer, the obligation to communicate with third parties, and the desirability of consulting legal counsel.

1.140 Client Advocacy
Some professional services involving client advocacy may stretch the bounds of performance standards, go beyond sound and reasonable professional practice, or compromise credibility, thereby creating threats to the CPA’s compliance with the rules and damaging the reputation of the CPA and the CPA’s firm. If such circumstances exist, the CPA and CPA’s firm should determine whether it is appropriate to perform the professional services.

1.150 Use of a Third-Party Service Provider
Clients might not know that a CPA would use a third-party service provider to assist in providing the professional services. *Therefore, before disclosing confidential client information to a third-party service provider, the member should inform the client, preferably in writing, that the member may use a third-party service provider.* If the client objects to the use of a third-party

service provider, the CPA either should not use the third-party service provider to perform the professional services or should decline to perform the engagement.

A CPA is not required to inform the client when he or she uses a third-party service provider to provide administrative support services to the CPA (for example, record storage, software application hosting, or authorized e-file tax transmittal services).

1.200 - Independence Rule
A member in public practice should be independent when performing professional services as required by standards-setting bodies.
AICPA professional standards require a CPA firm, including the firm's partners and professional employees, to be independent whenever the firm performs an attest service for a client. Attest services include the following:

- Financial statement audits
- Financial statement reviews
- Other attest services, as defined in Statements on Standards for Attestation Engagements

Performing a compilation of a client's financial statements does not require independence. However, if a nonindependent firm issues such a compilation report, the report should include an indication of the accountant's lack of independence.

A covered member and firm are not required to be independent to perform services that are not attest services (for example, tax preparation or advice or consulting services, such as personal financial planning) if they are the only services the firm provides to a client.

The AICPA rules apply to covered members (see the definition in the glossary).

Below is a summary of the major points of the AICPA Independence Rule.

Interpretations
1.220 Accounting Firms
Network and Network Firms: Occasionally, firms will join groups or membership associations to enhance their capabilities to provide professional services or take advantages of other services, resources or relationships. As such, they may fall under the definition of a network or network firm, and must comply with independence rules with regards to attest work for other firms in the network. The association may be considered to be a network if they have one of the following characteristics:

1. Share a common brand name or initials as part of the firm name. Firms should carefully consider how it describes that membership and take steps to avoid the perception that it belongs to a network.
2. Share common control with other firms in the association through ownership, management, or other means (for example, by contract).
3. Share profits or costs, with certain exceptions
4. Share a common business strategy involving ongoing collaboration.
5. Share significant professional resources, such common systems, partners and staff, technical departments, etc. within certain limitations.

6. Share common quality control policies and procedures that the association monitors.

Alternative Practice Structures (APSs): Alternative practice structures are a form of organization in which a firm that provides attest services is closely aligned, or owned and controlled, with another public or private organization that performs other professional services. When two or more new CPA firms are "closely aligned" with another organization, issues arise as to whether owners of one perform services or have significant economic interests in another. The self-interest, management participation, self-review, advocacy, or undue influence threats to a covered member's compliance with the "Independence Rule" may not be at an acceptable level unless certain safeguards are implemented by other individuals or entities. Section 1.220.020 addresses ASP independence in greater depth and should be reviewed when dealing with closely aligned organizations receiving and providing attest services.

Firm Mergers and Acquisitions: Impairment to independence can develop if a firm merges with or is acquired by another firm. Previous employment relationships can create impairments. For instance, a partner or employee may have been formerly employed by or had a key role in the new attest client that resulted from the acquisition or merger. Safeguards must be put in place to ensure independence, including:

- eliminating participation of the former employer in the attest engagement team for that client
- assessing relationship of the former employee with the attest client, and whether the attest team will be reviewing the former employee's work while at the client
- ensuring that the attest team maintained integrity, objectivity and professional skepticism.

Impairments may also result when nonattest services were provided to an entity that subsequently becomes a new attest client as a result of the acquisition or merger, and those nonattest services would have been prohibited.

If the acquiring firm provided the prohibited nonattest services to the attest client of the acquired firm during the period of the financial statements, independence is impaired with respect to the attest client.

If the acquired firm provided the prohibited nonattest service to the attest client of the acquiring firm prior to the financial statement period covered by the acquiring firm's next attest report, independence is not impaired for the acquiring firm.

However, if the nonattest services were performed during the financial statement period covered in the attest report, independence is impaired unless certain conditions are satisfied:

- nonattest services are terminated prior the merger/acquisition closing date,
- no individuals who worked on the nonattest services are on the engagement team
- all threats are evaluated, and threats are reduced to acceptable level by applying appropriate safeguards.

Review 1.220.040 for more information.

1.230.010 Unpaid Fees
The existence of unpaid fees to a CPA for professional services previously provided to an attest client may create self-interest, undue influence, or advocacy threats with the Independence Rule. Threats to the compliance with the Independence Rule would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards if the attest client has unpaid fees for professional services provided *for more than one year prior to the date of the current-year report*. Unpaid fees include fees that are unbilled or a note receivable arising from such fees. Note: This does not apply to fees outstanding from an attest client in bankruptcy.

1.240 Financial Interests
There are numerous financial relationships that may affect independence. Generally, a member (and their spouse and dependents) should avoid any direct financial interest in a client, regardless of how immaterial, or any indirect interest that is material.
Keep in the mind the rules for following financial relationships:

1. *Unsolicited financial interests.* Independence is not impaired if the interest in the client received (e.g., by gift or inheritance) is disposed of promptly (no more than 30 days after the member has the right of disposal). If the member has no such right, independence is impaired by a direct or material indirect interest unless (s)he (a) does not participate in the engagement and (b) disposes of the interest promptly after the right exists.
2. *Mutual funds.* Ownership of fund shares is a direct financial interest in the fund. Underlying investments in the fund are indirect interests. Materiality is evaluated if (a) the fund is not diversified, or (b) the covered member holds more than 5% of a diversified fund.
3. *Retirement, savings, or compensation plans.* Participation constitutes a direct financial interest in the plan. Investments of a plan sponsored by the member's firm are direct interests of the firm. Investments of a plan controlled or supervised by the member are the member's direct interests. Otherwise, they are indirect interests of the members. Investments in a defined benefit plan are not financial interests of the plan in the absence of control or supervision.
4. *Partnerships*. A partnership interest is a direct financial interest of the owner. The financial interests of the partnership are direct interests of a general partner. The financial interests of a limited partnership are indirect interests of a limited partner who does not control the entity or supervise investments.
5. *Limited liability companies.* An owner's interest in an LLC is direct.
    a. A member-manager has a direct interest in the LLC's financial interests.
    b. A nonmanager has an indirect interest in the LLC's financial interests unless the operating agreement gives him/her control of the LLC or the right to supervise its investments.
6. *Section 529 plans*. These plans are prepaid tuition or savings plans sponsored by states or colleges.

a. *Prepaid tuition plans.* The account owner has a direct interest in the plan but an indirect interest in its investments. (S)he does not participate in investment returns.
b. *Savings plans*. The account owner has a direct interest in the plan and its investments because (s)he decides in which plan to invest. If the plan subsequently invests in an attest client, the member should transfer the account to another plan or account owner. If transfer incurs a significant penalty or tax, it may be delayed if the member does not participate in, or have the ability to influence, the engagement.
c. A beneficiary of a Section 529 plan has no financial interest in the plan or its investments.

7. *Trust and Estates*. If a covered member is a grantor of a trust or a blind trust, the member has a direct financial interest if he/she can (a) amend or revoke the trust, (b) control the trust, (c) supervise its investments, or (d) the trust will ultimately revert back to the grantor.
8. *Insurance products.* If a policy offers no investment option, it is not a financial interest. Thus, independence is not impaired with respect to the insurer if the policy was issued under normal terms, procedures, and requirements. An investment option is a financial interest. Whether it is direct or indirect is determined based on the principles applied throughout this independence rule. (*See 1.257 Insurance Products*)

Case Study
Situation: John Woods, a partner of Woods & Costas, CPAs, has an indirect financial interest in the auditor's' client, Alpha Manufacturing that is immaterial to John's net worth.
Independent: An immaterial, indirect financial interest does not impair an auditor's independence.
Situation: Kelly Costas, a partner of Woods & Costas, owns a vacation home with Steve Hunter, a principal shareholder of Alpha Manufacturing. The value of the vacation home is material to Kelley Costas.
Not Independent. An auditor's joint interest in a vacation home with a principal shareholder of a client (presumably one able to exercise significant influence over the client) is considered a joint closely held investment that impairs independence if it is material to the auditor.

1.260 Loans and Leases with Lending Institution
Loans from financial institution clients may impact the CPAs objectivity and independence since any kind of favorable treatment by the financial institution would create a financial interest in the institution. Any direct financial interest by the CPA may cause the CPA to lose independence.
A member should not a loan to or from an attest client, or to an individual owning 10 percent or more of a client's securities or other ownership interests.
Permitted loans. The following loans are permitted even if the client is one for which independence is required, provided that they are obtained under normal lending procedures, terms, and requirements and are always kept current:

- Automobile loans and leases collateralized by the automobile
- Loans fully collateralized by the cash surrender value of insurance
- Loans fully collateralized by cash deposits
- Credit cards and overdraft reserve accounts with an aggregate outstanding balance of $10,000 or less on a current basis by the payment due date

Grandfathered loans. Independence is not impaired by (a) unsecured loans that are not material to the covered member's net worth or (b) secured loans (including home mortgages) provided that the loans were obtained from a financial institution under its normal lending procedures, terms, and requirements. However, loans are grandfathered only if:

a. They were kept fully current at all times after the borrower became a covered member, and the terms did not change in a way not allowed in the original agreement.
b. They were obtained:
    i. From a financial institution before it became a client requiring independence;
    ii. From a client not requiring independence and were sold to one requiring independence;
    iii. From a client requiring independence before the borrower became a covered member relative to the client.

The date a grandfathered loan is obtained is the date a loan commitment or line of credit was granted.
The collateral for a secured grandfathered loan must equal or exceed the remaining balance of the loan during its term. If the loan exceeds the value of collateral, this excess must not be material to the covered member's net worth.

1.265 Business Relationships
Independence is impaired if, during the engagement or at the time of expressing an opinion, a member's firm had any material *cooperative arrangement* with the client.

- A cooperative arrangement means joint participation in a business activity (arrangements to provide products or services to a third party, joint ventures to develop or market products or services, etc.).
- A cooperative arrangement is not present when (1) the participants are governed by separate understandings, (2) responsibility for the other party's activities does not exist, and (3) neither party is the other's agent.

A self-interest threat could exist with material jointly held investments, including vacation homes.

1.270 Family Relationships with Attest Client
Family members may impair independence. If a covered member's immediate family is employed by an attest client but is not in a key position, threats would be at an acceptable level and independence would not be impaired. However, if a covered member's immediate family is in a key position with an attest client during the period covered by the financial statements or during the period of the professional engagement, threats to independence 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.

Neither a member of the attest team, or their immediate family, acting alone or together, should invest in an attest client's outstanding equity or other ownership during the period of professional engagement.

Having a close relative employed by an attest client may also affect independence. Independence can be impaired if the close relative is either in a key position with the attest client, or if the close relative has a material financial interest in the attest client, or a financial interest that enabled the close relative to exercise significant influence over the attest client. (1.270.100)

1.275 Current Employment or Association with an Attest Client
A partner or employee of the attest team may not be employed by the client. There are some exceptions, such as when the partner or employee is an adjunct faculty member at a college or university and does not hold a key position or have any influence on the attest team. See 1.275.005 for more information.

Independent Contractors: Attest firms should not employ independent contractors who are employed by or associated with the attest clients in a key position. For instance, consider the situation where a strategic management consultant is working for the attest client. Independence would be impaired if the firm also hired the consultant. However, if the person is not in a key position, the AICPA provides guidance in their ethics FAQ for the firm to consider, such as

- how close the independent contractor's office would be to the attest team office,
- the percentage of income the contractor derives from the firm versus the client versus other firms
- the percentage of time the contractor provides to the firm versus the client versus other firms.
- whether other conflicts of interest may arise.

See the *Appendix - AICPA Ethics FAQ* for more information.

A partner or professional employee of a firm holding an honorary position with a not-for-profit organization will sometimes allow his/her name to be used on letterheads and circulated materials to lend prestige to the group. Independence is not impaired if the position is clearly honorary and the individual is not able to vote or participate in board or management decisions. Moreover, (s)he must be identified as an honorary director or trustee. (1.275.010)
Review Rule 1.277 in the Appendix for rules about former employment or association with attest clients.

1.279 Consideration or Subsequent Employment or Association with Attest Client
A team member's consideration of employment or association with the client impairs independence absent prompt reporting to the firm and removal from the team.

If a partner or employee joins an attest client in a key position, the former partner or employee must eliminate all financial and professional ties to the firm. Furthermore, the ongoing attest engagement team should consider whether there is a need to modify procedures to reduce the risk that the former employee's knowledge of the procedures could affect the effectiveness of the attest engagement.

1.290 Effect of Actual or Threatened Litigation
Litigation or the threat of litigation between a covered member and an attest client may create self-interest or adverse interest threats to independence. For instance, the client's management may become less willing to make complete disclosure if a lawsuit is in the works with the attest firm. In the following situations, independence would always be impaired:

- Litigation is begun by the client's present management alleging deficiencies in audit work
- The member commences litigation at the client's management alleging fraud or deceit

Independence is not impaired when the threatened or actual litigation is not related to the audit and the amount is not material. Examples include disputes over billings for services and results of tax advice.
Sometimes stockholders may file lawsuits against the attest client. Independence is not impaired necessarily, but in some instances could be. For instance, as a result of the lawsuit, cross-claims are filed by the management against the attest firm, and then the attest firm alleges the client engaged in fraud.
If a reasonable person would conclude that litigation poses an unacceptable risk of impairment of independence, the member should disengage or disclaim an opinion for lack of independence.

Situation: The management of Alpha Manufacturing is being sued by shareholders due to some previous irregularities in financial statements audited by Woods & Costas, CPAs. Alpha is likely to file a cross claim against Woods & Costas.
Not Independent. Independence is not necessarily impaired when a client is sued regarding previous financial statements. However, threatened litigation by current client management asserting deficient audit work impairs independence.

1.295 Nonattest Services
Before a member and his or her firm performs nonattest services (such as tax or consulting services) for an attest client, (s)he must avoid impairment of independence. If the applicable independence rules of an authoritative body (e.g., the SEC or a state board of accountancy) are more restrictive, the member must comply with those rules.
General Requirements. Performing management functions or making management decisions impairs independence, but providing advice, research, and recommendations does not.

- The member should be satisfied that the client will make an informed judgment about the results of nonattest services and be able to designate a competent employee (preferably a senior manager) to oversee the services; evaluate their adequacy and results; make management decisions and perform management functions; accept responsibility for results; and establish and maintain internal controls.

- The member and client should agree about the objectives and limitations of the engagement, the services to be performed, and mutual responsibilities. The understanding should be documented in writing. This requirement does not apply to routine services, or those provided before the client became an attest client.

General activities that impair independence include:

- Exercise or possession of authority over transactions on a client's behalf
- Preparing source documents evidencing transactions
- Custody of client assets
- Supervision of client employees in normal activities
- Determining member recommendations to be implemented
- Reporting to the board on behalf of management
- Service as a stock transfer or escrow agent, registrar, or general counsel
- Establishing or maintaining controls for a client, such as performing ongoing monitoring.

Examples of nonattest services that may not impair independence if the general requirements are met include:

- bookkeeping,
- disbursement,
- benefit plan administration (e.g., preparing participant account valuations and statements),
- investment advisory,
- finance,
- executive search,
- business risk consulting, and
- IT (but designing a system or operating a network impairs independence).

Tax compliance services. Preparing a return and transmitting it and the payment does not impair independence if:

- the member does not have control of client funds and
- the client-designated person who oversees the process approves the return and, if required, signs it.

But a member's signing and filing the return impairs independence unless:

- the taxing authority has a procedure in place for such action or
- a designated client manager has reviewed the documents and authorized the member to sign and file.

Authorized representation of a client in administrative proceedings does not impair independence if the client gives prior agreement to the resolution of the tax matter. But representation in a court or public hearing is an impairment.

An appraisal, valuation, or actuarial service impairs independence if the results are material to the financial statements and significant subjectivity is involved. For example, a valuation for a business combination, but not an actuarial valuation for a pension liability, usually involves significant subjectivity. Furthermore, appraisal, valuation, and actuarial services not performed for financial statement purposes do not impair independence if the other requirements of Interpretation 1.295 are satisfied. Such services must involve determination of all significant assumptions and matters of judgment by the client. The client also should be able to make informed decisions and accept responsibility.

Forensic accounting services. Litigation services involve assisting in actual or potential legal or regulatory proceedings. They include expert witness services, that is, the expression of an opinion based on the member's expertise, not his/her knowledge of disputed facts. These services impair independence unless:

- they are rendered to a large group of parties,
- no attest client is the lead plaintiff or defendant, and
- other requirements related to the influence of attest clients on the proceedings are met.

However, testimony as a fact witness does not impair independence. Litigation consulting services are advisory and do not impair independence as long as expert testimony is not given. Other litigation services involve serving as a trier of fact, arbitrator, etc. If a client is involved in the matter, independence is impaired. But service as a mediator or facilitator without decision-making authority in a dispute resolution procedure is not an impairment. Investigative services do not involve actual or potential litigation, although they may require the same skills needed for litigation services. They do not impair independence.

Internal audit assistance services impair independence unless the member ensures that the client understands its responsibility for internal control and managing the internal audit function. Accordingly, the member must ensure that the client:

- designates an individual(s) with suitable skill, knowledge, or experience (preferably a senior manager) to oversee internal audit;
- determines the scope, risk, and frequency of its activities;
- evaluates the findings and results; and
- evaluates the adequacy of its procedures.

The member should be satisfied that the client's governing body is informed about his/her role so that it can develop proper guidelines.
The member may assist the individual responsible for the internal audit function in preliminary risk assessment, preparation of the audit plan, and recommendation of priorities.
Independence is impaired if the member, among other things:

- performs an ongoing monitoring or control function,
- determines which control recommendations are adopted,
- reports to the board on behalf of management,
- approves or is responsible for the overall audit work plan, or

- is a client employee or manager (or the equivalent).

Services that are normal extensions of the external audit scope (e.g., confirming receivables or analyzing balances) and engagements under the attestation standards do not impair independence.
SEC regulations issued under the Sarbanes-Oxley Act of 2002 prohibit auditors of issuers (public companies) from performing certain nonaudit services:

- Appraisal and other valuation services if the results are subject to audit.
- Designing and implementing financial information systems if the results are subject to audit.
- Actuarial functions if the results are subject to audit.
- Management services.
- Human resource services.
- Bookkeeping if the results are subject to audit.
- Legal and other expert services not pertaining to the audit (client advocacy, including internal fact-finding and providing explanations of conclusions).
- Investment banking or advisory services.
- Broker-dealer services.
- Internal audit outsourcing that involves financial accounting controls, systems, or statements.
- Tax services not preapproved by the audit committee or that are prohibited nonaudit services.
- Any other nonaudit services not preapproved by the audit committee.

Situation: Alpha Manufacturing solicited Woods & Costas, CPAs to perform permitted tax services. Alpha's audit committee approved the arrangement. These services consist of preparing an income tax return. The return is approved and signed by a designated client manager.
Independent: Independence is not impaired if the firm provides tax services as long as the services are not prohibited nonaudit services and the provision of the services has been approved by the client's audit committee. But preparing a tax return could impair independence, e.g., if the member had control of client funds or the return was not approved by a client-designated person.

1.295.143 Hosting Services
Under a new ethics interpretation, which takes effect in 2019, hosting services can impair independence when a CPA takes responsibility for maintaining internal control over an attest client’s data or records, whether financial or nonfinancial in nature.
For example, the member assumes responsibility for safeguarding the information by agreeing to:

- Be the sole host of a client’s financial or nonfinancial information system;

- Be the custodian for the client's data such that the client's data are incomplete and accessible only through the CPA; or
- Provide business continuity or disaster recovery services to the client.

Examples of activities that are considered hosting services, and as such will impair independence if performed for an attest client, include accepting responsibility for the following:

a. Housing the attest client's website or other non-financial information system
b. Keeping the attest client's data or records on the attest client's behalf, for example, the attest client's general ledger information, supporting schedules (such as, depreciation or amortization schedules), lease agreements or other legal documents are stored on the member's firm's servers or servers licensed by the member's firm or the member is responsible for storing hard copy versions of the data or records
c. Being the attest client's business continuity or disaster recovery provider

Review rule 1.295.143 in the Appendix for more examples of how providing hosting services may or may not impair independence.

1.297 Independence Standards and Agreed-Upon Procedures Engagements
This interpretation applies only to agreed-upon Procedures (AUP) engagements. When providing nonattest services that would otherwise impair independence, independence would not be impaired as long the nonattest services do not related to the specific subject matter of the SSAE engagement. Also, independence would not be impaired if the following covered members and their immediate families are independent of the responsible party(ies):

a. An individual on the agreed upon procedures engagement team.
b. An individual who directly supervises or manages the agreed upon procedures engagement partner.
c. Individuals who consult with the attest engagement team about technical or industry-related matters specific to the agreed upon procedures engagement.

Independence is impaired and cannot be reduced to an acceptable level by any safeguards if the firm had a material relationship with the responsible party prohibited under rules covering financial interests, trustees or executors, joint closely held investments, or loans.
When the party that engages the firm is not the responsible party or associated therewith, individuals on the attest engagement need not be independent of the party that engaged the firm. However, they should consider their responsibilities regarding conflicts of interest.

1.298 Breach of an Independence
When a breach is identified, the CPA should promptly communicate the breach to an appropriate individual within the firm. The responsible individual should report the breach to those who need to take appropriate action. The responsible individual should be satisfied that the interest or relationship that caused the breach has been terminated, suspended, or eliminated and should address the consequences of the breach.

Depending upon the significance of the breach, it may be necessary to terminate the attest engagement or it may be possible to take action that satisfactorily addresses the consequences of

the breach. In making this determination, the responsible individual should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available to the member at that time, would likely conclude that the attest engagement team's integrity, objectivity, and professional skepticism would be compromised and therefore whether independence is impaired.

Examples of actions that the responsible individual may consider include the following:

a. Remove the relevant individual from the attest engagement team
b. Conduct an additional review of the affected attest work or re-performing that work to the extent necessary; in either case, using different personnel
c. Recommend that the attest client engage another firm to review or re-perform the affected attest work to the extent necessary
d. Engage another firm to evaluate the results of the nonattest service or have another firm re-perform the nonattest service to the extent necessary to enable it to take responsibility for the service if the breach relates to a nonattest service that affects the accounting records or an amount that is recorded in the financial statements.

See 1.298.010 for more information.

Other Ethics Rulings on Independence

Independence is not impaired in the following situations:

1. Membership in a client trade association provided the member is not an officer or a director, or in a position equivalent to management.
2. The member provides only advisory services for a client.
3. A member is *designated* to serve as an executor of an individual’s estate that owns the majority of the stock of a corporation. Independence with respect to the corporation is not impaired unless the member *serves* as executor.
4. A CPA is a director of a federated fund-raising organization, e.g., United Way, and audits local charities receiving funds. Independence with respect to the charities is not impaired unless the organization exercises managerial control over them.
5. A CPA and a client bank serve in a co-fiduciary capacity with respect to an estate, provided the estate assets are not material.
6. A client financial services company has custody of a CPA’s assets (not in depository accounts); services are provided under its normal procedures, terms, and requirements; and any assets subject to risk of loss are immaterial to the CPA’s net worth.
7. Independence is not impaired if a CPA audits an employee benefit plan unless a partner or professional employee of the firm had significant influence over the employer(s); was in a key position with the employer; or was associated with the employer as a promoter, underwriter, or voting trustee.
8. The mere servicing of a CPA’s loan by a client financial institution.

9. When a CPA has a checking or savings account, certificate of deposit, or money market account in a client financial institution, provided the amounts are fully insured. Uninsured amounts do not impair independence if they are immaterial or if they are reduced to an immaterial balance within 30 days. A firm's independence is not impaired if the probability is remote that the depository institution will have financial difficulty.
10. Membership in a client credit union if all the following are met:
    a. Each CPA qualifies to join the credit union without regard to the professional services.
    b. The CPA vote must not have significant influence over policies.
    c. Loans must be limited to grandfathered and other permitted loans made under normal procedures, terms, and requirements.
    d. Any deposits with the credit union must meet the conditions in number 12.
11. A CPA's service as treasurer of a mayoral campaign organization. Independence is impaired with respect to the organization itself, but not the political party of the candidate or the city.
12. If a CPA leases property to or from a client under an operating lease with terms comparable to those of similar leases, and all amounts are paid in accordance with the lease. If, however, the lease is a capital lease, independence would be impaired unless the lease is tantamount to a permitted loan.

> **Situation**: Ben Costas, a partner of Woods & Costas, owns the building in which Alpha Manufacturing's corporate offices are located. The lease qualifies as a capital lease but not a grandfathered loan.
> **Not independent**: Leasing property to a client under a capital lease is deemed to be a loan to the client. Independence is impaired unless the loan is a grandfathered loan.

13. Inclusion of a clause in an engagement letter providing for CPA indemnification by the client.

> **Situation**: The engagement letter sent to Alpha Manufacturing by Woods & Costas contains an indemnification clause. It requires Alpha to reimburse Green & Martin for any losses due to a lawsuit based on Alpha's financial statements.
> **Independent**: Inclusion of a clause in the engagement letter providing for indemnification of the firm by the client does not impair independence.

14. A predispute agreement with a client to use alternative dispute resolution (ADR) techniques.
15. Commencement of an ADR proceeding. However, independence may be impaired if the proceeding is sufficiently similar to litigation because the parties have material adverse interests, e.g., in binding arbitration.
16. Performing extended audit services regarding reporting on internal control if management assumes responsibility for control, and management does not rely on the member's work as the primary basis for its assertion.

Independence is impaired in the following situations:

1. The CPA signs or cosigns checks or purchase orders or exercises general supervision to ensure compliance as a representative of a creditors' committee in control of a debtor corporation.
2. With respect to a foundation and an estate if the member is a trustee of the foundation that is the beneficiary of the estate.
3. A CPA serves on the board of directors of a client nonprofit social club. NOTE: The board of directors has the ultimate responsibility for the affairs of the club.
4. A CPA is on a client's committee that administers the deferred compensation program.
5. A CPA is a director of a company and an auditor of the profit sharing and retirement trust.
6. A CPA owns an immaterial amount of bonds in a municipal authority (considered a loan).
7. If billed or unbilled fees, or a note arising from the fees, for client services rendered more than 1 year before the current year's report date remain unpaid. (1.230.010.02)
8. Audit fees that are long past due take on the characteristics of a loan under Independence Rule. Not applicable if the client is in bankruptcy. (1.230.010.03)
9. When a CPA is on the board of directors of a fund-raising organization; unless the position is honorary.
10. For both partnerships, when two limited partnerships have the same general partner and a CPA has a material interest in one of the partnerships.
11. The use of partners, shareholders, and professional employees from another firm that is not independent of the client. Their work can be used in the same manner as that of internal auditors.
12. A CPA's service on a client's advisory board unless it
    a. Is in fact advisory.
    b. Has no authority to make management decisions, and
    c. Is distinct from the board of directors with few common members.
13. A CPA who is not independent may not express an audit opinion or issue a review report, but (s)he may issue a compilation report after disclosing the lack of independence.
14. A CPA who is a general partner in a partnership that invests in a client. If the CPA is a limited partner, independence would not be impaired unless the interest in the client is material.
15. Agreeing to indemnify a client for losses arising from lawsuits, etc., that relate directly or indirectly to client acts impairs independence.
16. When a CPA has significant influence over an entity with significant influence over a client.
17. With respect to the client and the plan if a CPA participates in a client's health and welfare plan. But, if participation arises from permitted employment of the immediate

family of the CPA, no impairment occurs provided the plan is offered to all employees in equivalent positions.

18. Acceptance of a gift from an attest client by a CPA on the engagement team or able to influence the engagement unless the value is clearly insignificant. Acceptance of entertainment from the attest client, or the offer of a gift or entertainment to the attest client, does not impair independence if it is reasonable in the circumstances.

Case Study
Situation: Tim Robin is a staff auditor for Woods & Costas, CPAs who is currently working on the Alpha Manufacturing audit engagement. Tim Robin's sister works in the sales department of Alpha Manufacturing.
Independent: Independence is impaired if an individual participating in the audit has a close relative who has a key position with the client. The sales position held by Tim's sister is not a key position. Thus, independence is not impaired. A close relative is defined as a parent, sibling, or nondependent child.

Chapter 2 Review Questions – Section 1

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

1. Which of the following statements best explains why the CPA profession has found it essential to promulgate ethical standards and to establish means for ensuring their observance?

   A. A distinguishing mark of a profession is its acceptance of responsibility to the public.
   B. A requirement for a profession is to establish ethical standards that stress primarily a responsibility to clients and colleagues.
   C. Ethical standards that emphasize excellence in performance over material rewards establish a reputation for competence and character.
   D. Vigorous enforcement of an established code of ethics is the best way to prevent unscrupulous acts.

2. The AICPA Code of Professional Conduct states, in part, that a CPA should maintain integrity and objectivity. Objectivity in the Code refers to a CPA's ability __________

   A. To maintain an impartial attitude on all matters that come under the CPA's review.
   B. To independently distinguish between accounting practices that are acceptable and those that are not.
   C. To be unyielding in all matters dealing with auditing procedures.
   D. To independently choose between alternate accounting principles and auditing standards.

3. Which of the following reports may be issued only by an accountant who is independent of a client?

   A. Reviews and audits of financial statements
   B. Tax service reports approved by the audit committee
   C. Review of an IT system
   D. Compilation report of client’s financial statements

1.300 - General Standards

A CPA must comply with the following:

1. Undertake only those services that the CPA can reasonably expect to complete with *professional competence*.
2. Exercise *due professional care* when performing professional services.
3. Adequately *plan and supervise* performance of professional services.
4. Obtain *sufficient relevant data* to provide a reasonable basis for conclusions in relation to any professional service.

Interpretations

A CPA should have the competence to complete professional services according to professional standards and with reasonable care and diligence.

1. Competence involves technical qualifications and the ability to supervise and evaluate the work. It relates to knowledge of standards, techniques, and technical subject matter and to the ability to exercise sound judgment.
2. In some cases, additional research and consultation is a normal part of performing services. However, if a CPA cannot gain sufficient competence, (s)he should suggest the engagement of someone competent.
3. If a CPA is unable to gain sufficient competence, the CPA 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.
4. A CPA who employs a specialist to perform consulting services for the CPA's clients must be qualified to supervise and evaluate the work of that specialist. Although the CPA is not required to be able to perform each of the specialist's tasks, the CPA should be able to define the tasks and evaluate the end product.
5. The CPA has a responsibility to make sure that a subcontractor (s)he has selected has the professional qualifications and skills needed. Use of a third-party to assist in providing professional services does not change the duty to comply with the general and technical standards.
6. If a CPA submits financial statements in his/her capacity as an officer, shareholder, partner, director, or employee to a third party, the CPA's relationship to the entity should be clearly communicated. No implication of independence should be made. Rule 1.320 applies if the communication states that the financial statements conform with GAAP. If the member acts as a public practitioner or submits the statements on his/her public practitioner's letterhead, (s)he should comply with applicable standards, including disclosure of lack of independence.

Case Study - Competence
Mike Williams had followed a fairly common career path so far. After working for a large accounting firm for 2 years, he moved to a smaller firm, Burns and Associates, (B&A) to have greater overall responsibility and more exposure to the clients. After working at B&A for 3 years, he was approached by one of their larger clients, Beamer Enterprises, to become their controller. Eventually he hoped to become a CFO, but he knew he needed much more experience first.
After Mike had been working at Beamer for 3 months, he was approached by the president who informed Mike that the CFO has quit. The president also informed Mike that the company would be going public within 6 months. The president then offered Mike the position.
Mike had mixed feelings. He really wanted the job, and the addition salary, but he had never been responsible for a public company. Mike knew he didn't have the training or experience, but he was a faster learner. Could he rely on the expertise of others to help him through, or should he inform the president that another person would be a better candidate?
What should Mike do?
Solution: Mike knows he doesn't currently have the skills, experience, or competence to handle the CFO role for Beamer Enterprise. At least not in the short term while the company prepares to go public. Mike should decline the offer, and let the president know he will do everything to help the company in his current role of controller.

1.310 - Compliance with Standards Rule

A CPA who performs auditing, review, compilation, management consulting, tax, or other professional services must comply with standards issued by designated bodies (the PCAOB and relevant AICPA committees and boards).

1.320 - Accounting Principle Rule

A CPA should not state that any financial data is in conformity with generally accepted accounting principles (GAAP), if the statements contain any departure from an accounting principle. However, if the CPA can demonstrate that, due to unusual circumstances, the financial statements or data would have been misleading without a departure from GAAP, the CPA can comply with the rule by

1) describing the departure;
2) its approximate effects, if practicable; and
3) the reasons compliance with the principle would be misleading.

Interpretations

1. Professional judgment should be used in determining what constitutes unusual circumstances requiring a departure from established principles to prevent the financial statements or data from being misleading. Events that may justify such departures are new legislation or evolution of a new form of business transaction. An unusual degree of materiality or conflicting industry practices ordinarily do not justify departures.
2. The body designated to establish accounting principles for nongovernmental entities is the Federal Accounting Standards Advisory Board (FASAB); FASB; the GASB, with respect to Statements of Governmental Accounting Standards; and IASB.

1.400 - Acts Discreditable

A CPA shall not commit an act that is discreditable to the profession.

Interpretations

The following list includes Acts Discreditable:

1. Discrimination and Harassment in Employment Practices

A CPA must not discriminate based on sex, religion, race or color, age, disabilities, national origin or violate any other federal or state antidiscrimination laws.

2. Solicitation or Disclosure of CPA Questions and Answers

3. Failure to File a Tax Return or Pay a Tax Liability

4. Negligence in the Preparation of Financial Statements or Records

A CPA shall be considered in violation of the "Acts Discreditable Rule" if the CPA, by virtue of his or her negligence, does any of the following:

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

5. Not Following Requirements of Government Bodies, Commissions or Other Regulatory Agencies.

A CPA must follow GAAP and the requirements of governing bodies, commissions, or regulatory agencies when preparing financial statements or related information or in performing attest services for entities subject to their jurisdiction. For example, the SEC and PCAOB have created such requirements. If the CPA performs attest services related to reports to governing bodies, etc., (s)he must follow the requirements of those bodies as well as GAAS. A material departure from the requirements is an act discreditable unless the CPA discloses the reasons.

6. Not Applying Government Audits Standards

In a governmental audit, failure to adhere to applicable audit standards, guides, procedures, statutes, rules, and regulations is an act discreditable to the profession unless the report discloses the failure and the reasons therefore.

7. Using Indemnification and Limitation of Liability Provisions

An indemnification clause agrees that one party will not hold the other party liable for any future fines or legal actions. Regulators may prohibit regulated entities from entering into certain kinds of indemnification and limitation of liability agreements in connection with attest services. Regulators also may prohibit CPA s from providing services under such agreements. Failing to comply with such prohibitions is an act discreditable.

8. Failing to Maintain Confidential Information Obtained From Employment or Volunteer Activities

A CPA should maintain the confidentiality of his or her employer's or firm's (employer) confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer's vendors, customers, or lenders (for example, any confidential information

pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the member is working in a volunteer capacity).

9. False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services

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.

10. Failing to Properly Use the CPA Credential

A CPA should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A CPA who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Acts Discreditable Rule" [1.400.001].

11. Ignoring Requests for Records

Client-provided records are "accounting or other records belonging to the client that were provided to the CPA by or on behalf of the client." Client records must be returned after a client demands them even if fees have not been paid. This ethical standard applies even if the state in which the CPA practices grants a lien on certain records in his/her possession.
A CPA 's *working papers* include, but are not limited to, audit programs, analytical review schedules, and statistical sampling results, analyses, and schedules prepared by the CPA. *Working papers* are the CPA's property and need not be made available unless required by (a) statute, (b) regulation, or (c) contract.
Client records prepared by the CPA include accounting and other records (e.g., tax returns, journals, ledgers, and supporting schedules) that the CPA was engaged to prepare. They may be withheld if fees are due or the engagement is incomplete.
Supporting records contain information not in the client's records, without which its financial information is incomplete. Supporting records, such as entries and related calculations, are produced by the CPA. They are not otherwise available to the client. Supporting records for an issued work product should be given to the client upon request unless fees are due for that product.
The CPA may:

(a) charge a reasonable fee,
(b) provide records in any usable form, and
(c) retain copies. Moreover, the records provided must be in a requested format only if the engagement was to prepare them in that format.

Compliance with a client's request usually should be within 45 days.

Note: State boards may have more restrictive requirements regarding records than the AICPA. For instance, the board may require that CPA s provide records even if fees have not been paid CPA s must follow the more restrictive requirements of their state board.

12. Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice

A CPA that sells or transfers all or part of a practice to another person or firm, should send a written request to each client requesting the client's consent to transfer its files to the new person or firm. The CPA should notify that consent is presumed if the client does not reply within 90 days. The CPA should wait for the consent or the 90 days has lapsed before transferring any files, and should retain evidence of the actual or presumed consent. The acquiring firm should confirm the consent process has been followed.

Any CPA discontinuing a practice, without transferring the practice, must inform all current clients in writing of the discontinuation, and make arrangements to return any clients records, as required by rules governing requests for records.

If the CPA is unable to contact a client, the member must retain the files in a confidential manner, as required by rules governing record retention.

13. Removing Client Files or Proprietary Information from a Firm

A CPA whose employment was terminated must not take or retain (a) originals or copies (in any format) from the firm's client files or (b) proprietary information without the firm's permission, unless the CPA has a contractual arrangement with the firm allowing such action.

14. A CPA should not disclose confidential information from a prospective client or a nonclient without consent.

Former Chief Financial Officer of Bankrate Inc. Sentenced to 10 Years in Prison for Orchestrating a Complex Accounting and Securities Fraud Scheme

The former chief financial officer of Bankrate Inc., a publicly traded financial services and marketing company formerly headquartered in North Palm Beach, Florida, was sentenced today to 10 years in prison for orchestrating an accounting and securities fraud scheme that caused more than $25 million in shareholder losses.

Assistant Attorney General Brian A. Benczkowski of the Justice Department's Criminal Division, U.S. Attorney Ariana Fajardo Orshan of the Southern District of Florida and Inspector in Charge Delany DeLeon-Colon of the U.S. Postal Inspection Service's Criminal Investigations Group made the announcement.

Edward J. DiMaria, 53, of Fairfield County, Connecticut, was sentenced by Chief U.S. District Judge K. Michael Moore of the Southern District of Florida, who also imposed three years of supervised release and ordered DiMaria to pay restitution in the amount of $21,234,214. On June 28, DiMaria pleaded guilty to one count of conspiracy to making false statements to a public company's accountants, falsifying a public company's books, records and accounts, and securities fraud; and one count of making materially false statements to the Securities and Exchange Commission (SEC).

"While serving as Bankrate's CFO, Edward DiMaria blatantly manipulated the company's publicly reported financial statements by repeatedly lying and directing others to lie to auditors, regulators, and shareholders," said Assistant Attorney General Benczkowski. "The significant sentence handed down today underscores the serious nature of corporate fraud and the damage it causes to shareholders and to the public's trust in our financial markets. The sentence also demonstrates the Department's commitment to prosecuting corporate misconduct to the fullest

extent of the law."
"The U.S. Postal Inspection Service has an extensive history of investigating complex financial fraud schemes in order to protect investors as well as the integrity of the financial marketplace from fraudulent activities by trusted insiders who abuse their positions," said Inspector in Charge Delany DeLeon-Colon. "Anyone who engages in this type of financial fraud scheme should know they will be found and they will be held accountable."
As part of his guilty plea, DiMaria admitted that between 2010 and 2014 he directed and conspired to commit a complex scheme to artificially inflate Bankrate's earnings through so-called "cookie jar" or "cushion" accounting, whereby millions of dollars in unsupported expense accruals were purposefully left on Bankrate's books and then selectively reversed in later quarters to boost earnings. In addition, DiMaria admitted that he conspired with other Bankrate employees to misrepresent certain company expenses as "deal costs" in order to artificially inflate publicly reported adjusted earnings metrics. DiMaria made materially false statements to Bankrate's independent auditors to conceal the improper accounting entries, and he caused Bankrate's financial statements filed with the SEC to be materially misstated, he admitted.
Hyunjin Lerner, Bankrate's former vice president of finance, previously pleaded guilty for his role in the conspiracy. Lerner was sentenced by Judge Moore earlier this year to serve 60 months in prison.
SEC Press Release

1.510 - Contingent Fees

Rules on Contingent Fees and Commissions prohibit, among other acts, the receipt of contingent fees by a CPA in public practice for the performance of certain services and the receipt of a commission for the referral of products or services under certain circumstances. The Code's objective is to keep the CPA that receives a contingent fee or commission from a possible conflict of interest within the service to be performed.

A contingent fee is established as part of an agreement under which the amount of the fee is dependent upon the finding or result.

1. The receipt of contingent fees by a CPA is prohibited when a CPA in public practice performs an audit, a review, a compilation when the report will be used by third parties and the report does not disclose the CPA's lack of independence, or an examination of prospective financial information.
2. Fees are not deemed to be contingent if fixed by courts or other public authorities, or in tax matters, if they are based on the results of judicial proceedings or the findings of governmental agencies.

Contingent Fees in Tax Matters. The use of contingent fees is limited to a great degree in accounting practice. The area in which contingent fees situations arise most regularly is the tax area. The following are examples, of circumstances where a contingent fee would be permitted.

1. Representation of a client in an examination by a revenue agent
2. Filing an amended tax return claiming a refund based on a tax issue that is the subject of a test case involving a different taxpayer
3. Representation of a client who is obtaining a private letter ruling

A contingent fee is NOT permitted for preparing an original or amended tax return or a claim for a tax refund. An example of circumstances in which a contingent fee is not allowed is the preparation of an amended income tax return for a client claiming a refund of taxes because of an inadvertent omission of a proper deduction.

Note:

1. A contingent fee or commission is considered to be received when the performance of related services is complete and the fee or commission is determined.
2. A CPA who provides investment advisory services for an attest client for a percentage of the investment portfolio violates contingent fee rules unless the fee is a specified percentage of the portfolio, the dollar amount of the portfolio is determined at the beginning of each quarterly (or longer) period and is adjusted only for the client's additions or withdrawals, and the fee arrangement is not renewed more often than quarterly.

1.520 - Commissions and Referral Fees

A commission is compensation for either recommending or referring a 3rd party product or service to a client, or recommending or referring a client's product or service to a 3rd party. A CPA in public practice should not receive a commission when the CPA or the CPA's firm also performs for that client:

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

Any commissions that are allowed must be disclosed to any person or entity to whom the member recommends a product or service.

A CPA's spouse may provide services to the CPA's attest client for a contingent fee or refer products or services for a commission to or from the CPA's attest client, provided the spouse's activities are separate from the CPA's practice and the CPA is not significantly involved. However, a conflict of interest issue may still arise.

A CPA may not refer for commissions products to clients through distributors and agents when the CPA is performing any of the services described above.

If a CPA purchases a product, taking title to the product and assuming all the associated risks of ownership, any profit the member receives on reselling it to a client would not constitute a commission.

If, in providing professional services to a client, a CPA subcontracts the services of another person or entity, any mark-up of the cost of the subcontracted services would not constitute a commission.

A referral fee is compensation for recommending or referring any service of a CPA to any person. Referral fees are not considered commissions. Any CPA who accepts a referral fee for recommending services of a CPA or who pays a referral fee to obtain a client must disclose the arrangement to the client.

State boards or other regulatory bodies may have more restrictive rules governing commissions.

1.600 - Advertising and Other Forms of Solicitation

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

False, misleading, or deceptive acts are prohibited because they are against public interest. These prohibited activities include:

1. Creating false expectations of favorable results
2. Implying the ability to influence any court, regulatory agency, or similar body
3. Representing that specific services will be performed for a stated fee when it is likely at the time of the representation that the fees will be substantially increased and the client is not advised of the possibility
4. Other representations that would cause a reasonable person to misunderstand or be deceived

CPAs are permitted to render services to clients of third parties. If the third party obtained its clients through advertising, the members must ascertain that all promotional efforts were within the Rules of Conduct. CPAs must not do through others what they are prohibited from doing themselves.

1.700 - Confidential Client Information Rule

A CPA should not disclose confidential client information without the client's consent.
A CPA may disclose confidential information without a client's permission in the following circumstances:

1. To comply with requirements of other professional standards - audit, review, and tax standards
2. To comply with a validly issued and enforceable subpoena or summons or in order to comply with applicable laws and regulations
3. To cooperate in a peer review of the CPA's professional practice under AICPA or state CPA society or board of accountancy authorization
4. To initiate a complaint with or respond to any inquiry made by the professional ethics division, trial board of the AICPA, or an investigative or disciplinary body of a state society or board of accountancy

A CPA who withdrew from an engagement because of fraud on a client's tax return should suggest that the successor obtain permission from the client to reveal the reasons for leaving.

A CPA who prepares a joint tax return should consider both spouses to be clients. If the spouses are undergoing a divorce, the CPA will not violate confidentiality rules if (s)he releases information to either spouse. But the legal implications should be discussed with an attorney. Before using a third party to assist in providing professional services, a CPA should

- have a contract with the provider to protect client confidentiality and
- be reasonably assured that the provider's procedures are sufficient for this purpose.

Absent a contract, specific client consent is needed to disclose confidential client information. The rule against disclosure of confidential information does not prohibit the review of a CPA's professional practice pursuant to a purchase, sale, or merger of the practice. However, appropriate precautions (e.g., a written confidentiality agreement) should be taken so that the prospective buyer does not disclose any confidential client information. CPAs who obtain client files through an acquisition must not disclose any confidential client information in the files. A CPA may give a client's profit and loss percentages to a trade association provided the CPA has permission from the client.

Knowledge and expertise obtained from a prior engagement may be used on behalf of a current client provided that the details of the other engagement are not revealed without permission. A CPA may reveal a client's name without permission unless disclosure would constitute release of confidential information.

1.800 - Form of Organization and Name Rule

A CPA may practice public accounting only in a form of organization allowed by law or regulation that conforms with resolutions of the AICPA Council.

- The firm name must not be misleading.
- Names of past owners may be included in the name of the successor organization.
- A firm cannot designate itself as "members of the AICPA" unless all CPA owners are members.

See other restrictions on organizations and names for Rule 1.800 in the Appendix.

Case Studies of AICPA Ethics Violations

1. The Case of the Almost Stolen Clients

RULES THAT APPLY:

AICPA Rule 1.600, *Advertising or Other Forms of Solicitation*

THE PLAYERS:

Respondent: Mr. Knotmee

Complaint Submitted by: The Firm

CASE DETAILS:

In a letter to the ICPAS**, The Firm indicated that Mr. Knotmee, a former employee, improperly solicited clients of The Firm after his departure. In particular, The Firm stated that:

- At time of Mr. Knotmee's termination, he was asked to return all copies of any client lists and information. However, he failed to comply with this request.

- Prior to Mr. Knotmee's termination, his personnel file disappeared, which contained the non-compete agreement.
- In a solicitation (marketing) letter, Mr. Knotmee claims to employ current employees of The Firm. However, these employees have stated that they indeed do not work for Mr. Knotmee.
- The Firm disputed some of the claims that Mr. Knotmee made in his marketing letter. Among the disputed claims:
- Mr. Knotmee stated he was a consulting manager at The Firm. - The Firm argued that he was classified as staff.
- Mr. Knotmee stated that he parted company with The Firm on April 15, 20xx. - The Firm stated that Mr. Knotmee was terminated on March 31 on the same year and that the reasons Mr. Knotmee gave for his dismissal are not representative of reality.
- Mr. Knotmee stated that many of The Firm's associates worked in conjunction with Mr. Knotmee's company. - The Firm stated that there are NO employees at The Firm who work for Mr. Knotmee's company.
- In Mr. Knotmee's resume, he stated that he is a member of the AICPA. - The Firm knows this to be false.

The ICPAS contacted Mr. Knotmee to inform him of the complaint made by The Firm, and to request a meeting. In the meeting between Mr. Knotmee and the ICPAS, Mr. Knotmee conceded that he should not have claimed to be member of AICPA since he is not. He stated that it was an oversight and he did not attempt to deceive. He also was under the impression that it is the responsibility of The Firm to prove advertising material is false. The Ethics Committee informed him that it is the obligation of the member to verify his own advertising materials. Mr. Knotmee supported his fee claims by presenting invoices by The Firm and by other accounting firms. However, since that type of information is confidential, it could not be disclosed, otherwise it would violate another ethics rule.

Mr. Knotmee said that although he has no employees now except himself, the persons he listed on his solicitation letter would work with him on his request. Mr. Knotmee did not receive any clients from the marketing letter. He promised to refrain from soliciting The Firm's clients in the future.

CONCLUSION:

The ICPAS found prima facie evidence that Mr. Knotmee had violated Advertising Rule 1.600.

CORRECTIVE ACTION:

The ICPAS and the AICPA instructed Mr. Knotmee to immediately comply with the ICPAS Code of Professional Conduct, to take and pass the AICPA course, Professional Ethics for CPAs, and to submit evidence that he has passed course.

LESSONS LEARNED:

While we all like to make our resumes as informative as possible, make sure the information is correct, and that you don't pretend to be who you are not. Information that is false, misleading, or deceptive can get you into big trouble!

2. The Case of the Harmless Mistakes
RULES THAT APPLY:
AICPA 1.300, *General Standards*
AICPA 1.400, *Acts Discreditable*
THE PLAYERS:
Respondent: Mr. Happy
Complainant: Mr. Grumpus
Client: Company RED
CASE DETAILS:
In a letter to the ICPAS**, Mr. Grumpus indicated that Mr. Happy and his company billed excessively for work done for Company RED that was considered substandard because it contained errors in projected financial statements. Mr. Grumpus also claimed that the overly aggressive collections method that Mr. Happy used was of low professional conduct. Mr. Happy is a former employee of Mr. Grumpus and his company.

Mr. Happy responded via an interview with the ICPAS and indicated that the error in the projected financial statements was a failure to include the amount of interest expense in the determination of net income. Mr. Happy indicated that the mistake was in the software formula, causing the subtotal not to foot. Mr. Happy said that the error was immaterial. If materiality is based on projected revenue, the errors amounted to less than two percent for each of the three years in question. If it is based on percentage of error on net income, the errors amount to 40%, 15%, and 6% for the same years. Mr. Grumpus relied on the PPC Forecasts and Projections Guide in determining materiality issue. As stated in the PPC guide materiality could be as high as twice that used for the historical financial statements.

Mr. Happy also said that the projected financial statements were not relied upon and that the users were sophisticated financial professionals who caught the error and made manual and mental corrections to the statements. The error had no effect on the complainant's analysis of the projected venture and did not affect their conclusions about not pursuing the venture. The ICPAS investigator contacted Company RED and discovered that had the numbers been correct, the merger would not have been completed anyway due to seller related issues. Mr. Happy said that an offer to reissue the financial statements was made and that Company RED declined. The ICPAS investigator told Mr. Happy that he should have notified Company RED in writing to state that the financial statements should be reissued.

The second issue concerning unpaid fees is being contested by Company RED as being too high due to excessive hours and credits that have not been applied as stated. Mr. Happy has not issued the billing credit on the advice of legal counsel. The interest charges per the respondent and the complainant have been eliminated from the statements submitted. The ethics committee feels that at this point, the fees should be settled between the parties and will not be an issue in the ethics investigation.

CONCLUSION:
The case was closed with a determination that no violation of the Code of Professional Conduct occurred. In a letter to Mr. Happy, the committee suggested that as a protective

measure, he should put in writing any offers to reissue financial reports should such circumstances arise in the future.

CORRECTIVE ACTION:

None.

LESSONS LEARNED:

While fee disputes are a common source of complaints to the Ethics Committee, they generally do not get involved in them. However in this case the Committee debated whether the work product was being relied on. The Committee determined that although the projection was materially flawed, the primary users had discovered the error and took the error into consideration during their negotiations. At this point, the projection was no longer being relied on.

If a document is in error and the accountant knows this, it is the accountant's responsibility to take all efforts to make all users aware of this, typically through recalling a report and reissuing. However, if the report is not being relied on due to the "staleness" of the document, or the "special purpose" nature of the document having expired, there is no need to recall the report.

3. The Case of the Inadequate Accountant

RULES THAT APPLY:

AICPA Rule 1.310, *Compliance with Standards*
AICPA Rule 1.320, *Accounting Principles*

THE PLAYERS:

Respondent: Mr. Indigo
Complainant: Mr. Whiner
Audited Party: Loser Township

CASE DETAILS:

Mr. Indigo performed an audit of the financial statements of the Loser Township for the year ended March 31, 20xx.

Mr. Whiner wrote in a letter to the ICPAS that Mr. Indigo's audit contained major deficiencies. The ICPAS notified Mr. Indigo of the complaint. The ICPAS Ethics Committee investigators met with Mr. Indigo at his office.

At the meeting, Mr. Indigo made the following statements:

- The Loser Township is one of three municipal clients. Their primary practice is in tax and monthly work.
- The firm has not completed a quality review as of yet. The review was scheduled for March 20xx, but was not started. None of the governmental audit work appears to follow yellow book standards.
  The firm has available to it, the AICPA audit guide Audits of State and Local Governmental Units and referred to it during the audit.
- The firm also utilized a PPC Guide on Auditor's Reports in drafting its report on the Loser Township financial statements.

The following deficiencies were discussed and noted at the meeting:

- The financial statements presented a prior year column that was also audited by Mr. Indigo. However, the auditor's opinion made no reference to the prior year. Other statements were inaccurate or missing.
- Based on review of the footnotes to the financial statements, the following notes were not present:
    - Reporting entity note;
    - Description of funds;
    - Detail on property tax recognition
    - Change of general fixed asset-shown as an exhibit not part of the notes;
    - Insurance coverage for cash and investment disclosure;
    - Disclosure on interfund transfers.
- The statements, including the footnotes, would not be a complete disclosure and, as such, are not "liftable" as presented.
- The following items were not present in the workpapers:
    - Assessment of Risk
    - Determination of Materiality
    - Evidence of Review
    - Evidence of Planning

CONCLUSION:

The committee found evidence that Mr. Indigo violated the following rules: - Compliance with Standards, and *Accounting Principles*

CORRECTIVE ACTION:

The Committee instructed Mr. Indigo to comply immediately with professional standards applicable to professional service he performs. They also instructed him to complete 16 hours of specified CPE courses within one year, and show evidence of completion.

LESSONS LEARNED:

Don't try to do work that is unfamiliar or new to you. Accounting standards have become very complex and specialized. This accountant mainly did monthly and tax work, and only had a few municipal clients. In a case such as this, he may have been better off referring the municipal client to an auditor with more expertise in this field. Another option is to do a joint venture with another firm that has more experience. The corrective action in this case focused on trying to educate the member in the area in which he had some inadequacy. But remember that all the CPE in the world cannot take the place of experience.

*Special thanks to Dr. Howard A. Kanter of the DePaul University School of Accountancy and the ICPAS Ethics Committee for developing and maintaining the Ethics Case Studies.

** ICPAS refers to Illinois CPA Society

Chapter 2 Review Questions – Section 2

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

4. According to Conduct Rule 1.600, *Advertising and Other Forms of Solicitation,* advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest, and AICPA members in public practice shall not seek to obtain clients in such a manner. Such activities include all the following EXCEPT:

   A. An indication of the CPA's educational and professional attainments.
   B. An implication of the ability to influence a court.
   C. A claim to be able to save the taxpayer 20% of a determined tax liability.
   D. The creation of unjustified expectations of favorable results.

5. AICPA Conduct Rule 1.700 is violated when a member in public practice:

   A. Provides client profit and loss percentages to a trade association without the client's consent.
   B. Uses outside computer services to process tax returns.
   C. Performs consulting services for similar clients.
   D. Advises potential consulting services clients about previous problems on similar engagements.

6. A CPA's retention of client records as a means of enforcing payment of an overdue audit fee is an action that is _____________

   A. Not addressed by the AICPA Code of Professional Conduct.
   B. Acceptable if sanctioned by state law.
   C. Prohibited under the AICPA Code of Professional Conduct.
   D. A violation of GAAS.

Chapter 3 – Other Ethical Standards

Learning Objectives

After studying this chapter you will be able to:
- Identify the key issues of corporate responsibility law (Sarbanes-Oxley act) that influence auditor independence.
- Identify licensing and disciplinary mechanisms within the profession.
- Identify the ethical standards required of accountants and financial professionals by the Institute of Management Accountants (IMA).

In addition to the AICPA's rules and interpretations, several other bodies also provide guidelines or regulations governing the ethical conduct of CPA's. This chapter will discuss the ethical requirements of these regulations and organizations.

Corporate Responsibility Law (Sarbanes-Oxley Act)

President George W. Bush signed the Sarbanes-Oxley Act of 2002 (Public Law 107-204) on July 30, 2002. As enacted, the law directly impacted the following groups:

1. CPAs and CPA firms auditing public companies;
2. Publicly traded companies, their employees, officers, and owners—including holders of more than 10 percent of the outstanding common shares. This category would include CPAs employed by publicly traded companies as chief financial officers (CFOs) or in the finance department;
3. Attorneys who work for or have as clients publicly traded companies; and
4. Brokers, dealers, investment bankers and financial analysts who work for these companies.

The Act changes how publicly traded companies are audited, and reshapes the financial reporting system. This Act adopts tough new provisions to deter and punish corporate and accounting fraud and corruption, ensures justice for wrongdoers, and protects the interests of workers and shareholders.

This law improves the quality and transparency of financial reporting, independent audits, and accounting services for public companies. It also:
- Created a Public Company Accounting Oversight Board (www.pcaobus.org) to enforce professional standards, ethics, and competence for the accounting profession;
- Strengthens the independence of firms that audit public companies;
- Increases corporate responsibility and the usefulness of corporate financial disclosure;
- Increased penalties for corporate wrongdoing;
- Protects the objectivity and independence of securities analysts; and
- Increases Securities and Exchange Commission resources.

Under this law, CEOs and chief financial officers must personally vouch for the truth and fairness of their company's disclosures. And those financial disclosures will be broader and better than ever before.

Corporate officials will play by the same rules as their employees. In the periods when workers are prevented from buying and selling company stock in their pensions or 401(k)s, corporate officials will also be banned from any buying or selling.

Corporate misdeeds will be found and punished. This law authorizes new funding for investigators and technology at the SEC to uncover wrongdoing. The SEC will now have the administrative authority to bar dishonest directors and officers from ever again serving in positions of corporate responsibility. The penalties for obstructing justice and shredding documents are greatly increased.

Public Company Accounting Oversight Board (PCAOB)

- The law establishes a five-member accounting oversight board that is subject to Securities and Exchange Commission (SEC) oversight.
- Though the board oversees accounting firms, only two members of the board may be CPAs.
- The SEC will appoint the board.
- Duties of the board include registering public accounting firms that prepare audit reports; and establishing or adopting auditing, quality control, ethics and independence standards.
- The board also inspects, investigates and disciplines public accounting firms and enforces compliance with the act.
- *Registration with the Board Is Mandatory* for public accounting firms, foreign or domestic, that participate in the preparation or issuance of any audit report with respect to a public company. Registration and annual fees collected from each registered CPA firm will go towards the costs of processing and reviewing applications and annual reports.
- *Seven-Year Record Retention Requirement.* PCAOB must adopt a rule to require registered CPA firms to prepare and maintain audit work papers and other information related to an audit for at least seven years in sufficient detail to support the conclusions reached in the audit report. (A separate criminal provision requires retention of all audit and review workpapers for five years from the end of the fiscal year in which the audit or review was completed.)
- *Cooperation with CPA Groups.* The board will cooperate with professional accountant groups and advisory groups to increase the effectiveness of the standards setting process. (The PCAOB may cooperate, but authority to set standards rests with the PCAOB, subject to SEC review.)
- *Annual Inspections.* Inspection of registered public accounting firms shall occur annually for every registered public accounting firm that regularly provides audit reports for more than 100 issuers (at least once every three years for registered firms that audit fewer than 100 issuers).
- *Investigations.* The board may investigate any act, omission or practice by a registered firm or an individual associated with a registered firm for any possible violation of the act, the board's rules, professional standards, or provisions of the securities laws relating to the preparation and issuance of audit reports. The board may require testimony or

documents and information (including audit work papers) from a registered firm or individual associated with a registered firm or in the possession of any other person.

- Sanctions for violations that the board finds may include:
  a. Suspension or revocation of a registration;
  b. Suspension or bar of a person from further associating with any registered public accounting firm;
  c. Limitations on the activities of a firm or person associated with the firm; and
  d. Penalize the firm up to $2 million per violation, up to a maximum of $15 million.
  e. Individuals employed or associated with a registered firm who violate the act can face penalties that range from required additional continuing professional education (CPE) or training, disbarment of the individual from further association with any registered public accounting firm, or even a fine up to $100,000 for each violation, up to a maximum of $750,000. A portion of the penalties collected will go to accounting scholarships.
- Funding. The law also provides independent funding for the Financial Accounting Standards Board (FASB). While the SEC and American Institute of CPAs (AICPA) both have recognized FASB as the standard setting body for accounting principles, federal authority to issue auditing, quality control, ethics and independence standards may seriously impact the AICPAs' role in official pronouncements.

Other Requirements for CPA Firms

- *Audit Reports Require Concurring Partner Review*. Requires a concurring or second partner's review and approval of all audit reports and their issuance.
- *"Revolving Door" Employment of CPAs with Audit Clients Is Banned.* A registered CPA firm is prohibited from auditing any SEC registered client whose chief executive, CFO, controller or equivalent was on the audit team of the firm within the past year.
- *Audit Partner Rotation Required*. Audit partners who either have performed audit services or been responsible for reviewing the audit of a particular client must be rotated every five consecutive years. CPAs should read carefully the requirements for rotation of both the partner-in-charge and the concurring review partner for certain organizational constraints.
- *No Firm Rotation Requirement*. Firm rotation is not required. However, the U.S. Comptroller General will study and review the potential effects of mandatory rotation and will report its findings to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services.
- *CPA Firms Are Required to Report Directly to the Audit Committee. The* Sarbanes-Oxley Act requires that the audit committee of a public company hire and pay the external auditors. Such affiliation inhibits management from changing auditors to gain acceptance of a questionable accounting method. Also, a potential successor auditor must inquire of the predecessor auditor before accepting an engagement.
- *CPA Firm Consolidations to Be Studied.* The U.S. Comptroller General will conduct a study analyzing the impact of the merger of CPA firms to determine if consolidation leads to higher costs, lower quality of services, impairment of auditor independence, or lack of choice.
- *Corporate and Criminal Fraud Accountability.* Changes to the securities laws can penalize anyone found to have destroyed, altered, hid or falsified records or documents to

impede, obstruct or influence an investigation conducted by any federal agency, or in bankruptcy, with fines or up to 20 years imprisonment, or both.

- *Current Requirements for Audit Firms*. Accountants are required to maintain all audit or review workpapers for a period of five years from the end of the fiscal period in which the audit or review was concluded.
- *Additional Rules*. The law requires the SEC to promulgate rules and regulations on the retention of any and all materials related to an audit, including communications, correspondence and other documents created, sent or received in connection with an audit or review. For violating the requirement or the rules that will be developed will result in a fine, or up to 10 years imprisonment, or both.

Internal Control Report

Under Section 404 of the Act, management must establish and document internal control procedures and include in the annual report a report on the company's *internal control over financial reporting.* This report is to include:

1. A statement of management's responsibility for internal control;
2. Management's assessment of the effectiveness of internal control as of the end of the most recent fiscal year;
3. Identification of the framework used to evaluate the effectiveness of internal control (such as the report of the Committee of Sponsoring Organizations);
4. A statement about whether significant changes in controls were made after their evaluation, including any corrective actions; and
5. A statement that the external auditor has issued an attestation report on management's assessment.

Because of Section 404, two audit opinions are expressed: one on internal control and one on the financial statements. The auditor must attest to and report on management's assessment. The auditor must evaluate whether the structure and procedures

- Include records accurately and fairly reflecting the firm's transactions.
- Provide reasonable assurance that transactions are recorded so as to permit statements to be prepared in accordance with GAAP.

The auditor's report also must describe any material weaknesses in the controls. The evaluation is not to be the subject of a separate engagement but be in conjunction with the audit of the financial statements.

Requirements for Corporations, Their Officers and Board Members

No Lying to the Auditor. The act makes unlawful for an officer or director or anyone acting for a principal to take any action to fraudulently influence, coerce, manipulate or mislead the auditing CPA firm.

Code of Ethics for Financial Officers. The SEC is mandated to issue rules adopting a code of ethics for senior financial officers.

Financial Expert Requirement. The SEC is required to issue rules requiring a publicly traded company's audit committee to be comprised of at least one member who is a financial expert.

Audit Committee Responsible for Public Accounting Firm. The Act vests the audit committee of a publicly traded company with responsibility for the appointment, compensation and oversight of any registered public accounting firm employed to perform audit services.

NOTE: The Act requires that the audit committee of a public company hire and pay the external auditors. Such affiliation inhibits management from changing auditors to gain acceptance of a questionable accounting method. Also, a potential successor auditor must inquire of the predecessor auditor before accepting an engagement.

Audit Committee Independence. Requires audit committee members to be members of the board of directors of the company, and to otherwise be independent.

CEOs & CFOs Required to Affirm Financials. Chief executive officers (CEOs) and CFOs must certify in every annual report that they have reviewed the report and that it does not contain untrue statements or omissions of material facts.

Penalty for Violation. If material noncompliance causes the company to restate its financials, the CEO and CFO forfeit any bonuses and other incentives received during the 12-month period following the first filing of the erroneous financials.

CEOs & CFOs Must Enact Internal Controls. CEOs and CFOs will be responsible for establishing and maintaining internal controls to ensure they are notified of material information.

Penalties for Fraud. The act also has stiffened penalties for corporate and criminal fraud by company insiders. The law makes it a crime to destroy, alter or falsify records in a federal investigation or if a company declares bankruptcy. The penalty for those found guilty includes fines, or up to 20 years imprisonment, or both.

Companies Affected by the Act. Publicly traded companies affected by the Act are those defined as an "issuer" under Section 3 of the Securities Exchange Act of 1934, whose securities are registered under Section 12 of the 1934 Act. An issuer also is considered a company that is required to file reports under Section 15(d) of the Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933.

Debts Not Dischargeable in Bankruptcy. Amends federal bankruptcy law to make non-dischargeable in bankruptcy certain debts that result from a violation relating to federal or state securities law, or of common law fraud pertaining to securities sales or purchases.

Expanded Statute of Limitations for Securities Fraud. For a civil action brought by a non-government entity or individual, an action involving a claim of securities fraud, deceit or manipulation may be brought not later than the earlier of two years after discovery or five years after the violation.

No Listing on National Exchanges for Violators. The SEC will direct national securities exchanges and associations to prohibit the listing of securities of a noncompliant company.

No Insider Trading. No insider trading is permitted during pension fund blackout periods. The insider must forfeit any profit during this period to the company.

SEC Rules on Enhanced Financial Disclosures.

1. *Off-Balance Sheet Transactions*: All quarterly and annual financial reports filed with the SEC must disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities. Disclosure must be made on significant aspects relating to financial condition, liquidity, capital expenditures, resources, and components of revenue and expenses.
2. *Pro Forma Figures:* Pro forma financial information in any report filed with the SEC or in any public release cannot contain false or misleading statements or omit material facts necessary to make the financial information not misleading.

No Personal Loans. No personal loans or extensions of credit to company executives either directly or through a subsidiary, except for certain extensions of credit under an open-ended credit plan or charge card, home improvement and manufactured home loans, or extensions of credit by a broker or dealer to its employee to buy, trade, or carry securities. The terms of permitted loans cannot be more favorable than those offered to the general public.

Criminal Penalties Enhanced*

BEHAVIOR	**SENTENCE**
The alteration, destruction, concealment of any records with the intent of obstructing a federal investigation.	Fine and/or up to 10 year's imprisonment.
Failure to maintain audit or review "work papers" for at least five years.	Fine and/or up to 5 year's imprisonment.
Anyone who "knowingly executes, or attempts to execute, a scheme" to defraud a purchaser of securities.	Fine and/or up to 10 year's imprisonment.
Any CEO or CFO who "recklessly" violates his or her certification of the company's financial statements.	Fine of up to $1,000,000 and/or up to 10 years imprisonment.
If violation is willful.	Fine of up to $5 million and/or up to 20 years imprisonment.
Two or more persons who conspire to commit any offense against or to defraud the U.S. or its agencies.	Fine and/or up to 10 year's imprisonment.
Any person who "corruptly" alters, destroys,	Fine and/or up to 20 year's imprisonment.

conceals, etc., any records or documents with the intent of impairing the integrity of the record or document for use in an official proceeding.	
Mail and wire fraud.	Increase from 5 to 20 years imprisonment.
Violating applicable Employee Retirement Income Security Act (ERISA) provisions.	Various lengths depending on violation.

*Source: Sarbanes-Oxley Act of 2002 and New York City Office of the Comptroller.

Consulting Services Prohibited by Sarbanes-Oxley Act of 2002
Title II of the Sarbanes-Oxley Act of 2002 prohibits most "consulting" services outside the scope of practice of auditors.

Prohibited services. Even if pre-approved by the issuer's audit committee, prohibited services include:

1. Bookkeeping and related services,
2. Design and implementation of financial information systems,
3. Appraisal or valuation services (including fairness opinions and contribution-in-kind reports), (*Note:* The valuations relate to financial statement items and not valuations per se.)
4. Actuarial services,
5. Internal audit outsourcing, *Note:* "Operational" internal audits are allowed.
6. Services that provide any management or human resources,
7. Investment or broker/dealer services, and
8. Legal and "expert services unrelated to the audit."
9. Any other service that the board determines, by regulation, is impermissible.

Services Not Prohibited. Firms, however, may provide tax services (including tax planning and tax compliance) or others that are not listed, provided the firm receives pre-approval from the board. However, certain tax planning products, like tax avoidance services, may be considered prohibited nonaudit services.

Note: The definition of consulting services includes consultations, advisory services, implementation services, transaction services, staff and other support services, and product services.

AICPA's Standards for Tax Services

The AICPA has issued seven Statements on Standards for Tax Services (SSTS). The statements are enforceable under the AICPA's *Code of Professional Conduct.*

SSTS No. 1 — Tax Return Positions

1. An AICPA member should not recommend a position unless (s)he has a good faith belief that the position has a realistic possibility of being sustained if challenged. A member may reach such a position on the basis of well-reasoned articles or treatises or pronouncements of the taxing authority.

2. A member should not prepare or sign a return if (s)he knows it takes a position that the member knows either a)exploits the audit selection process of a taxing authority, or b) serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.
3. A member may recommend a position that is not frivolous (knowingly advanced in bad faith and improper) if (s)he advises disclosures. The member may prepare or sign a return containing such a position if the position is properly disclosed.
4. A member should advise the taxpayer of possible penalties associated with the recommended tax return position.
5. A member has the right and responsibility to be an advocate for the taxpayer. A taxpayer has no obligation to pay more taxes than legally owed.

SSTS Interpretation No. 1-1, "Reporting and Disclosure Standards," of Statement on Standards for Tax Services No. 1, Tax Return Positions
This interpretation provides that a member should not recommend a tax return position or take a position on a tax return that the member prepares unless that position satisfies applicable reporting and disclosure standards. The tax laws of various taxing jurisdictions contain similar limitations on the ability to recommend or take certain tax return positions.

SSTS Interpretation No. 1-2, "Tax Planning," of Statement on Standards for Tax Services No. 1, Tax Return Positions
This interpretation has its origins in the AICPA's desire to provide adequate guidance to its members with respect to providing services in connection with tax planning. Its goal is to clarify existing standards, recognizing the compelling need for a comprehensive interpretation of a member's responsibilities in connection with tax planning. This guidance is intended to clarify how those standards would apply across the spectrum of tax planning.

SSTS No. 2— Answers to Questions on Returns

1. A member should make a reasonable effort to obtain appropriate answers to all questions on a tax return before signing as preparer.
2. Examples of reasonable grounds for omitting an answer
    a. Information is not readily available, and the answer is insignificant with respect to taxable income or loss or the tax liability.
    b. Genuine uncertainty exists as to the meaning of the question in relation to the particular return.
    c. The answer to the question is voluminous, and the return states that the data will be supplied upon examination.
3. A member should not omit an answer merely because it might prove disadvantageous to a taxpayer.
4. A member should consider whether the omission of an answer to a question may cause the return to be deemed incomplete or result in penalties.
5. A taxpayer is not required to explain on the return the omission of an answer when reasonable grounds exist for the omission. The member should consider whether the omission causes the return to be incomplete.

SSTS No. 3— Certain Procedural Aspects of Preparing Returns

1. A member may rely, without verification, on information provided by the taxpayer or third parties. Reasonable inquiries should be made if information appears to be incorrect, incomplete, or inconsistent on its face or on the basis of other facts known. Prior returns should be consulted if feasible.
2. Inquiries should be made to determine whether the taxpayer has met requirements to maintain books, records, or documentation to support deductions. Even though there is no requirement to examine underlying documentation, a member should encourage the taxpayer to provide supporting data where appropriate. For example, a member should encourage the taxpayer to submit underlying documents for use in tax return preparation to permit full consideration of income and deductions arising from security transactions and from pass-through entities, such as estates, trusts, partnerships, and S corporations.
3. A member who prepares a return should consider information known to that member from another taxpayer's return if the information is relevant, its consideration is necessary to properly prepare that tax return, and its use does not violate any law or rule of confidentiality.
4. A member should make use of a taxpayer's returns for one or more prior years in preparing the current return whenever feasible. Reference to prior returns and discussion of prior-year tax determinations with the taxpayer should provide information to determine the taxpayer's general tax status, avoid the omission or duplication of items, and afford a basis for the treatment of similar or related transactions. As with the examination of information supplied for the current year's return, the extent of comparison of the details of income and deduction between years depends on the particular circumstances

SSTS No. 4— Use of Estimates

1. A member may use the taxpayer's estimates if it is impracticable to obtain exact data, and the estimates are reasonable under the facts.
2. Estimates should be presented so as not to imply greater accuracy than exists.
3. The taxpayer is responsible for providing the estimated data.
4. Appraisals and valuations are not considered estimates.
5. Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual circumstances where nondisclosure might mislead the taxing authority regarding the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:
    a. A taxpayer has died or is ill at the time the return must be filed.
    b. A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
    c. There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
    d. Fire, computer failure, or natural disaster has destroyed the relevant records.

SSTS No. 5— Departure from a Position Previously Conducted in an Administrative Proceeding or Court Decision

The treatment of an item as determined in an administrative proceeding or a court decision does not restrict the recommendation of a different tax treatment in later years, unless the taxpayer is bound to a specified treatment in the later year.

Explanation: If an administrative proceeding or court decision has resulted in a determination concerning a specific tax treatment of an item in a prior year's return, a member will usually recommend this same tax treatment in subsequent years. However, departures from consistent treatment may be justified under such circumstances as the following:

a. Taxing authorities tend to act consistently in the disposition of an item that was the subject of a prior administrative proceeding but generally are not bound to do so. Similarly, a taxpayer is not bound to follow the tax treatment of an item as consented to in an earlier administrative proceeding.
b. The determination in the administrative proceeding or the court's decision may have been caused by a lack of documentation. Supporting data for the later year may be appropriate.
c. A taxpayer may have yielded in the administrative proceeding for settlement purposes or not appealed the court decision, even though the position met the standards in SSTS No. 1.
d. Court decisions, rulings, or other authorities that are more favorable to a taxpayer's current position may have developed since the prior administrative proceeding was concluded or the prior court decision was rendered.

SSTS No. 6— Knowledge of Error: Return Preparation and Administrative Proceedings

1. The member should inform the taxpayer upon becoming aware of an error in a previously filed return or that the taxpayer did not file a required form.
2. The member should recommend measures to take.
3. The member is not obligated to inform the taxing authority and may not do so without the taxpayer's permission, unless required by law.
4. If the member is requested to prepare a return when the taxpayer has not corrected a previous year's error, the member should consider whether to continue a professional relationship with the taxpayer or withdraw.
5. If the member prepares the current return, the member should take reasonable steps to ensure that the error is not repeated.
6. Errors include a position on a return that no longer meets these standards (SSTS No. 1) because of retroactive legislation, judicial decisions, or administrative pronouncements. An error does not include an item with an insignificant effect.

SSTS No. 7— Form and Content of Advice to Clients

1. When providing tax advice to a taxpayer, a member should use judgment to ensure that the advice reflects professional competence and appropriately meets the taxpayer's needs.
2. When advising or consulting on tax matters, the member should follow SSTS No. 1.
3. A member is not obligated to communicate with the taxpayer when subsequent developments affect previous advice. However, (s)he is obligated to do so when helping to implement the plans associated with the advice or when undertaking the obligation by specific agreement.

4. Tax advice can be in any form. However, important, unusual, or complicated transactions should be in writing.
5. In deciding on the form of advice provided to a taxpayer, a member should exercise professional judgment and should consider such factors as the following:
    a. The importance of the transaction and amounts involved
    b. The specific or general nature of the taxpayer's inquiry
    c. The time available for development and submission of the advice
    d. The technical complexity involved
    e. The existence of authorities and precedents
    f. The tax sophistication of the taxpayer
    g. The need to seek other professional advice
    h. The type of transaction and whether it is subject to heightened reporting or disclosure requirements
    i. The potential penalty consequences of the tax return position for which the advice is rendered
    j. Whether any potential applicable penalties can be avoided through disclosure
    k. Whether the member intends for the taxpayer to rely upon the advice to avoid potential penalties
6. In providing tax advice, a member should be cognizant of applicable confidentiality privileges.

Licensing and Disciplinary Systems within the Profession

AICPA's Professional Ethics Division and Joint Trial Board.
The Professional Ethics Division investigates ethics violations. It imposes sanctions in less serious cases. For example, it may require an AICPA member to take additional CPE courses as a remedial measure.

More serious infractions come before a joint trial board panel, which can acquit, admonish (censure), suspend, or expel a member. It may also take such other disciplinary, remedial, or corrective action as it deems to be appropriate. The CPA Letter publishes information about suspensions and expulsions.

1. A decision of a trial board panel may be appealed to the full trial board. The determination of this body is conclusive.
2. Upon the member's exhaustion of legal appeals, automatic expulsion without a hearing results when a member has been convicted of, or has received an adverse judgment for:
    a. Committing a felony
    b. Willfully failing to file a tax return
    c. Filing a fraudulent tax return on the member's or a client's behalf
    d. Aiding in preparing a fraudulent tax return for a client
3. Automatic expulsion also occurs when a member's CPA certificate is revoked by action of any governmental agency, e.g., a state board of accountancy.
4. Expulsion from the AICPA or a state society does not bar the individual from the practice of public accounting.
    a. A valid state-issued license is required to practice.

  b. Thus, violation of a state code of conduct promulgated by a board of accountancy is more serious than expulsion from the AICPA because it may result in revocation of the CPA certificate.

Joint Ethics Enforcement Program (JEEP)

1. The AICPA and most state societies have agreements that permit referral of an ethics complaint either to the AICPA or to a state society.
2. The AICPA handles matters of national concern, those involving two or more states, and those in litigation. JEEP also promotes formal cooperation between the ethics committees of the AICPA and of the state societies.

The SEC, IRS, and PCAOB may also discipline accountants.
The SEC may seek an injunction from a court to prohibit future violations of the securities laws. Moreover, under its Rule of Practice 2(e), the SEC may conduct administrative proceedings that are quasi-judicial. Such hearings are before administrative law judges with limited discovery, relaxed evidentiary rules, and appeal only within the SEC.

1. Such proceedings may result in suspension or permanent revocation of the right to practice before the SEC, including the right to sign any document filed by an SEC registrant. Sanctions are imposed if the accountant:
   a. Does not have the qualifications to represent others
   b. Lacks character or integrity
   c. Has engaged in unethical or unprofessional conduct
   d. Has willfully violated, or willfully aided and abetted the violation of, the federal securities laws or their rules and regulations
2. Suspension by the SEC may also result from:
   a. Conviction of a felony, or a misdemeanor involving moral turpitude
   b. Revocation or suspension of a license to practice
   c. Being permanently enjoined from violation of the federal securities acts
3. Some Rule 2(e) proceedings have prohibited not only individuals but also accounting firms from accepting SEC clients.
4. Under the Securities Law Enforcement Act of 1990, the SEC may impose civil penalties in administrative proceedings of up to $100,000 for a natural person and $500,000 for any other person. Furthermore, the SEC may order a violator to account for and surrender any profits from wrongdoing and may issue cease-and-desist orders for violations.

The IRS may prohibit an accountant from practicing before the IRS if the person is incompetent or disreputable or does not comply with tax rules and regulations. The IRS may also impose fines.
The PCAOB was established by the Sarbanes-Oxley Act of 2002.

1. A firm's registration application must contain information about a firm's quality control and a description of all actions pending against it. This information may have a great effect on enforcement actions and potential punishments. Moreover, the firm must give consent to cooperate with PCAOB investigations.
2. The PCAOB has rule-making authority regarding quality control, ethics and auditing standards. These rules, especially those governing quality control, will have great relevance to enforcement actions.

3. The PCAOB will inspect large firms annually and report violations to the SEC and state authorities. All attestation engagements, notably those in litigation, may be reviewed. The inspection also involves a quality control assessment. Furthermore, the inspection report must include the firm's response. The firm then has twelve months to correct the reported weaknesses.
4. The PCAOB has substantially the same investigatory scope with respect to accountants as the SEC. The PCAOB may request that the SEC issue subpoenas to third parties, and it may deregister any uncooperative firm.
5. The PCAOB has no injunctive power, but it may institute administrative proceedings. It may seek disassociation of a person from a registered firm, suspension (temporary or permanent) of the firm's registration, or a penalty of up to $15 million. The extreme cases in which the harshest penalties may be imposed include repeated instances of negligent misconduct. By contrast, the SEC may impose the severest punishments when the firm has engaged in just one instance of highly unreasonable conduct.
6. Sarbanes-Oxley requires each registered public accounting firm to report annually to the PCAOB. A firm also may be required to submit special (event-based) reports. The PCAOB has issued rules implementing these provisions.
   a. Annual reports must provide information about such matters as (1) audit reports issued during the year, (2) disciplinary history of new members of the firm, and (3) fees billed.
   b. Special reports must be filed within 30 days after reportable events, including the initiation of certain legal, administrative, or disciplinary actions against the firm or certain classes of individuals.

State **Boards of Accountancy and State CPA Societies**
State boards are governmental agencies that license CPAs to use the designation "Certified Public Accountant" and prohibit non-CPAs from performing the attest function. They can suspend or revoke licensure through administrative process, for example, in trial board hearings. Requirements for licensure differ. In addition to passing the CPA examination, a candidate may need to satisfy educational, experience, and residency criteria that vary from state to state.
State CPA societies are voluntary, private organizations that can admonish, suspend, or expel members.
Note: A CPA may not claim to be endorsed by the Institute. A member may, however, state that (s)he is a member.

IMA's Standards of Ethical Conduct for Accountants and Financial Professionals
Accountants and financial professionals have an obligation to the public, their profession, the organizations they serve, and themselves, to maintain the highest standards of ethical conduct. In recognition of this obligation, the *Institute of Management Accountants (IMA)* has promulgated the following standards of ethical conduct for accountants and financial professionals. Accountants and financial professionals shall not commit acts contrary to these standards nor shall they condone the commission of such acts by others within their organizations.

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

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

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

I. Competency
Each member has a responsibility to:

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

II. Confidentiality
Each member has a responsibility to:

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

III. Integrity
Each member has a responsibility to:

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

IV. Credibility
Each member has a responsibility to:

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

Resolution of Ethical Conflict

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

1. Discuss the issue with your immediate supervisor except when it appears that the supervisor is involved. In that case, present the issue to the next level. If you cannot achieve a satisfactory resolution, submit the issue to the next management level. If your immediate superior is the chief executive officer or equivalent, the acceptable reviewing

authority may be a group such as the audit committee, executive committee, board of directors, board of trustees, or owners. Contact with levels above the immediate superior should be initiated only with your superior's knowledge, assuming he or she is not involved. Communication of such problems to authorities or individuals not employed or engaged by the organization is not considered appropriate, unless you believe there is a clear violation of the law.

2. Clarify relevant ethical issues by initiating a confidential discussion with an IMA Ethics Counselor or other impartial advisor to obtain a better understanding of possible courses of action.
3. Consult your own attorney as to legal obligations and rights concerning the ethical conflict.

(*Source:* IMA Statement of Ethical Professional Practice,)

Q: Rose is a financial manager who has discovered that her company is violating environmental regulations. If her immediate superior is involved, what is her appropriate action?

A: According to the IMA Code of Ethics, the accountant/finance professional should "discuss such problems with the immediate superior except when it appears that the superior is involved, in which case the problem should be presented initially to the next higher managerial level. If satisfactory resolution cannot be achieved when the problem is initially presented, submit the issues to the next higher managerial level. If the immediate superior is the chief executive officer, or equivalent, the acceptable reviewing authority may be a group such as the audit committee, executive committee, board of directors, board of trustees, or owners."

Chapter 3 Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

1. The Sarbanes-Oxley Act has strengthened auditor independence by requiring that management ___________

   A. Engage auditors to report in accordance with the Foreign Corrupt Practices Act.
   B. Report the nature of disagreements with former auditors.
   C. Select auditors through audit committees.
   D. Hire a different CPA firm from the one that performs the audit to perform the company's tax work.

2. The Sarbanes-Oxley Act limits the nonaudit services that an audit firm can provide to public company audit clients. Which of the following services is still an allowable service that an auditor may provide to a public client?

   A. Internal audit outsourcing.
   B. Tax compliance services.
   C. Legal services.
   D. Management consulting services.

3. In accordance with the AICPA's *Statements on Standards for Tax Services*, when a reasonable basis exists for omission of an answer to an applicable question on a tax return, ___________

   A. The preparer need not provide an explanation for the omission on the return.
   B. A brief explanation of the reason for the omission must be provided on the return.
   C. The question should be marked as nonapplicable.
   D. A note on the return should state that the answer will be provided if the information is requested.

4. In which situation is an accountant/ financial professional permitted to communicate confidential information to individuals or authorities outside the firm?

   A. There is an ethical conflict and the board has refused to take action.
   B. Such communication is legally prescribed.
   C. The accountant/financial professional knowingly communicates the information indirectly through a subordinate.
   D. An officer at the accountant/financial professional's bank has requested information on a transaction that could influence the firm's stock price.

5. Julie is a financial manager who has discovered that her company is violating regulations. If her immediate superior is involved, what is the appropriate action?

A. Do nothing since she has a duty of loyalty to the organization.
B. Consult the audit committee.
C. Present the matter to the next higher managerial level.
D. Confront her immediate superior.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

Chapter 1 Review Answers

1. All of the following are a major focus of ethics EXCEPT:

A. Incorrect. A key focus of ethics is the concept of integrity (or honesty). Integrity in broad terms will imply that no business professional in the course of their business functions should be party to the falsification of any facts or information or make any statement which knowingly is misleading, false or deceptive.

B. Correct. An ethical person can be very ambitious but should consider what promotes the greatest good to the greatest number of people, even if it results in some personal sacrifice.

C. Incorrect. Professional competence and due care imply that business professionals should always perform their functions in accordance with law and regulations. In other words, business transactions and professional functions should not be undertaken unless one possesses the required competence and technical skills.

D. Incorrect. The business professional should objectively look at any activities which create a conflict of interest, and then work to avoid or eliminate them.

Chapter 2 Review Answers - Section 1

1. Which of the following statements best explains why the CPA profession has found it essential to promulgate ethical standards and to establish means for ensuring their observance?

A. Correct. According to the Principles section of the Code of Professional Conduct, *The Public Interest*, "Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism." According to the accompanying explanation, "A distinguishing mark of a profession is acceptance of its responsibility to the public."

B. Incorrect. The responsibility of CPAs is to a public that is not limited to clients and colleagues but includes all those who rely on their objectivity and integrity.

C. Incorrect. Excellence in performance is but one of the effects of accepting responsibility to the public.

D. Incorrect. Vigorous enforcement is significant but secondary to the creation of an environment in the profession that fosters voluntary adherence to ethical principles.

2. The AICPA Code of Professional Conduct states, in part, that a CPA should maintain integrity and objectivity. Objectivity in the Code refers to a CPA's ability __________

A. **Correct. According to the Principles, *Objectivity*, "Objectivity is a state of mind, a quality that lends itself to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest."**
B. Incorrect. The CPA uses both judgment and GAAP to evaluate whether a client's accounting practices are acceptable.
C. Incorrect. The CPA is expected to use professional judgment, which may include flexibility, in applying audit procedures.
D. Incorrect. Auditing standards are concerned with the quality of the auditor's performance, whereas adherence to accounting principles by management is a prerequisite for fairly stated financial statements.

3. Which of the following reports may be issued only by an accountant who is independent of a client?

A. **Correct. Conduct Rule 1.200, *Independence,* states, “A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.” Such standards include Statements on Standards for Attestation Engagements, which apply to, among other things, reviews and audits of financial statements (forecasts and projections).**
B. Incorrect. Although most consulting services are prohibited by the Sarbanes-Oxley (SOX) Act of 2002 for auditors of public companies, tax services are allowed by auditors but only after approval from the audit committee and with proper safeguards.
C. Incorrect. Independence is not required reviewing IT systems, but designing or operating the system would impair independence.
D. Incorrect. Compilation reports on financial statement do not require independence. A CPA who is not independent may not express an audit opinion or issue a review report, but (s)he may issue a compilation report after disclosing the lack of independence.

Chapter 2 Review Answers - Section 2

4. According to Rule 1.600, *Advertising and Other Forms of Solicitation,* advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest, and AICPA members in public practice shall not seek to obtain clients in such a manner. Such activities include all the following EXCEPT:

A. **Correct. Advertising and solicitation are acceptable as long as they do not involve falsehood or deception.**
B. Incorrect. Advertisements suggesting any influence over courts, tribunals, regulatory agencies, or a similar body or official are deceptive and prohibited.

C. Incorrect. A correct amount of tax liability exists and any claim to save a taxpayer part of that amount are prohibited under Rule 1.600 because they are misleading and against public interests.
D. Incorrect. It is misleading to create false and unjustified expectations of favorable results.

5. AICPA Conduct Rule 1.700 is violated when a member in public practice:

A. Correct. AICPA Conduct Rule 1.700, *Confidential Client Information* , states that, prior to disclosing confidential client profit and loss percentages to a trade association, the CPA must have specific client consent.
B. Incorrect. According to the Ethics Rules, using outside computer services to process tax returns is permissible as long as client confidentiality is maintained.
C. Incorrect. Most CPAs perform consulting services for clients in the same or related industries, and as long as the member doesn't share confidential information, it is permissible to have clients in similar business activities.
D. Incorrect. According to AICPA Conduct Rule 1.700, *Confidential Client Information*, CPAs must make full disclosure about any reservations concerning the usefulness of potential consulting services, especially those based on past experience with similar engagements. However, the use of any specific client information must remain confidential or be waived by the client.

6. A CPA's retention of client records as a means of enforcing payment of an overdue audit fee is an action that is ____________

A. Incorrect. This is addressed in the code. CPAs should return the papers regardless of whether they receive payment. Conduct Rule 1.400, *Acts Discreditable,* prohibits retention of client records as a means of enforcing payment of an overdue audit fee.
B. Incorrect. The profession may require CPAs to adhere to standards beyond the legal minimum.
C. Correct. An Interpretation of Conduct Rule 1.400, *Acts Discreditable*, defines client records as "any accounting or other records belonging to the client that were provided to the member by or on behalf of the client." This Interpretation prohibits the retention (after a demand is made for them) of client records to enforce payment or for any other purpose. Such an act is deemed to be discreditable to the profession.
D. Incorrect. This is not a violation of GAAS, generally accepted auditing standards; it is a violation of the Code of Professional Standards.

Chapter 3 Review Answers

1. The Sarbanes-Oxley Act has strengthened auditor independence by requiring that management ___________

A. Incorrect. The SEC does not require an audit report in accordance with the FCPA, but the Act does increase penalties for corporate wrongdoing and ensure that corporate officials personally vouch for the truth and fairness of their company's disclosures.
B. Incorrect. Reporting the nature of disagreements with former auditors has been a long-time SEC requirement. Furthermore, the SEC should be notified of auditor changes, whether by company dismissal or auditor resignations.
C. Correct. The Sarbanes-Oxley Act requires that the audit committee of a public company hire and pay the external auditors. Such affiliation inhibits management from changing auditors to gain acceptance of a questionable accounting method. Also, a potential successor auditor must inquire of the predecessor auditor before accepting an engagement.
D. Incorrect. The Sarbanes-Oxley Act does not restrict who may perform a company's tax work. Other types of engagements, such as the outsourcing of the internal audit function and certain consulting services, are limited.

2. The Sarbanes-Oxley Act limits the nonaudit services that an audit firm can provide to public company audit clients. Which of the following services is still an allowable service that an auditor may provide to a public client?

A. Incorrect. The Sarbanes-Oxley Act prohibits companies from outsourcing internal audit work to their external audit providers, even if pre-approved by the issuer's audit committee, because it negatively impacts independence.
B. Correct. Audit firms may provide conventional tax planning and compliance services to public audit clients.
C. Incorrect. The Sarbanes-Oxley Act prohibits audit firms from providing legal and internal auditing services to public audit clients.
D. Incorrect. Title II of the Sarbanes-Oxley Act of 2002 prohibits most "consulting" services outside the scope of practice of auditors.

3. In accordance with the AICPA's *Statements on Standards for Tax Services*, when a reasonable basis exists for omission of an answer to an applicable question on a tax return, ___________

- **A. Correct. According to SSTS No.2, the member should sign the preparer's declaration when a question has not been answered only if (s)he has made "a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return." Given reasonable grounds for the omission, the member is not required to provide an explanation on the return, although (s)he must consider whether the omission may cause the return to be incomplete.**
- B. Incorrect. Given reasonable grounds for omissions, the member is not required to provide an explanation. However, the member should not omit an answer merely because it might be disadvantageous to a taxpayer.
- C. Incorrect. Omissions may be reasonable on grounds other than inapplicability, and no such marking is required.
- D. Incorrect. No such note is required. The taxpayer is not required to explain the omission of an answer when reasonable grounds exist. However, the member should consider whether the omission causes the return to be incomplete.

4. In which situation is an accountant/ financial professional permitted to communicate confidential information to individuals or authorities outside the firm?

- A. Incorrect. There is an ethical conflict if a board takes a problem to authorities or individuals not employed or engaged by the organization and prior to adhering to the established due process practices established by the company's policy.
- **B. Correct. According to the IMA Code of Ethics, accountants/financial professionals are responsible for observing the standard of confidentiality. Thus, the accountant/financial professional should "refrain from disclosing confidential information acquired in the course of his/her work except when authorized, unless legally obligated to do so."**
- C. Incorrect. The accountant/financial professional should "inform subordinates as to what is appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality."
- D. Incorrect. The accountant/financial professional is required to "refrain from using or appearing to use confidential information acquired in the course of his/her work for unethical or illegal advantage either personally or through third parties."

5. Julie is a financial manager who has discovered that her company is violating regulations. If her immediate superior is involved, what is the appropriate action?

A. Incorrect. “Practitioners of management accounting and financial management have an obligation to the public, their profession, the organization they serve, and themselves, to maintain the highest standards of ethical conduct."

B. Incorrect. The audit committee would be consulted first only if it were the next higher managerial level.

C. Correct. To resolve an ethical problem, the financial manager/management accountant's first step is usually to consult his/her immediate superior. If that individual is involved, the matter should be taken to the next higher level of management.

D. Incorrect. If the superior is involved, the next higher managerial level should be consulted first in order to avoid an ethical conflict of interest.

Appendix A: Other AICPA Rules

1.277 Former Employment or Association with Attest Client
A former partner or professional employee of the firm who is employed by or associated with an attest client in a key position impairs the firm's independence unless:

a. The covered member ceases to participate in all employee health and welfare plans sponsored by the attest client, unless the attest client is legally required to the member to participate in plan (for example, COBRA), and the member pays 100 percent of the member's portion of the of the cost of participation on a current basis.
b. The covered member ceases to participate in all other employee benefit plans by liquidating or transferring, at the earliest date permitted under the plan, all vested benefits in the attest client's defined benefit plans, defined contribution plans, share-based compensation arrangements, deferred compensation plans, and other similar arrangements.

   However, when a covered member's participation in one of these plans results from former employment or association with an attest client, threats would be at an acceptable level and independence would not be impaired provided the liquidation or transfer of any vested benefits is either not permitted under the terms of the plan or would result in a penalty significant to the benefits being imposed upon such liquidation or transfer and the covered member:

   i. does not participate on the attest engagement team or
   ii. is not an individual in a position to influence the attest engagement.

   A penalty includes an early withdrawal penalty levied under the applicable tax law but excludes other income taxes that would be owed, or market losses that may be incurred, as a result of such liquidation or transfer.
c. The covered member disposes of any direct financial interest or material indirect financial interests in the attest client.
d. The covered member collects or repays any loans to or from the attest client, except for loans specifically permitted or grandfathered by the interpretations of the "Loans, Leases, and Guarantees" subtopic [1.260] under the "Independence Rule."
e. Covered members should evaluate whether other relationships with the attest client create threats that require the member to apply safeguards to reduce those threats to an acceptable level.

1.295.143 Hosting Services
Under a new ethics interpretation, which takes effect in 2019, hosting services can impair independence when a CPA takes responsibility for maintaining internal control over an attest client's data or records, whether financial or nonfinancial in nature.
For example, the member assumes responsibility for safeguarding the information by agreeing to:

- Be the sole host of a client's financial or nonfinancial information system;

- Be the custodian for the client's data such that the client's data are incomplete and accessible only through the CPA; or
- Provide business continuity or disaster recovery services to the client.

Examples of activities that are considered hosting services, and as such will impair independence if performed for an attest client, include accepting responsibility for the following:

d. Housing the attest client's website or other non-financial information system
e. Keeping the attest client's data or records on the attest client's behalf, for example, the attest client's general ledger information, supporting schedules (such as, depreciation or amortization schedules), lease agreements or other legal documents are stored on the member's firm's servers or servers licensed by the member's firm or the member is responsible for storing hard copy versions of the data or records
f. Being the attest client's business continuity or disaster recovery provider

Examples of activities that are not considered to be hosting services, and as such will not impair independence provided members comply with the requirements of the other interpretations of the "Nonattest Services" subtopic include these:

a. Retaining a copy of an attest client's data or records as documentation to support a service the member provided to the attest client. Some examples are as follows:
    - The payroll data that support a payroll tax return prepared by the member for the attest client
    - A bank reconciliation that supports attest procedures performed by the member on the attest client's cash account
    - The attest client's vendor data used to prepare an analysis of vendor activity
b. Retaining, for a member's records, a copy of a work product prepared by the member (for example, a tax return).
c. Using general ledger software to facilitate the delivery of bookkeeping services when either of the following occurs:
    - The member and the attest client maintain separate instances of the software on their respective servers, and the member provides updated financial information electronically to the attest client.
    - The attest client enters into an agreement with a third-party service provider to maintain its software in a cloud-based solution and grants the member access to the software so that the member can perform the bookkeeping service for the attest client.
d. Retaining data collected by the member related to a work product that the member prepared for an attest client. For example, the member conducts an employee survey and provides the attest client with a report. The member retains the survey data collected to support the work product.

e. Electronically exchanging data, records, or the member's work product with an attest client or on behalf of an attest client at the attest client's request. For example, the member uses a portal as follows:
    - To exchange data and records with the attest client related to professional services provided by the member to the attest client
    - To deliver the member's work product to third parties at the attest client's request

   To avoid providing hosting services, members should terminate the attest client's access to the data or records in the portal within a reasonable period of time after the conclusion of the engagement.
f. Licensing software to an attest client that the attest client uses to input its data and receive an output that the attest client is responsible for maintaining, provided the software does not perform an activity that, if performed directly by the member, would impair independence.
g. Having possession of a depreciation schedule prepared by the member, provided the depreciation schedule and calculation are given to the attest client so that attest client's books and records are complete.
h. Retaining an attest client's original data or records to facilitate the performance of a nonattest service (for example, obtaining original records to prepare the attest client's tax return), provided that the data or records are returned to the attest client at the end of the engagement or, in a multi-year engagement, at least annually. This does not apply to ongoing hosting services as described in paragraph .01 of this interpretation.

1.800 - Form of Organization and Name Rule

A CPA may practice public accounting only in a form of organization allowed by law or regulation that conforms with resolutions of the AICPA Council.

- The firm name must not be misleading.
- Names of past owners may be included in the name of the successor organization.
- A firm cannot designate itself as "members of the AICPA" unless all CPA owners are members.

According to the relevant AICPA Council Resolution, a member may practice public accounting only in a firm or organization with certain characteristics.

1. If such an entity performs any audit under the SASs, a review under the SSARSs, or an examination of prospective information under the SSAEs or holds itself out as a firm of CPAs, an entity must have the following attributes:
    - CPAs must own a majority of the firm in terms of financial interests and voting rights.
    - A non-CPA owner, including an investor or commercial enterprise, must be actively engaged in providing services to clients as his/her/its principal occupation.
    - A CPA must have ultimate responsibility for all services provided.

- Non-CPA owners cannot hold themselves out to be CPAs, must abide by the Code, must complete the work-related CPE requirements, and are ineligible for AICPA membership.
- Owners must own their equity in their own right.
- Ownership must be transferred to the firm or to other qualified owners within a reasonable time if the owner ceases to be actively engaged in the firm.

2. The characteristics of all other entities are considered to be whatever is legally permissible except as indicated in 3) below.
3. If a firm or organization not meeting the requirements above performs compilations under SSARSs, a CPA must have ultimate responsibility for any such services and for each business unit performing such services. Moreover, any compilation report must be signed individually by a CPA.

Ownership of a Separate Business: A CPA in the practice of public accounting may own an interest in a separate business that performs the services for which standards are established. If the CPA, individually or with his/her firm or CPAs of the firm, controls the separate business (as defined by U.S. GAAP), the entity and all its owners and employees must comply with the Code. Absent such control, the CPA, but not the separate business, its other owners, and its employees, would be subject to the Code.

Alternative Practice Structures: The overriding focus of the Council Resolution, the Code, and other AICPA requirements is that CPAs remain responsible, financially and otherwise, for the attest work performed to protect the public interest. However, in the context of alternative practice structures (APSs), CPAs may own the majority of financial interests in the attest firm, but substantially all revenues may be paid to another entity in return for services and the lease of employees, equipment, etc. Nevertheless, given the previously mentioned safeguards, if the CPA-owners of the attest firm remain financially responsible under state law, they are deemed to be in compliance with the financial-interests requirement of the Resolution.
Other Interpretations:

1. Although CPAs may share an office, have the same employees, etc., they should not use a letterhead with both their names unless a partnership exists.
2. A CPA and a non-CPA who dissolve their partnership should sign an audit report, after dissolution, in a way not implying a partnership.
3. A CPA may have his/her own CPA practice and be a partner of a public accounting firm all other members of which are noncertified.

4. A partnership may continue to practice using the managing partner's name as the firm name after (s)he withdraws. "And Company" should be added to the partnership name.

5. If a CPA forms a partnership with a non-CPA, the CPA is responsible for the non-CPA's violation of the Code.
6. A firm may use an established firm name in different states even though the roster of partners differs.

7. When two partnerships merge, they may retain a title that includes a retired or former partner's name.
8. A CPA employed by a firm with one or more non-CPA practitioners must obey the Rules of Conduct. If the CPA becomes a partner, (s)he is responsible for compliance with the Rules of Conduct by all associated practitioners.
9. CPA firms that are associated for joint advertising and other purposes should practice under their own names and indicate the association in other ways. Each firm should use its own letterhead indicating the others as correspondents. The firm may wish to avoid such perception by clearly describing the nature of its membership in the association (for example, by stating on its stationery or promotional material that it is "an independently owned and operated member firm of XYZ Association".)
10. A CPA in partnership with non-CPAs may sign the firm name to a report and below it affix his/her name with the CPA designation. However, it must be clear that the partnership does not consist entirely of CPAs.
11. The designation "Personal Financial Specialists" may only be used on a letterhead when all partners or shareholders have the AICPA-awarded designation. However, the individual members holding the designation may use it after their names.
12. In addition, the CPA should consider the rules and regulations of his or her state board(s) of accountancy concerning misleading firm names that may be more restrictive than the requirements in this interpretation.

Appendix B: AICPA Ethics FAQ

Introduction
The answers to these frequently asked questions (FAQs) are based on guidance the AICPA Professional Ethics Division staff provided in response to members' inquiries. The FAQs are not rules, regulations, or statements of the Professional Ethics Executive Committee and, therefore, are not authoritative guidance. The Conceptual Framework for Members in Public Practice (ET sec. 1.000.010) and The Conceptual Framework for Members in Business (ET sec. 2.000.010) should be used in conjunction with these FAQs. Further, the answers do not address the requirements of other regulatory bodies, such as the state boards of accountancy, the Securities and Exchange Commission (SEC), and the U.S. Government Accountability Office whose positions may differ from those of the AICPA.

Blind Trusts
Question. A covered member creates a blind trust and transfers assets into the blind trust. The covered member will not supervise or participate in the trust's investment decisions during the term of the trust. Will the trust and the underlying assets be considered the covered member's direct financial interests?
Answer. Although the covered member will not supervise or participate in the trust's investments decisions during the term of the trust, the trust and the underlying investments will be considered the covered member's direct financial interest if: (1) the covered member retains the right to amend or revoke the trust, or (2) the underlying trust investments will ultimately revert to the covered member as the grantor of the trust. See the "Trusts Investments" interpretation (ET sec. 1.245.020) under the "Independence Rule" (ET sec. 1.200.001) for other rights and responsibilities that would cause a trust and the underlying investments to be considered direct financial interests of a covered member.

Campaign Contributions
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.

Disclosure of Commissions
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.

Independent Contractors
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:
    i. The percentage of income the individual derives from the member's firm in relation to the individual's total "self-employed" or earned income.
    ii. The percentage of income the individual derives from the client entity in relation to the individual's total earned income.
    iii. The amount of time the individual devotes to the member's firm versus time devoted to the attest client.
    iv. 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.

Letter Of Intent to Purchase Practice
Question. Would independence be impaired under the "Independence Rule" if a member enters into a non-binding letter of intent to sell his or her practice to a purchaser that is not independent with respect to one or more of the member's attest clients?
Answer. No. A non-binding letter of intent to sell the member's practice would not impair the independence of the member if the purchaser is not independent with respect to one or more of the member's attest clients.

Pro Bono/Below Cost Fees
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."

Compliance with SSCS's When Member Does Not Hold out as CPA

Question. The "Compliance with Standards Rule" requires that a member who performs professional services, including consulting services, comply with standards promulgated by bodies designated by Council, regardless of whether the member is holding out as a CPA. The standards applicable to members performing consulting services are set forth in the Statements on Standards for Consulting Services (SSCSs) and specifically state that such standards apply to members holding out as a CPA while providing consulting services. Would a member who does not hold out as a CPA be in compliance with "Compliance with Standards Rule" if the member did not comply with the SSCSs while performing consulting services for a client?

Answer. Yes. Because the SSCSs apply to those members holding out as CPAs, a member who does not hold out as a CPA would not be in violation of "Compliance with Standards Rule" if the member performed consulting services that did not comply with the SSCSs. The member must still comply with all other rules of the code, including the "General Standards Rule" which requires that the member comply with the following standards:

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.

Use of Standards That Have Not Been Established by a Body Designated by AICPA Council

Question: May a member perform a professional service using standards that have not been established by a body designated by AICPA Council, as set forth in appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards" (Council resolution) (ET appendix A) of the AICPA Code of Professional Conduct (hereinafter referred to as "alternative standards")?

Answer: Yes, there are circumstances in which a member is permitted to perform a professional service using alternative standards. However, the member must consider whether the professional service can be covered by technical standards established by a body designated by AICPA Council (hereinafter referred to as "established standards"). Examples of such standards are the Statements on Auditing Standards (SASs), Statements on Standards for Attestation

Engagements (SSAEs), Statements on Standards for Accounting and Review Services (SSARSs) and Statement on Standards for Consulting Services (SSCS). The "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) states the following:

A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council. The Council resolution sets forth those bodies designated by Council to promulgate technical standards and includes AICPA standard-setting bodies, such as the Accounting and Review Services Committee (ARSC), Auditing Standards Board (ASB), and Management Consulting Services Executive Committee. (See all bodies designated by Council at appendix A).

When a member is engaged to perform a professional service that can be covered by established standards, the member must perform the service using such established standards. The member is permitted to also apply any relevant alternative standards.

When a member is engaged to perform a professional service that, based on his or her professional judgment, cannot be covered by established standards, the member will not be considered to be in violation of the "Compliance With Standards Rule" if only the alternative standards are applied.

Irrespective of the professional service performed by the member and whether he or she applies established or alternative standards, or both, the member must always comply with the "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) when performing any professional service. This rule requires that a member comply with the following standards:

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.

Members should also be aware that laws or regulations, including state boards of accountancy rules and regulations, may require the professional service to be performed under established standards.

Form of Communication

Question. The "Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice" interpretation [1.400.205] requires certain communications to the client be in writing. Would electronic communications such as email be an acceptable form of communication?

Answer. Yes, provided electronic communication is considered an acceptable form of written notice to the client under the applicable state law.

Transfer of Client Files to Another Partner in The Firm

Question. When a partner leaves a firm and his or her clients are transferred to another partner in the firm, do the requirements of the "Transfer of Files and Return of Client Records in Sales, Transfer, Discontinuance or Acquisition of Practice" interpretation need to be applied?
Answer. No. In such situations the ownership of the firm has not been transferred outside of the firm, rather the clients have only been reassigned to a different partner in the firm.

Electronic Records
Question 1: Are the electronic data files created when a member prepares a tax return for a client using the member's own tax preparation software considered to be a member's working paper or a member-prepared record as defined in the "Records Requests" interpretation (ET sec. 1.400.200), and must it be provided to the client upon request?"
Answer 1: The electronic tax data file would generally be considered a member's working paper that has been created in the performance of the tax return preparation engagement but not a file that the member was specifically engaged to prepare (that is, the tax return is the work product the member has been engaged to prepare). The information contained in the tax data file is typically obtained from the client's books and records as well as the client's representations. Such information should therefore be available to the client through means other than the tax data file and the client's tax return records would not be rendered incomplete without the tax data file. Accordingly, the tax data file would not meet the description of a member-prepared record. Working papers are considered to be the member's property under the interpretation and therefore, a member would not be required to provide the electronic data file to the client. However, state and federal statutes and regulations and contractual agreements may impose additional requirements on the member. The member must observe the highest standard of professional conduct which exists in the matter.

Question 2: Are account grouping schedules, depreciation schedules and carryover schedules prepared by a member to support a client's business tax return considered to be a member's working paper or a member-prepared record as defined in the "Records Requests" interpretation and must they be provided to the client upon request?
Answer 2: Grouping schedules, depreciation schedules and carryover schedules, are considered member-prepared records. However, since the client's records would be incomplete without this information the member would need to provide them to the client unless fees remain unpaid for the tax engagement.

Question 3: Are the adjusting entries proposed by a member to reconcile a client's book and tax records considered to be a member's working paper or a member-prepared records as defined in the "Records Requests" interpretation and must they be provided to the client upon request?
Answer 3: These adjusting entries are considered member-prepared records. Since the client's records would be incomplete without this information the member would need to provide them to the client unless fees remain unpaid for the tax engagement.

Glossary

This is a glossary of key terms with definitions. Please review any terms you are not familiar with.

Acceptable level
A level where a reasonable and informed third party would likely conclude, weighing all specific facts and circumstances, that compliance with the rules is not compromised.

Attest engagement
An engagement in which a practitioner will issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion of another party. This engagement requires independence.

Attest engagement team
Participants in the engagement, including partners who perform concurring or second reviews and all employees and contractors retained by the firm, but excluding specialists.

Audit committee
Selected members of a client's board of directors whose responsibilities include helping auditors to remain independent of management.

Client
Any person or entity, other than the member's employee, that engages a member or a member's firm to perform professional services.

Close relatives
Parents, siblings, or nondependent children.

Confidential client information
Client information that may not be disclosed without the specific consent of the client except under authoritative professional or legal investigation

Corporate governance
The system of checks and balances designed to ensure that corporate managers are just as vigilant on behalf of long-term shareholder value as they would be if it was their own money at risk. It is also the process whereby shareholders—the actual owners of any publicly traded firm—assert their ownership rights, through an elected board of directors and the CEO and other officers and managers they appoint and oversee.

Covered member
Covered members are defined as:

a. an individual on the attest engagement team.
b. an individual in a position to influence the attest engagement.
c. a partner, partner equivalent, or manager who provides more than 10 hours of nonattest services to the attest client within any fiscal year. Designation as

covered member ends on the later of (i) the date that the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) the date he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis.

d. a partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest engagement.
e. the firm, including the firm's employee benefit plans.
f. an entity whose operating, financial, or accounting policies can be controlled by any of the individuals or entities described in items a–e or two or more such individuals or entities if they act together.

Deontology (Kantian ethics)
The concept of duty and the rightness of acts. It emphasizes maxims, duties, rules, and principles that are so important that they should be followed whatever the consequences.

Direct financial interest
The ownership of stock or other equity shares by members or their immediate family.

Ethical dilemma
A situation in which a decision must be made about the appropriate behavior.

Ethics
Standards of professional conduct and business practices adhered to by professionals in order to enhance their profession and maximize idealism, justice and fairness when dealing with the public, clients and other members of their profession.

Financial institution
An entity that normally makes loans to the public.

Firm
A form of organization permitted by law or regulation that is consistent with the resolutions of the AICPA's Council and practices public accounting. The term "firm" includes the individual partners thereof except for the purposes of Rule 1.200, *Independence.*

Immediate family
A covered member's spouse, equivalent of a spouse, or dependents.

Independence of mind
The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

Independence in appearance
The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, to reasonably conclude that

the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.

Independence in fact
The auditor's ability to take an unbiased viewpoint in the performance of professional services.

Independence Standards Board (ISB)
An autonomous private-sector body established under an agreement between the SEC and the AICPA to provide a conceptual framework for independence issues related to audits of public companies. The ISB dissolved around 2001 (ISB existed 1997-2001).

Indirect financial interest
A close, but not direct, ownership relationship between the auditor and the client; an example is the ownership of stock by a member's grandparent.

Individual in a position to influence the attest engagement
One who (1) evaluates the attest engagement partner or recommends his/her compensation; (2) directly supervises or manages that partner, including all levels above such supervisor or manager; (3) consults with the engagement team about technical or industry-related issues; or (4) participates in or oversees quality control for the engagement, including all senior levels.

Institute
The American Institute of Certified Public Accountants (AICPA).

Internal Control Report
A report on the company's internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act. For example, the report must include a statement of management's responsibility for internal control.

Interpretations
The means used to explain the application of the spirit of a Principle or Rule to specific situations in which the Principle or Rule may not be sufficiently clear or explicit.

Joint closely held investment
An investment in any entity or property by the member and (1) the client, (2) the client's officers or directors, or (3) an owner who can exercise significant influence if the investment permits such parties to control the entity or property.

Key position
One in which an individual is primarily responsible for significant accounting functions supporting material financial statement components or for the preparation of the statements. A key position is also one able to influence financial statement content, for example, director, CEO, CFO, general counsel, chief accountant, director of internal audit, or treasurer.

Laws
Bodies of rules governing members of a community, state, organization, professional, etc ... and enforced by authority or compelling legislation.

Member
A member, associate member, or international associate of the AICPA.

Moral
An accepted rule or standard of human behavior.

Normal lending procedures, terms, and requirements
Those reasonably comparable with those for similar loans to others from the financial institution in the period when a commitment was made for a loan to a covered member.

Objectivity
A state of mind, a quality that lends itself to a member's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

Period of the professional engagement
The period that starts at the earlier of when the member signs an initial engagement letter to perform attest services or begins to perform. It continues for the entire professional relationship; it does not end with the issuance of a report and start again with the next year's engagement. This period ends with the later of notification by the member or client or by issuance of a report.

Principles
Broad guidelines for behavior and are not intended to be specific. Principles cover the concepts of responsibilities to the public, integrity, objectivity and independence, professional due care, as well as to whom the principles apply.

Privileged information
Client information that the professional cannot be legally required to provide; information that an accountant obtains from a client is confidential but not privileged.

Public company accounting oversight board (PCAOB)
(www.pcaobus.com) established in 2002 as a result of the Sarbanes-Oxley Act, a private sector, non-profit corporation set up to oversee the audits of public companies and ensure that accountancy firms should no longer derive non-audit revenue streams, such as consultancy, from their audit clients.

Rules
Enforceable guidelines that govern all services performed by the CPA in the practice of public accounting.

Safeguards
Actions or other measures to eliminate threats or reduce them to acceptable levels.

Sarbanes-Oxley Act (SOX)
Wide-ranging U.S. corporate reform legislation, coauthored by the Democrat in charge of the Senate Banking Committee, Paul Sarbanes, and Republican Congressman Michael Oxley. The Act, which became law in July 2002, lays down stringent procedures regarding the accuracy and reliability of corporate disclosures, places restrictions on auditors providing non-audit services and obliges top executives to verify their accounts personally. Section 409 is especially tough and requires that companies must disclose information on material changes in the financial condition or operations of the issuer on a rapid and current basis.
Special purpose entities (SPEs)
A type of corporate entity or limited partnership created for a specific transaction or business, especially one unrelated to a company's main business. Their losses and risks generally aren't recorded on a company's balance sheet.

Threat
The risk that relationships or circumstances could compromise a member's compliance with the rules.

Utilitarianism (teleological ethics)
The promotion that the best long-term interest of everyone concerned should be the moral standard. One should take those actions that lead to the greatest balance of good versus bad consequences.

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Qualified Assessment

Ethics for California
Course # 4130574, Version 1912
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Course Expiration Date

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1. What is the main reason for ethical guidelines?

   A. To provide an exact solution to every problem
   B. To set the statutes, rules, and regulations
   C. To aid in the decision-making process
   D. To help attain financial success in the profession

2. Which of the following is NOT one of the AICPA's 6 principles for ethical conduct?

   A. Freedom
   B. Due Care
   C. Public Interest
   D. Responsibility

3. In applying the 6 principles of the AICPA code of professional conduct, which one is especially critical for CPAs when they are providing attest services?

   A. Independence
   B. Scope
   C. Due care
   D. Integrity

4. *Responsibility* is a critical principal in the accounting profession. Which of the following statements best explains the term?

   A. Acting to benefit the public interest, honor the public trust and demonstrate commitment to professionalism
   B. A reputation for competence and character
   C. Exercising sensitive professionalism and moral judgments in all their activities
   D. A requirement for a professional to strive for improved competence and quality service

5. Which of the following most completely describes how *independence* has been defined by the accounting profession?

A. Performing an audit without anyone else's assistance.
B. Avoiding the appearance of significant interests in the affairs of an audit client.
C. Possessing the ability to act with integrity, objectivity, and professional skepticism.
D. Accepting responsibility to act professionally and in accordance with a professional code of ethics.

6. Sam Williams, CPA, uses his website to solicit new clients and to provide his existing clients and potential clients with useful accounting and tax information. In addition, as a benefit to his clients, he lists the services of some of his clients on the website, usually with a glowing review and a strong recommendation. What type of a threat is this to the AICPA Rules of Conduct?

A. Self-interest threat
B. Familiarity threat
C. Advocacy threat
D. Self-review threat

7. Which of the following AICPA Rules of Conduct applies ONLY to members in the practice of public accounting?

A. Compliance with Standards
B. General Standards
C. Accounting Principles
D. Contingent fees

8. When can a CPA subordinate his or her professional judgment to that of others?

A. Never
B. In every audit engagement
C. In every engagement except tax services
D. In every engagement except management advisory services

9. According to the AICPA's ethical standards, an auditor would be considered independent in which of the following instances?

A. The auditor obtained an auto loan from a client financial institution, at market rates and conditions.
B. The auditor is also an attorney who advises the client as its general counsel.
C. The auditor donates service as treasurer of a charitable organization that is a client during the period covered by the financial statements.
D. The client owes the auditor for two years of unpaid auditor fees.

10. James Baldwin, CPA, made a departure in a set of financial statements that does not comply with GAAP. He did this because he believed that the statements would be misleading without the departure. According to the Accounting Principles rule issued by the AICPA, James is required to disclose all of the following items EXCEPT:

A. A description of the departure
B. The approximate effects of the departure in comparison to the application of GAAP
C. Other examples or rulings where the departure was used and approved by the AICPA
D. The reasons compliance would have been misleading

11. All of the following statements are true for the AICPA rules regarding records EXCEPT:

A. Working papers may be withheld when fees due to the member for that specific work have not been paid
B. Copies of previous tax returns provided by the client should be returned
C. The CPA may retain a copy of the records
D. Records must be provided within 30 days.

12. According to the AICPA Code of Professional Conduct, which of the following acts is generally prohibited?

A. Purchasing a product from a third party and reselling it to a client.
B. Writing a financial management newsletter that is distributed through a publishing company.
C. Accepting a commission for recommending a product to an audit client.
D. Paying a referral fee to obtain a client, after that referral fee was disclosed to the client.

13. With regards to advertising and solicitation, which of the following is FALSE?

A. Advertising shall not be misleading.
B. A CPA should not guarantee tax savings.
C. A CPA can highlight favorable relationships within the IRS.
D. A CPA can advertise their low prices.

14. CPAs must always be aware of confidentiality rules. Which of the following is a situation where a CPA cannot disclose confidential client information without the consent of the client?

A. When disclosure is required by a court order
B. When requested by the client's financial institution
C. When the CPA is undergoing a peer review
D. When required by the state board

15. Which of the following would be a misleading name, according to the AICPA rules on organization form and names?

A. John Smith, a self-employed CPA who employs a bookkeeper, uses the name “Smith and Associates”.
B. Susan Thomas, a self-employed CPA with no employees, uses the name “Thomas, Certified Public Accountants”.
C. Robert Jones and Tim Ellis, partners, use the name “Jones and Partners”.
D. “Edwards, Johnson and Pearson, CPAs”, although Meredith Johnson died 3 years ago.

16. ___________________ is not one of the issue(s) addressed by the Sarbanes-Oxley Act of 2002:

A. Creating a Public Company Accounting Oversight Board
B. Increasing the accuracy of corporate tax returns
C. Strengthening the independence of firms that audit public companies
D. Increasing corporate responsibility

17. A member of the AICPA who is engaged to prepare an income tax return has a duty to prepare it in such a manner that the tax is ___________

A. Computed in conformity with generally accepted accounting principles.
B. No more than legally owed.
C. Supported by the taxpayer’s audited financial statements.
D. Not subject to change upon audit.

18. Which of the following is a violation of the AICPA’s standards for tax services?

A. Janie, a CPA, does not sign a tax return because her client refuses to report his self-employment income.
B. Tom sees information from his client that looks incorrect, so Tom asks for verification of the data from his client.
C. Andrew tells his client about potential penalties associated with Andrew’s recommended tax positions on a tax return that Andrew has completed.
D. Margaret instructs one of her clients to submit a document to the IRS with the hope that it may delay further IRS action.

19. Which of the following bodies ordinarily would have the authority to suspend or revoke a CPA's license to practice public accounting?

A. The SEC
B. The AICPA
C. A state CPA society
D. A state board of accountancy

20. In accordance with the IMA Standards of Ethical Conduct for Accountants and Financial Professionals, CPAs should must work to continually develop professional knowledge and skills. What IMA standard is this?

A. Competency
B. Confidentiality
C. Integrity
D. Credibility

Answer Sheet

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4. ___	8. ___	12. ___	16. ___	20. ___

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