



**Virginia Society of  
Certified Public  
Accountants**

# **Ethics 2011 — Your License Depends on It!**

Leader's Guide

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# Why Take an Ethics Class?

## **1. To comply with the CPE requirements of the state in which you are licensed as a CPA.**

This training has been created to help you meet the Virginia Board of Accountancy's (VBOA) 2011 ethics requirement, which is a 2-hour CPE requirement. In 2003, the Virginia General Assembly passed a law requiring all CPAs in Virginia to take an annual ethics CPE course. Annually, the VBOA provides an outline of topics to be included (This year's outline can be found at [boa.virginia.gov](http://boa.virginia.gov)), and this class has been designed to meet the objectives of that outline.

Additionally, this class *may* qualify for 2 CPE hours of ethics for CPAs licensed in other states, including:

- Maryland and Washington, D.C. CPAs, which have a biennial ethics requirement
- North Carolina non-resident certificate holders
- Other states — please refer to your state's specific regulations

## **2. To receive updates on some of the latest changes and additions to regulations and ethical guidelines applicable to Virginia CPAs.**

This class was not designed to be an *all-encompassing*, detailed update of recent changes to professional ethics that affect CPAs, and the information provided and scenarios presented are not intended to be official positions of the VBOA, American Institute of CPAs (AICPA), Internal Revenue Service (IRS), International Ethics Standards Board for Accountants (IESBA) or other standard-setting bodies. For specific advice or clarification, please research the applicable standards or seek advice from the appropriate governing/regulating organization.

## **3. To provide you with a couple of hours to reflect on the ethical responsibilities that come with holding a CPA license and practicing as a CPA.**

Ethics is a branch of philosophy that is hard to define, and many times an "ethical dilemma" will not have a black and white answer. Each of us will face various ethical challenges and decisions, both big and small, during our career. The more we can be educated on the recent guidelines, rules and principles, and the more we can reflect on practical applications of such, the better position we may be in when faced with ethical situations in the field.

# Resources

## Publications (Professional Ethics)

### Code of Virginia:

Title 54.1 Professions and Occupations; Chapter 44 — Public Accountants

<http://tinyurl.com/6f9ucox>

<http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+TOC5401000004400000000000>

### Virginia Board of Accountancy:

<http://www.boa.virginia.gov/>

### AICPA Code of Professional Conduct:

In standard form:

<http://tinyurl.com/2cyfzcx>

<http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/default.aspx>

In topical (indexed) form:

<http://tinyurl.com/4p64my2>

[http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et\\_topical\\_index.aspx](http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_topical_index.aspx)

## Organizations

### Virginia Board of Accountancy (VBOA)

[boa.virginia.gov](http://boa.virginia.gov)

E-mail: [boa@boa.virginia.gov](mailto:boa@boa.virginia.gov)

CPA Licensing Services & General Information: (804) 367-8505

CPA Examination Services: (804) 367-1111

[townhall.virginia.gov](http://townhall.virginia.gov) (source for all regulatory updates from state of Virginia, not just VBOA)

### Virginia Society of CPAs

[www.vscpa.com](http://www.vscpa.com)

CPE Hotline: (800) 341-8189

### Other Regulatory Organizations

You, as a licensed CPA, are regulated by the state(s) in which you are licensed, among other bodies, depending on the nature of your work or your organization's work. The VBOA incorporates by reference (per § 54.1-4413.3) and sets forth that persons and firms using the CPA title in Virginia shall follow the standards and any interpretive guidance issued by the following bodies:

- American Institute of CPAs (Code of Professional Conduct)
- Comptroller General of the United States
- Federal Accounting Standards Advisory Board
- Financial Accounting Standards Board
- Government Accounting Standards Board
- U.S. Securities and Exchange Commission
- Public Company Accounting Oversight Board

### American Institute of CPAs (AICPA)

[www.aicpa.org](http://www.aicpa.org)

AICPA hotline: (888) 777-7077

E-mail: [ethics@aicpa.org](mailto:ethics@aicpa.org)

**Federal Accounting Standards Advisory Board (FASAB)**

www.fasab.gov  
(202) 512-7350

**Financial Accounting Standards Board (FASB)**

www.fasb.org  
(203) 847-0700  
Codification: <http://asc.fasb.org/>

**Government Accountability Office (GAO)**

www.gao.gov  
(202) 512-3000  
Comptroller General of the United States is the Director of the Government Accountability Office

**Government Accounting Standards Board (GASB)**

www.gasb.org  
(203) 847-0700

**Public Company Accounting Oversight Board (PCAOB)**

www.pcaobus.org  
(202) 207-9100  
Independence and Ethics Rules and Standards (including AICPA Code of Professional Conduct references): <http://pcaobus.org/Standards/EI/Pages/default.aspx>

**U.S. Securities and Exchange Commission (SEC)**

www.sec.gov  
(888) SEC-6585

NOTE: Website URLs, e-mail addresses and phone numbers provided above and throughout this guide are subject to change.

**Recent Articles****Comparing the Ethics Codes: AICPA and IFAC**

Catherine Allen, *Journal of Accountancy*, October 2010  
<http://www.journalofaccountancy.com/Issues/2010/Oct/20103002.htm>

**Highlights of Finance and Accounting Ethics Research**

Cynthia E. Bolt-Lee and Janette Moody, *Journal of Accountancy*, October 2010  
<http://www.journalofaccountancy.com/Issues/2010/Oct/20102896.htm>

**Help for Solving CPAs' Ethical Dilemmas**

Martin A Leibowitz and Alan Reinstein, *Journal of Accountancy*, April 2009  
<http://www.journalofaccountancy.com/Issues/2009/Apr/20081358.htm>

**IRS Exempts CPA-Supervised Nonsigners From New Preparer Rules**

*Journal of Accountancy*, December 2010  
<http://www.journalofaccountancy.com/Web/20103705.htm>

**Why Ethics Matters: The SEC vs. Goldman Sachs**

Chuck Colson, *Breakpoint*, April 21, 2010  
<http://www.crosswalk.com/news/commentary/11629208/>

# Glossary of Terms

Unless otherwise noted, the following definitions are from the Code of Virginia § 54.1-4400. Definitions.

**Assurance** means any form of expressed or implied opinion or conclusion about the conformity of a financial statement with any recognition, measurement, presentation or disclosure principles for financial statements.

**Attest services** means audit, review or other attest services for which standards have been established by the Public Company Accounting Oversight Board, by the Auditing Standards Board or the Accounting and Review Services Committee of the American Institute of CPAs, or by any successor standard-setting authorities.

**Practice of public accounting** means the giving of an assurance other than (i) by the person or persons about whom the financial information is presented or (ii) by one or more owners, officers, employees or members of the governing body of the entity or entities about whom the financial information is presented.

**Providing services to the public using the CPA title** means providing services that are subject to the guidance of the standard-setting authorities listed in the standards of conduct and practice in subdivisions 5 and 6 of § 54.1-4413.3.

§ 54.1-4413.3. Standards of conduct and practice. (5 and 6 only listed below.)

5. Follow the technical standards, and the related interpretive guidance, issued by committees and boards of the American Institute of Certified Public Accountants that are designated by the Council of the American Institute of Certified Public Accountants to promulgate technical standards, or that are issued by any successor standard-setting authorities.

6. Follow the standards, and the related interpretive guidance, as applicable under the circumstances, issued by the Comptroller General of the United States, the Federal Accounting Standards Advisory Board, the Financial Accounting Standards Board, the Governmental Accounting Standards Board, the Public Company Accounting Oversight Board, the U. S. Securities and Exchange Commission, comparable international standard-setting authorities, or any successor standard-setting authorities.

**Providing services to an employer using the CPA title** means providing to an entity services that require the substantial use of accounting, financial, tax or other skills that are relevant, as determined by the Board.

**Substantial equivalency** means that the education, CPA exam and experience requirements contained in the statutes and administrative rules of another jurisdiction are comparable to, or exceed, the education, CPA exam and experience requirements contained in Chapter 44 of Title 54.1 of the Code of Virginia and the Board of Accountancy Regulations. (18VAC5-22)

**Using the CPA title in Virginia** means using "CPA," "Certified Public Accountant" or "public accountant" (i) in any form or manner of verbal communication to persons or entities located in Virginia or (ii) in any form or manner of written communication to persons or entities located in Virginia, including but not limited to the use in any abbreviation, acronym, phrase, or title that appears in business cards, the CPA wall certificate, Internet postings, letterhead, reports, signs, tax returns or any other document or device.



# Common Acronyms and Abbreviations

- **AICPA** — American Institute of CPAs
- **ASU** — Accounting Standards Update — update to the Accounting Standards Codification
- **ET** — Ethics (topical index of the AICPA Professional Code of Conduct)
- **IESBA** — International Ethics Standards Board for Accountants (independent standard setting organization within IFAC)
- **IFAC** — International Federation of Accountants
- **IRC** — Internal Revenue Code
- **GAAP** — Generally Accepted Accounting Principles
- **GAAS** — Generally Accepted Auditing Standards
- **GAGAS** — Generally Accepted Government Auditing Standards
- **PEEC** — Professional Ethics Executive Committee (of the AICPA)
- **PIOB** — Public Interest Oversight Board
- **SSAE** — Statements on Standards for Attestation Engagements
- **SSARS** — Statements on Standards for Accounting and Review Services
- **SQCS** — Statement on Quality Control Standards
- **SSTS** — Statements on Standards for Tax Services — enforceable tax practice standards for members of the AICPA
- **VAC** — Virginia Administrative Code (“Regulations”)
- **VBOA** — Virginia Board of Accountancy, sometimes referred to as “the Board”
- **VSCPA** — Virginia Society of CPAs

# Regulatory Updates and Developments

## New Virginia Board of Accountancy (VBOA) Regulations Effective September 16, 2010

### VBOA New Regulations

Per the VBOA website: "As a result of the comprehensive revisions to the accountancy statutes that became effective July 1, 2007, some new regulations were needed, and most of the previous regulations were no longer needed. Accordingly, the VBOA has replaced all of its regulations with new regulations effective September 16, 2010."

18VAC5-21 was repealed and replaced in its entirety by 18VAC5-22.

### New Clarification of Certain Definitions, Including "Principal Place of Business"

Certain issues further clarified include: persons or entities (clients) located in Virginia; the distinction between providing services to the public using the CPA title and providing services to an employer using the CPA title; if a principal place of business (individual or firm) is in Virginia; and if a college or university is an accredited institution.

#### **18VAC5-22-30. Determining whether persons or entities to whom communications are made, or for whom services are provided, are located in Virginia.**

For the purpose of complying with Chapter 44 (§ 54.1-4400 et seq.) of Title 54.1 of the Code of Virginia for communication to persons or entities located in Virginia or providing services for persons or entities located in Virginia, persons are considered to be located in Virginia if their primary residence for federal income tax reporting is located in Virginia, and entities are considered to be located in Virginia if they conduct any activities in Virginia.

#### **18VAC5-22-40. Determining whether a person who holds a Virginia license is providing services to the public using the CPA title or to an employer using the CPA title.**

For the purpose of determining whether a person who holds a Virginia license is providing services to the public using the CPA title or to an employer using the CPA title, as those terms are defined in § 54.1-4400 of the Code of Virginia, because of the written information readily available to the public through the board's Internet postings, holding a Virginia license constitutes using the CPA title. Accordingly, a person who holds a Virginia license:

1. Is providing services to the public using the CPA title if he provides services that are subject to the guidance of the standard-setting authorities listed in the standards of conduct and practice in subdivisions 5 and 6 of § 54.1-4413.3 of the Code of Virginia.
2. Is providing services to an employer using the CPA title if he provides to an entity services that require the substantial use of accounting, financial, tax, or other skills that are relevant, as determined by the board.

#### **18VAC5-22-50. Determining whether the principal place of business of a person using the CPA title, or of a firm, is in Virginia.**

Complying with subdivision A 1 of § 54.1-4409.1, subsection B of § 54.1-4411, or subsection B of § 54.1-4412.1 of the Code of Virginia requires the person or firm to use reasonable judgment in determining whether Virginia is the principal place of business in which the person provides services to the public using the CPA title or the firm provides attest services or compilation services. The determination shall be reasonable considering the facts and circumstances and can be based on quantitative or qualitative

assessments. The determination shall be reconsidered for changes in facts and circumstances that are not temporary.

#### **18VAC5-22-60. Determining whether a college or university is an accredited institution.**

A. For the purpose of complying with subdivision A 1 a of § 54.1-4409.2 of the Code of Virginia, a college or university that is not accredited by one of the six major regional accrediting organizations listed in the definition of accredited institution in § 54.1-4400 of the Code of Virginia or their successors shall be considered an accredited institution if it is accredited by an accrediting organization recognized by the Council on Higher Education Accreditation (CHEA) or its successor. Publication of the name of the accrediting organization by CHEA or its successor shall be sufficient notification that the accrediting organization is recognized by CHEA or its successor.

B. To determine whether a college or university is an accredited institution if it is accredited by an accrediting organization that is neither one of the six major regional accrediting organizations or their successors, nor an accrediting organization recognized by CHEA or its successor, representatives of the accrediting organization shall meet with a task force appointed by the board to study and recommend to the board how the organization shall demonstrate that its accreditation process and standards are substantially equivalent to the accreditation process and standards of the six major regional accrediting organizations or their successors. The size and composition of the task force shall depend on the facts and circumstances. However, at least one of the members of the task force shall have substantial experience with the accreditation process and standards of the six major regional accrediting organizations or their successors.

After the task force provides its recommendations to the board, the board shall decide what the requirements shall be to demonstrate that the accreditation process and standards of the accrediting organization are substantially equivalent to the accreditation process and standards of the six major regional accrediting organizations or their successors and shall communicate its decision to the organization. The organization shall then provide the required documentation to the board that will enable the board to decide whether a college or university accredited by the organization is an accredited institution as defined in § 54.1-4400 of the Code of Virginia.

### **New Regulations Breakout**

The new regulations are broken out into separate sections for:

- Education — Section 70 (18VAC5-22-70)
- Examination — Section 80
- Continuing Professional Education — Section 90
- Experience — Section 100

### **New Regulations — Experience**

Under the new regulations, self-employment will not meet the experience requirement, and experience does not need to be verified by a licensed CPA.

### **Additional Highlights**

Under the new regulations (18VAC5-22-110), it is not required that a person who holds the license of another state and meets substantial equivalency provisions under § 54.1-4411 notify the VBOA.

#### *“Release” of Reports*

Firms providing attest or compilation services are now provided latitude to establish their own policies and procedures to provide the firm with reasonable assurance about the competency of those persons who

release or authorize the release of reports (attest and compilation). Such persons must annually obtain a minimum of 8 CPE hours related to attest/compilation services.

**18VAC5-22-140. Persons who release or authorize the release of reports.**

A. To comply with subdivision D 4 of § 54.1-4412.1 of the Code of Virginia, a person who releases or authorizes the release of reports on attest services or compilation services provided for persons or entities located in Virginia shall annually obtain a minimum of eight hours of continuing professional education related to attest services or compilation services. The hours obtained to meet this requirement shall be considered in determining whether the person has complied with the requirements of 18VAC5-22-90.

B. Firms providing attest services or compilation services shall establish policies and procedures to provide the firm with reasonable assurance that persons who release or authorize the release of reports on attest services or compilation services possess the kinds of competencies that are appropriate given the facts and circumstances. These policies and procedures shall address the required technical proficiency, familiarity with the industry and the person or entity, skills that indicate sound professional judgment, and other competencies necessary under the circumstances.

## **Licensing Requirements and Firm Registration**

The new VBOA regulations do not address a majority of the additional licensing requirements because they were incorporated by reference into the statutes, §54.1-4409.1 and §54.1-4409.1. Additionally, firm registration is addressed in §54.1-4412.1. See the statutes for more information on these issues. Additionally, refer to Section 3, pages 3–4 (“Virginia Board of Accountancy (VBOA) Practical Aspects for Maintaining Licensure”) for additional information regarding your licensure requirements.

## **Using the CPA Title**

The following question is proposed in the course video: Do I need to continue my CPE if I do not use my CPA title anywhere?

The answer can be found in 18 VAC5-22-40. By virtue of the public information contained on the VBOA website about licensees, you are “using the CPA title” if you are licensed and provide services that are either subject to standard-setting authorities recognized by the VBOA, or at a job that requires the substantial use of accounting, financial, tax and related skills.

## **Additional Highlights**

### *Peer Review*

The new regulations allow the VBOA to waive the requirement for a peer review or grant additional time as follows:

**18VAC5-22-150. Monitoring program and peer review.**

In order to comply with subdivision D 6 of § 54.1-4412.1 of the Code of Virginia, a firm shall comply with all components of the monitoring program in which it is enrolled, except that, depending on the facts and circumstances, the board may waive the requirement for a peer review or grant additional time for complying with the requirement.

### *Confidential Consent Agreements*

Under the Code's provision for Confidential Consent Agreements (§ 54.1-4413.5), the VBOA has the right to enter into a confidential consent agreement with a person or firm in lieu of disciplinary action. The new regulations define "minor" violations as follows:

#### **18VAC5-22-160. Confidential consent agreements.**

To determine whether to enter into a confidential consent agreement under subsection A of § 54.1-4413.5 of the Code of Virginia, the board shall consider a violation minor if the board believes that the violation was not intentional misconduct, was not the result of gross negligence, and did not have a significant financial impact on persons or entities. The board shall enter into no more than two additional confidential consent agreements with a person or firm within 10 years after the first confidential consent agreement.

### *Communication Between the VBOA and Licensees*

The new regulations consolidate into one section all the information about communication between the VBOA and licensees:

#### **18VAC5-22-170. Communication between the board and licensees.**

A. When requested by the board:

1. Persons or firms applying for the issuance, renewal, or reinstatement of a Virginia license or for lifting the suspension of the privilege of using the CPA title in Virginia or providing attest services or compilation services for persons or entities located in Virginia shall provide the board with support for their conclusion that they have complied with applicable provisions of Chapter 44 (§ 54.1-4400 et seq.) of Title 54.1 of the Code of Virginia and this chapter.
2. Firms shall provide the board with proof of enrollment in a monitoring program and copies of reports and other documentation related to acceptance of their peer reviews.
3. Persons or firms shall provide the board documents related to the board's investigation of their possible violation of provisions of Chapter 44 (§ 54.1-4400 et seq.) of Title 54.1 of the Code of Virginia or this chapter.

Each person or firm shall respond within 30 calendar days to any request for information by the board under this subsection.

B. Each holder of a Virginia license shall notify the board in writing within 30 calendar days of any change in the holder's name or in the postal and electronic addresses where the person or firm may be reached.

C. The board shall transmit license renewal notices electronically unless a person or firm is unable to communicate electronically. However, § 54.1-4413.2 of the Code of Virginia places the responsibility for renewing a Virginia license on its holder, and that responsibility is not affected by whether the holder receives a license renewal notice.

### **Conclusion**

This concludes the section dedicated to the new VBOA regulations issued on September 16, 2010. Please refer to the "crosswalk" located on page 71 for a summary of key changes.

## **Circular 230 and other Tax Regulations Update**

### **Circular 230 History**

- IRS placed all signing and non-signing tax return providers under Treasury Circular 230.
- IRS required all individuals who are required to sign a federal tax return as a paid tax return preparer to register, obtain a PTIN, and pay registration fee before preparing any federal tax returns in 2011.
- CPAs are exempt from new tax CPE requirements and competency exam.

Note: The Office of Responsibility administers and enforces the regulations regarding practice before the IRS. Disciplinary proceedings for those subject to Circular 230 may result in private reprimand, public censure, suspension or disbarment from practice before the IRS and/or imposition of a monetary penalty.

### **Circular 230 Update**

In December 2010, the IRS released guidance on the implementation of new regulations governing tax return preparers (Notice 2011-6), and provided an exception to its return preparer regulation plan for nonsigning preparers who are supervised by a CPA. The exception is applicable if the individual is supervised by a registered CPA who signs the tax returns, is employed at the same CPA firm and passes the forthcoming IRS-required tax compliance check and suitability check.

### **e-File Mandate**

Effective for 2011 filings, all tax preparers who, in aggregate, anticipate filing 100 or more forms 1040, 1040A, 1040EZ and 1041s during the year must e-file or request an undue hardship waiver (Form 8944). Those who have clients who don't want to e-file should instruct those clients to check box 1 and manually send in Form 8948 along with their return.

Note that the threshold for 2012 is scheduled to change from 100 filings to 10, although there has been some talk about increasing the threshold.

### **Other Tax Updates**

Remember that professional standards and ethics rules can apply to a licensee's tax practice. These professional standards and ethics rules are found in many sources such as the AICPA Statements on Standards for Tax Services (updated for new standards effective January 1, 2010) and the AICPA Code of Professional Conduct. For federal tax practice, in addition to U.S. Treasury Department Circular 230, IRC § 6694., Understatement of taxpayer's liability by tax return preparer, was updated in 2010.

## **SSARS 19 and Codification**

### **SSARS**

An accountant must perform a compilation or review of a nonpublic entity in accordance with Statements on Standards for Accounting and Review Services (SSARS), as issued by the Accounting and Review Services Committee (ARSC). The exception to this includes prospective financial statements that are prepared and should be compiled in conformity with the SSAEs.

### **SSARS 19 and Codification**

SSARS 19 became effective for periods ending on or after December 15, 2010. This includes "SSARS Codification," which revised, reorganized and superseded various sections of the existing SSARS and is

designed to make the guidance more user-friendly. Codification, along with the various changes to be implemented from SSARS 19, will first be “used” during tax year 2011.

SSARS 19 includes a number of new requirements, including written engagement letters for compilations and reviews, increased documentation requirements and some new report language.

## **AICPA Code of Professional Conduct Codification**

### **AICPA (PEEC) Ethics Codification**

The codification of the Code of Professional Conduct from the AICPA’s Professional Ethics Executive Committee launched in December 2008 and is expected to take three to five years to implement. It is expected to have a topical layout and a new numbering sequence as well as improved search functions. It is also expected to include ongoing “convergence” with the International Ethics Standards Board for Accountants (IESBA) Code of Professional Accountants and to utilize more of a conceptual framework approach, similar to the Conceptual Framework for AICPA Independence Rules adopted in 2006 (ET 100-1) and the IESBA Code.

Certain changes go into effect in 2011, including changes to the Independence rules:

- The revisions to the section "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client" of Interpretation No. 101-1 (par. .02) will be effective on June 1, 2011.
- Interpretation No. 101-17, "NETWORKS AND NETWORK FIRMS" will be effective for engagements covering periods beginning on or after July 1, 2011.

### **Other PEEC Planned Activities 2011**

PEEC plans to clarify the meaning and intent of “establishing or maintaining internal controls” as used in Interpretation 101-3 and the Independence Conceptual Framework. Another priority is monitoring International Federation of Accountants (IFAC) Code and considering additional guidance for members in business and industry regarding whistle-blowing and illegal/fraud acts. PEEC also plans to define “an affiliate” of an attest client and modernize confidential client information guidance (rule 301).

### **GAO “Yellow Book” Changes**

The Government Audit Standards 2010 Exposure Draft (GAO-10-853G) from the Government Accountability Office (GAO) makes changes to the last “Yellow Book” revisions, issued in July 2007. The comment period ended November 11, 2010. Changes include a conceptual framework for independence (threats and safeguards) and reordering the “book.” View the regulations at [www.gao.gov/yellowbook](http://www.gao.gov/yellowbook).

### **International Ethics**

U.S. practitioners and employees within organizations with foreign operations or working with clients who have foreign operations, subsidiaries, affiliates, acquisitions, etc., may have to comply with the International Code of Ethics, known as the Code of Ethics for Professional Accountants, which is developed by the IESBA, an independent organization of IFAC.

The revised IESBA Code of Ethics for Professional Accountants is effective January 1, 2011, except for certain provisions, which will have transitional periods beyond January 1, 2011 — public interest entities, partner rotation, non-assurance divisions, relative size of fees and compensation and evaluation policies.

If your client or organization has *any* operations outside the United States, you should know the professional standards that apply to audits or accounting practices performed in those countries.

In light of the convergence of the IESBA Code of Ethics for Professional Accountants and the AICPA Code of Professional Conduct, the AICPA has indicated that “convergence” does not mean the AICPA will lighten their rules when a standard may seem in conflict and the international standard seems less strict.

## **SEC/PCAOB**

As of the date of the creation of this class, the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) are focusing a lot of attention on the forthcoming regulation of broker-dealers, including a proposed temporary rule for an interim inspection program for broker-dealer audits and dealer funding rules (proposed by PCAOB on December 14, 2010). See [www.pcaobus.org](http://www.pcaobus.org) for more information and up to date news and regulation changes or updates.



# Ethical Decision Model and Case Studies

There are numerous resources available for CPAs to utilize in confronting ethical scenarios. Using a formal model helps to ensure that a CPA is more “intentional” in their decision making process when presented with ethical situations, dilemmas and ultimately ... decisions.

The model we present comes from The Markkula Center for Applied Ethics at Santa Clara University and can be found on their website, along with other resources, at [www.scu.edu/ethics/decision](http://www.scu.edu/ethics/decision).

## Making an Ethical Decision

### Recognize an Ethical Issue

1. Could this decision or situation be damaging to someone or to some group? Does this decision involve a choice between a good and bad alternative, or perhaps between two “goods” or between two “bads”?
2. Is this issue about more than what is legal or what is most efficient? If so, how?

### Get the Facts

3. What are the relevant facts of the case? What facts are not known? Can I learn more about the situation? Do I know enough to make a decision?
4. What individuals and groups have an important stake in the outcome? Are some concerns more important? Why?
5. What are the options for acting? Have all the relevant persons and groups been consulted? Have I identified creative options?

### Evaluate Alternative Actions

6. Evaluate the options by asking the following questions:
  - Which option will produce the most good and do the least harm? (The Utilitarian Approach)

- Which option best respects the rights of all who have a stake? (The Rights Approach)
- Which option treats people equally or proportionately? (The Justice Approach)
- Which option best serves the community as a whole, not just some members? (The Common Good Approach)
- Which option leads me to act as the sort of person I want to be? (The Virtue Approach)

### Make a Decision and Test It

7. Considering all these approaches, which option best addresses the situation?
8. If I told someone I respect—or told a television audience—which option I have chosen, what would they say?

### Act and Reflect on the Outcome

9. How can my decision be implemented with the greatest care and attention to the concerns of all stakeholders?
10. How did my decision turn out and what have I learned from this specific situation?



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Markkula Center for Applied Ethics

[scu.edu/ethics](http://scu.edu/ethics)

# Case Study Sections

The BOA provided guidelines for the topics to cover:

**Required:**

- 1.) Planning and Supervision ET Section 201, Rule 201.01 ( C ) of the AICPA Code
- 2.) Form of Organization and Name — ET Section 505, Rule 505.01 of the AICPA Code of Professional Conduct

**One of the Following three is required:**

- 1.) Due Professional Care — ET Section 56, Article V and ET Section 201, Rule 201.01 (B) of the AICPA Code of Professional Conduct
- 2.) Public Interest — ET Section 53, Article II of the AICPA Code of Professional Conduct
- 3.) Independence — ET Section 100, Rule 101 of the AICPA Code of Professional Conduct

The following table provides guidance to assist the instructor and class in selecting individual case studies that may be more applicable to certain audiences. The applicable Code of Professional Conduct sections are provided starting on the next page, and the case studies start on page 61.

Case Study Number

Topic	Case Study Number	Government	Public Accounting	Private Accounting
Planning and Supervision	1		X	
Planning and Supervision	2	X		X
Planning and Supervision	3		X	
Planning and Supervision	4		X	
Planning and Supervision	5			X
Form of Org. and Name	6	All	All	All
Form of Org. and Name	7	All	All	All
Due Professional Care	8		X	
Due Professional Care	9	X		X
Due Professional Care	10			X
Public Interest	11		X	
Public Interest	12		X	X
Public Interest	13	X		
Public Interest	14	X	X	X
Independence	15		X	
Independence	16			X

## ET Section 201— General Standards

### .01 Rule 201 — General standards.

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

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

## ET Section 505 — Form of Organization and Name

### .01 Rule 505 — Form of organization and name.

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

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

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

[As amended January 14, 1992 and October 28, 1997. Revised May 15, 2000.]

### Interpretations Under Rule 505

#### — Form of Organization and Name

#### [.02] [505-1] — [Deleted]

#### .03 505-2 — Application of rules of conduct to members who own a separate business.

A member in the practice of public accounting may own an interest in a separate business that performs for clients any of the professional services of accounting, tax, personal financial planning, litigation support services, and those services for which standards are promulgated by bodies designated by Council (see ET section 92.25). If the member, individually or collectively with his or her firm or with members of his or her firm controls the separate business (as defined by generally accepted accounting principles [GAAP]), the entity and all its owners (including the member) and employees must comply with all of the provisions of the Code of Professional Conduct. For example, in applying Rule 503, *Commissions and Referral Fees* [ET section 503.01], if one or more members individually or collectively can control the separate business, such business would be subject to rule 503 [ET section 503.01], its interpretations and rulings. With respect to an attest client, rule 101 [ET section 101.01] and all its interpretations and rulings would apply to the separate business, its owners and employees. If the member, individually or collectively with his or her firm or with members of his or her firm, does not control the separate business, the provisions of the Code would apply to the member for his or her actions but not apply to the entity, its other owners and employees. For example, the entity could enter into a contingent fee arrangement with an attest client of the member or accept commissions for the referral of products or services to such attest client.

[Replaces previous interpretation 505-2, with the same title, March 1993, effective March 31, 1993. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

#### **.04 505-3 — Application of rule 505 to alternative practice structures.**

Rule 505, *Form of Organization and Name* [ET section 505.01], states, “A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.” The Council Resolution (the Resolution) requires, among other things, that a majority of the financial interests in a firm engaged in attest services (as defined therein) be owned by CPAs. In the context of alternative practice structures (APS) in which (1) the majority of the financial interests in the attest firm is owned by CPAs and (2) all or substantially all of the revenues are paid to another entity in return for services and the lease of employees, equipment, and office space, questions have arisen as to the applicability of rule 505 [ET section 505.01].

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

- Compliance with all aspects of applicable state law or regulation
- Enrollment in an AICPA-approved practice monitoring program
- Compliance with the independence rules prescribed by Rule 101, *Independence* [ET section 101.01]
- Compliance with applicable standards promulgated by Council-designated bodies (Rule 202, *Compliance With Standards* [ET section 202.01]) and all other provisions of the Code, including ET section 91, *Applicability*

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

[Effective December 31, 1998. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, June 2009.]

## **ET Section 56 — Article V: Due Care**

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

**.01** The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

**.02** Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles.

**.03** Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

**.04** Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

**.05** Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

## **ET Section 201 — General Standards**

### **.01 Rule 201 — General standards.**

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

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

[As adopted January 12, 1988.]

## **ET Section 53 — Article II: The Public Interest**

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

**.01** A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

**.02** In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

**.03** Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

.04 All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

## **ET Section 101 — Independence**

### **.01 Rule 101 — Independence.**

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

[As adopted January 12, 1988.]

#### **Interpretations under Rule 101 — Independence**

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

### **.02 101-1 — Interpretation of Rule 101.**

Independence shall be considered to be impaired if:

- A. During the period of the professional engagement <sup>fn\*</sup> a covered member
  1. Had or was committed to acquire any direct or material indirect financial interest in the client.
  2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and
    - i. The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or
    - ii. The trust or estate owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
    - iii. The value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate.
  3. Had a joint closely held investment that was material to the covered member.
  4. Except as specifically permitted in interpretation 101-5 [ET section 101.07], had any loan to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.
- B. During the period of the professional engagement, a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than 5 percent of a client's outstanding equity securities or other ownership interests.
- C. During the period covered by the financial statements or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n)
  1. Director, officer, or employee, or in any capacity equivalent to that of a member of management;

2. Promoter, underwriter, or voting trustee; or
3. Trustee for any pension or profit-sharing trust of the client.

### **Transition Period for Certain Business and Employment Relationships**

A business or employment relationship with a client that impairs independence under interpretation 101-1.C [ET section 101.02], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under rule 101 [ET section 101.01], and its interpretations and rulings as of November 2001, and the individual severed that relationship on or before May 31, 2002.

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

A firm's independence would be impaired if a covered member who was formerly <sup>fn 1</sup> (a) employed by a client or (b) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit sharing trust of the client:

- a. fails to disassociate himself or herself from the client prior to becoming a covered member. Disassociation includes the following:
  - i. Ceasing to participate in all employee health and welfare plans sponsored by the client, unless the client is legally required to allow the covered member to participate in the plan (for example, Consolidated Omnibus Budget Reconciliation Act (COBRA)) and the covered member pays 100 percent of his or her portion of the cost of participation on a current basis.
  - ii. Ceasing to participate in all other employee benefit plans by liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, share-based compensation arrangements, <sup>fn 2</sup> deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. <sup>fn 3</sup>  
When the covered member does not participate on the attest engagement team or is not in a position to influence the attest engagement, he or she is not required to liquidate or transfer any vested benefits if such an action is not permitted under the terms of the plan or if a penalty <sup>fn 4</sup> significant to the benefits is imposed upon such liquidation or transfer.
  - iii. Disposing of any direct or material indirect financial interests in the client.
  - iv. Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under Interpretation No. 101-5 (par. .07).
  - v. Assessing other relationships with the client to determine if such relationships create threats to independence that would require the application of safeguards to reduce the threats to an acceptable level.
- b. participates on the attest engagement team or is an individual in a position to influence the attest engagement for the client when the attest engagement covers any period that includes his or her former employment or association with that client.

### **Effective Date**

The revisions to the section "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client" of Interpretation No. 101-1 (par. .02) will be effective on June 1, 2011. Early application is permitted.

### **Application of the Independence Rules to a Covered Member's Immediate Family**

A covered member's immediate family is subject to Rule 101 (par. .01) and its interpretations and rulings. When materiality of a financial interest is identified as a factor affecting independence in these interpretations and rulings, the immediate family member and the covered member's interests should be combined.

The following exceptions address situations in which independence will not be considered impaired. Notwithstanding the following exceptions, the independence requirement in Interpretation No. 101-1(B) (par. .02) applies.

### ***Permitted Employment***

An individual in a covered member's immediate family may be employed by an attest client in a position other than a key position.

### ***Employee Benefit Plans Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans***

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a plan that is an attest client or that is sponsored by an attest client, other than a client's share-based compensation arrangement or nonqualified deferred compensation plan, provided that

- a. the plan is offered to all employees in comparable employment positions;
- b. the immediate family member does not serve in a position of governance (for example, board of trustees) for the plan; and
- c. the immediate family member does not have the ability to supervise or participate in the plan's investment decisions or in the selection of the investment options that will be made available to plan participants.

An immediate family member of a covered member may hold a direct or material indirect financial interest in an attest client through participation in a plan,<sup>fn 5</sup> provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement;
2. such investment is an unavoidable consequence<sup>fn 6</sup> of such participation; and
3. in the event that a plan option to invest in a nonattest client becomes available, the immediate family member selects such option and disposes of any direct or material indirect financial interests in the attest client as soon as practicable but no later than 30 days after such option becomes available.<sup>fn 7</sup>

### ***Share-Based Compensation Arrangements***

#### ***Share-Based Compensation Arrangements Resulting in Beneficial Financial Interests<sup>fn 8</sup> in Attest Clients***

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement, such as an employee stock ownership plan (ESOP), that results in his or her holding a beneficial financial interest in an attest client, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement.
2. the immediate family member does not serve as a trustee for the share-based compensation arrangement and does not have the ability to supervise or participate in the selection of the investment options, if any, that are available to participants.
3. when the beneficial financial interests are distributed or the immediate family member has the right to dispose of the shares, the immediate family member
  - a. disposes of the shares as soon as practicable but no later than 30 days after he or she has the right to dispose of the shares or
  - b. exercises his or her put option to require the employer to repurchase the beneficial financial interests as soon as permitted by the terms of the share-based compensation arrangement.<sup>fn 9</sup> Any repurchase obligation due to the immediate family member arising from exercise of the put option that is outstanding for more than 30 days would need to be immaterial to the covered member during the payout period.
4. benefits payable from the share-based compensation arrangement to the immediate family member upon termination of employment, whether through retirement, death, disability, or voluntary or involuntary termination, are funded by investment options other than the employer's



financial interests, and any unfunded benefits payable are immaterial to the covered member at all times during the payout period.

#### *Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client*

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement resulting in a right to acquire shares in an attest client, such as an employee stock option plan <sup>fn 10</sup> or restricted stock rights plan, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement and
2. the immediate family member exercises or forfeits these rights once he or she is vested and the closing market price of the underlying stock equals or exceeds the exercise price for 10 consecutive days (market period). The exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period. In addition, if the immediate family member exercises his or her right to acquire the shares, he or she should dispose of the shares as soon as practicable but no later than 30 days after the exercise date. <sup>fn 11</sup> If the employer repurchases the shares, any employer repurchase obligation due to the immediate family member that is outstanding for more than 30 days would need to be immaterial to the covered member during the payout period.

#### *Share-Based Compensation Arrangements Based Upon Stock Appreciation*

As a result of his or her permitted employment, an immediate family member of a covered member may participate in a share-based compensation arrangement based on the appreciation of an attest client's underlying shares, provided that

1. the share-based compensation arrangement (for example, a stock appreciation or phantom stock plan) does not provide for the issuance of rights to acquire the employer's financial interests.
2. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement.
3. the immediate family member exercises or forfeits his or her vested compensation rights if the underlying price of the employer's shares equals or exceeds the exercise price for 10 consecutive days (market period). Exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period.
4. any resulting compensation payable to the immediate family member that is outstanding for more than 30 days is immaterial to the covered member during the payout period.

#### ***Nonqualified Deferred Compensation Plan***

As a result of his or her permitted employment at an attest client, an immediate family member of a covered member may participate in a nonqualified deferred compensation plan, provided that

1. the covered member neither participates on the attest engagement team nor is in a position to influence the attest engagement;
2. the amount of the deferred compensation payable to the immediate family member is funded through life insurance, an annuity, a trust, or similar vehicle and any unfunded portion is immaterial to the covered member; and
3. any funding of the deferred compensation does not include financial interests in the attest client.

#### **Effective Date**

The revisions to the "Application of the Independence Rules to a Covered Member's Immediate Family" section of Interpretation No. 101-1 (par. .02) will be effective on June 1, 2011. Early application is permitted.

## Application of the Independence Rules to Close Relatives

Independence would be considered to be impaired if —

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

## Grandfathered Employment Relationships

Employment relationships of a covered member's immediate family and close relatives with an existing attest client that impair independence under this interpretation and that existed as of November 2001, will not be deemed to impair independence provided such relationships were permitted under preexisting requirements of rule 101 [ET section 101.01], and its interpretations and rulings.

## Other Considerations <sup>fn 8</sup>

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. In the absence of an independence interpretation or ruling under rule 101 [ET section 101.01] that addresses a particular circumstance, a member should evaluate whether that circumstance would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member's and the firm's independence. When making that evaluation, members should refer to the risk-based approach described in the Conceptual Framework for AICPA Independence Standards [see ET section 100.01]. If the threats to independence are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented. <sup>fn 12</sup>

[Paragraph added by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, November 1991, effective January 1, 1992, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective February 28, 1998, by the Professional Ethics Executive Committee. Revised, November 2001, effective May 31, 2002, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective July 31, 2002, by the Professional Ethics Executive Committee. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee. Revised, April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, August 2009, effective October 31, 2009, by the Professional Ethics Executive Committee.]

## [.03] [101-1]

[Formerly paragraph .02 renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly interpretation 101-1, renumbered as 101-4 and moved to paragraph .06, April 1992.]

## **.04 101-2 — Employment or association with attest clients.**

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

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may also be adjusted for inflation and interest may be paid on amounts due.
2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.
3. The former partner or professional employee does not participate or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:
  - The individual provides consultation to the firm
  - The firm provides the individual with an office and related amenities (for example, secretarial and telephone services)
  - The individual's name is included in the firm's office directory.
  - The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.
4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.
5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.
6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

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

With respect to conditions 4, 5, and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the positions he or she held at the firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure.<sup>fn 13</sup>

### **Considering Employment or Association With the Client**

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

employment or association with a client, the covered member should notify an appropriate person in the firm.

The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under rule 102 [ET section 102.01]. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and the individual involved.

[Replaces previous interpretation 101-2, Retired Partners and Firm Independence, August, 1989, effective August 31, 1989. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

### **.05 101-3 — Performance of nonattest services.**

Before a member or his or her firm ("member") performs nonattest services (for example, tax or consulting services) for an attest client,<sup>fn 14</sup> the member should determine that the requirements described in this interpretation have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired.

#### **Engagements Subject to Independence Rules of Certain Regulatory Bodies**

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the General Accounting Office [GAO], the Department of Labor [DOL], and state boards of accountancy) where a member performs nonattest services for an attest client and is required to be independent of the client under the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

#### **General Requirements for Performing Nonattest Services**

1. The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.
2. The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
  - a. Make all management decisions and perform all management functions;
  - b. Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
  - c. Evaluate the adequacy and results of the services performed; and
  - d. Accept responsibility for the results of the services;

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or reperform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.

3. Before performing nonattest services, the member should establish and document in writing <sup>fn 15</sup> his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:
  - a. Objectives of the engagement
  - b. Services to be performed
  - c. Client's acceptance of its responsibilities
  - d. Member's responsibilities
  - e. Any limitations of the engagementThe documentation requirement does not apply to:
  - a. Nonattest services performed prior to January 1, 2005.
  - b. Nonattest services performed prior to the client becoming an attest client. <sup>fn 16</sup>

General requirements 2 and 3 above do not apply to certain routine activities performed by the member such as providing advice and responding to the client's questions as part of the normal client-member relationship.

### **General Activities**

The following are some general activities that would impair a member's independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents, <sup>fn 17</sup> in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities
- Determining which recommendations of the member should be implemented
- Reporting to the board of directors on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent
- Establishing or maintaining internal controls, including performing ongoing monitoring activities <sup>fn 18</sup> for a client

### **Specific Examples of Nonattest Services**

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member's independence. These examples presume that the general requirements in the previous section "General Requirements for Performing Nonattest Services" have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

<b>Impact on Independence of Performance of Nonattest Services</b>		
<b>Type of Service</b>	<b>Independence Would Not Be Impaired</b>	<b>Independence Would Be Impaired</b>
Bookkeeping	<p>Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger.</p> <p>Prepare financial statements based on information in the trial balance.</p> <p>Post client-approved entries to a client's trial balance.</p> <p>Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</p>	<p>Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.</p> <p>Authorize or approve transactions.</p> <p>Prepare source documents.</p> <p>Make changes to source documents without client approval.</p>
Non tax disbursement	<p>Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.</p> <p>Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.<sup>fn 19</sup></p>	<p>Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.</p> <p>Accept responsibility to sign or cosign client checks, even if only in emergency situations.</p> <p>Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client.</p> <p>Approve vendor invoices for payment</p>
Benefit plan administration <sup>fn 20</sup>	<p>Communicate summary plan data to plan trustee.</p> <p>Advise client management regarding the application or impact of provisions of the plan document.</p> <p>Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member's electronic medium, such as an interactive voice response system or Internet connection or other media.</p> <p>Prepare account valuations for plan participants using data collected through the member's electronic or other media.</p> <p>Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other medium.</p>	<p>Make policy decisions on behalf of client management.</p> <p>When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence.</p> <p>Make disbursements on behalf of the plan.</p> <p>Have custody of assets of a plan.</p> <p>Serve a plan as a fiduciary as defined by ERISA.</p>

Investment — advisory or management	<p>Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, etc.</p> <p>Perform recordkeeping and reporting of client's portfolio balances including providing a comparative analysis of the client's investments to third-party benchmarks.</p> <p>Review the manner in which a client's portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client's investment policy statement; (2) meeting the client's investment objectives; and (3) conforming to the client's stated investment styles.</p> <p>Transmit a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.</p>	<p>Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments.</p> <p>Execute a transaction to buy or sell a client's investment.</p> <p>Have custody of client assets, such as taking temporary possession of securities purchased by a client.</p>
Corporate finance — consulting or advisory	<p>Assist in developing corporate strategies.</p> <p>Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria.</p> <p>Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.</p> <p>Assist in drafting an offering document or memorandum.</p> <p>Participate in transaction negotiations in an advisory capacity.</p> <p>Be named as a financial adviser in a client's private placement memoranda or offering documents.</p>	<p>Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.</p> <p>Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.</p> <p>Maintain custody of client securities.</p>
Executive or employee search	<p>Recommend a position description or candidate specifications.</p> <p>Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).</p> <p>Participate in employee hiring or compensation discussions in an advisory capacity.</p>	<p>Commit the client to employee compensation or benefit arrangements.</p> <p>Hire or terminate client employees.</p>
Business risk consulting	<p>Provide assistance in assessing the client's business risks and control processes.</p> <p>Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.</p>	<p>Make or approve business risk decisions.</p> <p>Present business risk considerations to the board or others on behalf of management.</p>
Information systems — design, installation or integration	<p>Install or integrate a client's financial information system that was not designed or developed by the member (e.g., an off-the-shelf accounting package).</p> <p>Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system.</p> <p>Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records.</p> <p>Provide training and instruction to client employees on an information and control system.</p>	<p>Design or develop a client's financial information system.</p> <p>Make other than insignificant modifications to source code underlying a client's existing financial information system.</p> <p>Supervise client personnel in the daily operation of a client's information system.</p> <p>Operate a client's local area network (LAN) system.</p>

## Tax Compliance Services

Tax compliance services addressed by this interpretation are preparation of a tax return,<sup>fn 21</sup> transmittal of a tax return and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, and authorized representation of clients in administrative proceedings before a taxing authority.

Preparing a tax return and transmitting the tax return and related tax payment to a taxing authority, in paper or electronic form, would not impair a member's independence provided the member does not have custody or control<sup>fn 22</sup> over the client's funds and the individual designated by the client to oversee the tax services:

- Reviews and approves the tax return and related tax payment; and,
- If required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

However, signing and filing a tax return on behalf of client management would impair independence, unless the member has the legal authority to do so and:

- a. The taxing authority has prescribed procedures in place for a client to permit a member to sign and file a tax return on behalf of the client (for example, Form 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in I.R.S. Form 8879; or
- b. An individual in client management who is authorized to sign and file the client's tax return provides the member with a signed statement that clearly identifies the return being filed and represents that:
  1. Such individual is authorized to sign and file the tax return;
  2. Such individual has reviewed the tax return, including accompanying schedules and statements, and it is true, correct and complete to the best of his or her knowledge and belief; and
  3. Such individual authorizes the member or another named individual in the member's firm to sign and file the tax return on behalf of the client.

Authorized representation of a client in administrative proceedings before a taxing authority would not impair a member's independence provided the member obtains client agreement prior to committing the client to a specific resolution with the taxing authority. However, representing a client in a court<sup>fn 23</sup> to resolve a tax dispute would impair a member's independence.

## Transition

Independence would not be impaired as a result of the more restrictive requirements of the tax compliance services provisions provided such services are pursuant to engagements commenced prior to February 28, 2007, and completed prior to January 1, 2008, and the member complied with all applicable independence interpretations and rulings in effect on February 28, 2007.

## Appraisal, Valuation, and Actuarial Services

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.

Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.



An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence.<sup>fn 24</sup> However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

## Forensic Accounting Services

For purposes of this interpretation, forensic accounting services<sup>fn 25</sup> are nonattest services that involve the application of special skills in accounting, auditing, finance, quantitative methods and certain areas of the law, and research, and investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings and consist of:

- Litigation services; and
- Investigative services.

Litigation services recognize the role of the member as an expert or consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of the following services:

- a. Expert witness services<sup>fn 26</sup> are those litigation services where a member is engaged to render an opinion before a trier of fact as to the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events.  
Expert witness services create the appearance that a member is advocating or promoting a client's position.<sup>fn 27</sup> Accordingly, if a member conditionally or unconditionally agrees to provide expert witness testimony for a client,<sup>fn 28</sup> independence would be considered to be impaired. However, independence would not be considered impaired if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more attest clients of the firm provided that at the outset of the engagement: 1) the member's attest clients constitute less than 20 percent of (i) the members of the group (ii) the voting interests of the group, and (iii) the claim; (2) no attest client within the group is designated as the "lead" plaintiff or defendant of the group; and (3) no attest client has the sole decision-making power to select or approve the expert witness.  
While testifying as a fact witness,<sup>fn 29</sup> a member may be questioned by the trier of fact or counsel as to his or her opinions pertaining to matters within the member's area of expertise. Answering such questions would not impair the member's independence.
- b. Litigation consulting services are those litigation services where a member provides advice about the facts, issues, and strategy of a matter. The consultant does not testify as an expert witness before a trier of fact.  
The performance of litigation consulting services would not impair independence provided the member complies with the general requirements set forth under this interpretation.<sup>fn 30</sup> However, if the member subsequently agrees to serve as an expert witness, independence would be considered to be impaired.
- c. Other services are those litigation services where a member serves as a trier of fact, special master, court-appointed expert, or arbitrator (including serving on an arbitration panel), in a matter involving a client. These other services create the appearance that the member is not independent. Accordingly, if a member serves in such a role, independence would be considered to be impaired. However, independence would not be considered impaired if a member serves as a mediator or any similar role in a matter involving a client provided the member is not making any decisions on behalf of the parties, but rather is acting as a facilitator by assisting the parties in reaching their own agreement.<sup>fn 31</sup>  
Investigative services include all forensic services not involving actual or threatened litigation such as performing analyses or investigations that may require the same skills as used in

litigation services. Such services would not impair independence provided the member complies with the general requirements set forth under this interpretation.

## Transition

Independence would not be impaired as a result of the more restrictive requirements of the forensic accounting services provisions, provided such services are pursuant to engagements commenced prior to February 28, 2007, and the member complied with all applicable independence interpretations and rulings in existence on February 28, 2007.

## Internal Audit Assistance Services

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as "internal audit outsourcing." In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational <sup>fn 32</sup> internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for <sup>fn 33</sup> directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

In addition to the general requirements of this interpretation, the member should ensure that client management:

- Designates an <sup>fn 34</sup> individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function;
- Determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services;
- Evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services; and
- Evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the member.

The member should also be satisfied that the client's board of directors, audit committee, or other governing body is informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide the client's governing body a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member is responsible for performing the internal audit procedures in accordance with the terms of the engagement and reporting thereon. The performance of such procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.

The following are examples of activities (in addition to those listed in the "General Activities" section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

### **Transition**

Independence would not be impaired as a result of the more restrictive requirements of interpretation 101-3, provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.

[Formerly paragraph .04, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective May 31, 1999, by the Professional Ethics Executive Committee. Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective December 31, 2003 (except for the documentation requirement, which takes effect for any new engagements that begin after December 31, 2004), with earlier application permitted, by the Professional Ethics Executive Committee. Revised, effective October 31, 2004, by the Professional Ethics Executive Committee. Revised, effective January 27, 2005, by the Professional Ethics Executive Committee.]

### **.06 101-4 — Honorary directorships and trusteeships of not-for-profit organization.**

Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be considered to impair independence under rule 101[ET section 101.01] provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or

she must be identified as an honorary director or honorary trustee. [Formerly paragraph .05, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly interpretation 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Renumbered as interpretation 101-4 and moved from paragraph .03, April, 1992. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## **.07 101-5 — Loans from financial institution clients and related terminology.**

Interpretation 101-1.A.4 [ET section 101.02] provides that, except as permitted in this interpretation, independence shall be considered to be impaired if a **covered member**<sup>fn †</sup> has any **loan** to or from a **client**, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests. This interpretation describes the conditions a covered member (or his or her **immediate family**) must meet in order to apply an exception for a "Grandfathered Loan" or "Other Permitted Loan."

### **Grandfathered Loans**

Unsecured loans that are not material to the covered member's net worth, home mortgages,<sup>fn 35</sup> and other secured loans<sup>fn 35</sup> are grandfathered if:

1. they were obtained from a financial institution under that institution's normal lending procedures, terms, and requirements,
2. after becoming a covered member they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement,<sup>fn 36</sup> and
3. they were:
  - a. obtained from the financial institution prior to its becoming a client requiring independence; or
  - b. obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or
  - c. obtained prior to February 5, 2001 and met the requirements of previous provisions of Interpretation 101-5 [ET section 101.07] covering grandfathered loans; or
  - d. obtained between February 5, 2001 and May 31, 2002, and the covered member was in compliance with the applicable independence requirements of the SEC during that period; or
  - e. obtained after May 31, 2002 from a financial institution client requiring independence by a borrower prior to his or her becoming a covered member with respect to that client

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.

For purposes of applying the grandfathered loans provision when the covered member is a partner in a partnership:

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

## Other Permitted Loans

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

1. Automobile loans and leases collateralized by the automobile.
2. Loans fully collateralized by the cash surrender value of an insurance policy.
3. Loans fully collateralized by cash deposits at the same financial institution (e.g., "passbook loans").
4. Aggregate outstanding balances from credit cards and overdraft reserve accounts that are reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period.

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

[Revised, November 30, 1987, by the Professional Ethics Executive Committee. Formerly paragraph .06, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References revised to reflect issuance of AICPA Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, November 1991, effective January 1, 1992 with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective February 28, 1998 by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, November 2002, by the Professional Ethics Executive Committee. Revised, September 2003, by the Professional Ethics Executive Committee.]

### **.08 101-6 — The effect of actual or threatened litigation on independence.**

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

#### **Litigation between client and member**

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

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

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.
2. The commencement of litigation by the covered member against the present management alleging management fraud or deceit would be considered to impair independence.

3. An expressed intention by the present management to commence litigation against the covered member alleging deficiencies in audit work for the client would be considered to impair independence if the auditor concludes that it is probable that such a claim will be filed.
4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered member's firm <sup>fn 37</sup> or to the client company <sup>fn 37</sup> would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

### **Litigation by security holders**

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

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered member in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered member's firm <sup>fn 38</sup> or to the client.
2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.
3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

### **Other third-party litigation**

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

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered member ("the plaintiff client"), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered member's firm <sup>fn 39</sup> or to the plaintiff client.

## **Effects of impairment of independence**

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

## **Termination of impairment**

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

[Formerly paragraph .07, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective September 30, 1995, by the Professional Ethics Executive Committee, by deletion of subhead and paragraph and reissuance as ethics ruling No. 100, Actions Permitted When Independence is Impaired, under rule 101. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## **[.09] [101-7] — [Deleted]**

[Formerly paragraph .08, renumbered by adoption of the Code of Professional Conduct on January 12, 1988.]

## **.10 101-8 — Effect on independence of financial interests in nonclients having investor or investee relationships with a covered member's client.**

### **Introduction**

Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in other rulings [ET section 191.138–.139, and .162–.163].

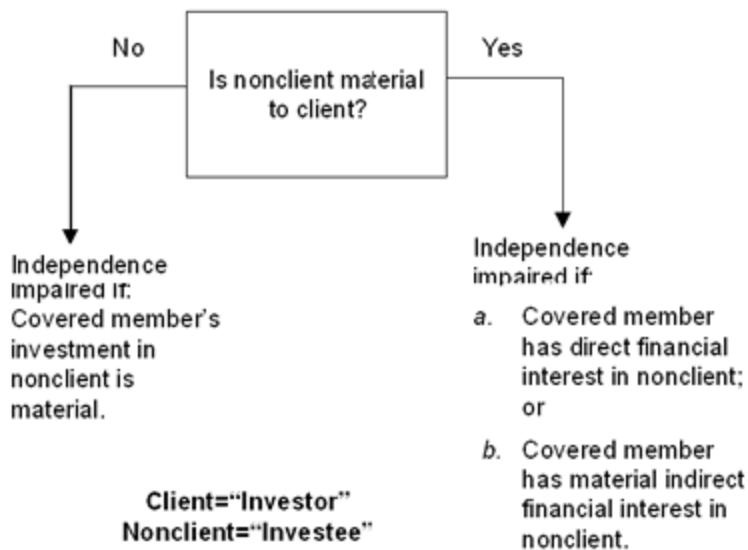
### **Terminology**

The following specifically identified terms are used in this interpretation as indicated:

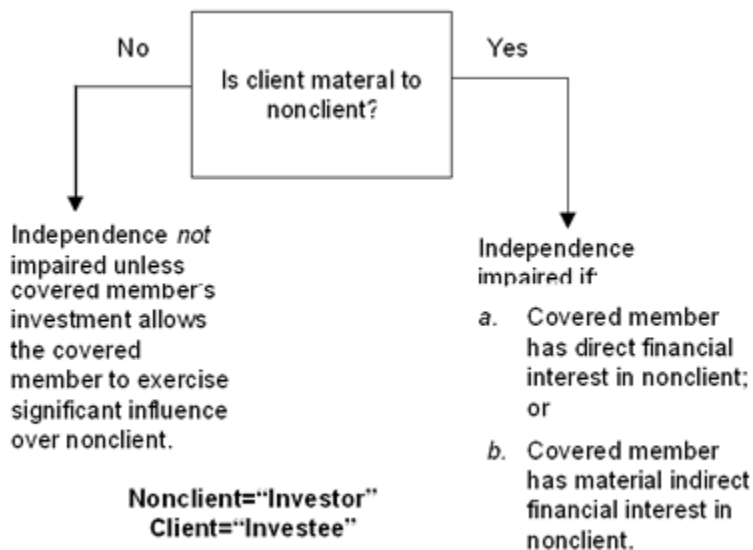
1. Client. The term client means the person or entity with whose financial statements a covered member is associated.
2. Significant Influence. The term significant influence is as defined in Financial Accounting Standards Board Accounting Standards Codification 323–10–15.
3. Investor. The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.
4. Investee. The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

### **Interpretation**

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



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



Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered member should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.

In general, in brother-sister common control situations, an immaterial financial interest of a covered member in the nonclient investee would not impair independence with respect to the client investee, provided the covered member could not exercise significant influence over the nonclient investor.



However, if a covered member's financial interest in a nonclient investee is material, the covered member could be influenced by the nonclient investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered member in the nonclient investor would not impair the independence of the covered member with respect to the client investor, provided that the covered member could not exercise significant influence over the nonclient investor.

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

[Revised, December 31, 1983, by the Professional Ethics Executive Committee. Formerly paragraph .09 renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-8, Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Member's Client, April 1991, effective April 30, 1991. Revised, December 31, 1991, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

### **[.11] [101-9] — [Deleted]**

### **.12 101-10 — The effect on independence of relationships with entities included in the governmental financial statements.** <sup>fn 40</sup>

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

#### **Auditor of Financial Reporting Entity**

A covered member issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity, as defined in paragraph 1 of this Interpretation. However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a member to be independent of that organization. However, the covered member and his or her immediate family should not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

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

A covered member who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, should be independent with respect to those financial statements that the covered member is reporting upon. The covered member is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered member and his or her immediate family should not hold a key position within the primary government. For purposes of this Interpretation, a covered member and immediate family member would not be considered employed by the primary government if the exceptions provided for in ET section 92.03 are met.<sup>fns 41-42</sup>

[Formerly paragraph .11, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-10, The Effect on Independence of Relationships Proscribed by Rule 101 and its Interpretations With Nonclient Entities Included With a Member's Client in the Financial Statements of a Governmental Reporting Entity, April 1991, effective April 30, 1991. Replaces previous interpretation 101-10, The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements, January 1996, effective January 31, 1996. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

### **.13 101-11 — Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements.**

Rule 101: *Independence* [ET section 101.01], and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are restricted to identified parties, only the following covered members, and their immediate families, are required to be independent with respect to the responsible party<sup>fn 43</sup> in accordance with rule 101 [ET section 101.01]:

- Individuals participating on the attest engagement team;
- Individuals who directly supervise or manage the attest engagement partner; and
- Individuals who consult with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.

In addition, independence would be considered to be impaired if the firm had a financial relationship covered by interpretation 101-1.A [ET section 101.02] with the responsible party that was material to the firm.

In cases where the firm provides non-attest services to the responsible party that are proscribed under interpretation 101-3 [ET section 101.05] and that do not directly relate to the subject matter of the attest engagement, independence would not be considered to be impaired.

In circumstances where the individual or entity that engages the firm is not the responsible party or associated with the responsible party, individuals on the attest engagement team need not be independent of the individual or entity, but should consider their responsibilities under interpretation 102-2 [ET section 102.03] with regard to any relationships that may exist with the individual or entity that engages them to perform these services.

This interpretation does not apply to an engagement performed under the Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, or to an examination or review engagement performed under the Statements on Standards for Attestation Engagements. [Replaces previous interpretation 101-11, Independence and Attest Engagements, January 1996, effective January 31, 1996. Revised, effective November 30, 2001, by the Professional Ethics Executive Committee.]

#### **.14 101-12 — Independence and cooperative arrangements with clients.**

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

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

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

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

- a. The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.
- b. The firm assumes no responsibility for the activities or results of the client, and vice versa.
- c. Neither party has the authority to act as the representative or agent of the other party.

In addition, the member's firm should consider the requirements of rule 302 [ET section 302.01] and rule 503 [ET section 503.01].

[Effective November 30, 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

#### **[.15] [101-13] — [Deleted]**

#### **.16 101-14 — The effect of alternative practice structures on the applicability of independence rules.**

Because of changes in the manner in which members<sup>fn ‡</sup> are structuring their practices, the AICPA's professional ethics executive committee (PEEC) studied various alternatives to "traditional structures" to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many "nontraditional structures," a substantial (the nonattest) portion of a member's practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled by the member. All such structures must comply with applicable laws, regulations, and Rule 505, *Form of Organization and Name* [ET section 505.01]. In complying with laws, regulations, and rule 505 [ET section 505.01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and

persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [ET section 505.01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the "traditional firm" engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and the chart below provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

The example APS in this interpretation is one where an existing CPA practice ("Oldfirm") is sold by its owners to another (possibly public) entity ("PublicCo"). PublicCo has subsidiaries or divisions such as a bank, insurance company or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (e.g., tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm ("Newfirm") to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

#### **APS Independence Rules for Covered Members**

The term covered member in an APS includes both employed and leased individuals. The firm in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

Partners of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

#### **APS Independence Rules for Persons and Entities Other Than Covered Members**

As stated above, the independence rules normally extend only to those persons and entities included in the definition of covered member. This normally would include only the "traditional firm" (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PEEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

1. **Direct Superiors.** Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can directly control the activities of such partner or manager. For this purpose, a person who can directly control is the immediate superior of the partner or manager who has the power to direct the activities of that

person so as to be able to directly or indirectly (e.g. through another entity over which the Direct Superior can exercise significant influence <sup>fn 44</sup>) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence <sup>fn 45</sup> are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

2. Indirect Superiors and Other PublicCo Entities. Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the **immediate family** of the Indirect Superior.

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement. Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

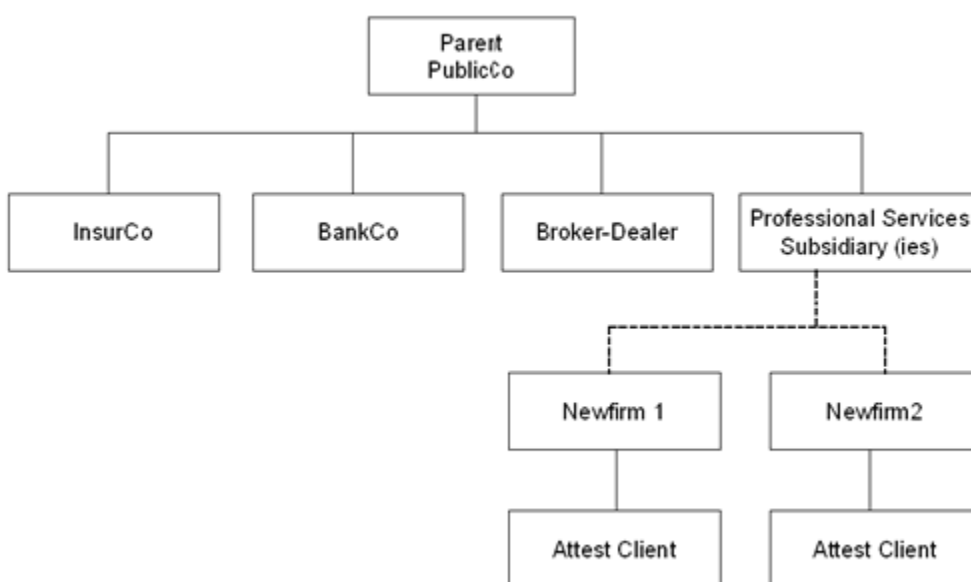
The rules for Indirect Superiors and Other PublicCo Entities are as follows:

- A. Indirect Superiors and Other PublicCo Entities may not have a relationship contemplated by interpretation 101-1.A [ET section 101.02] (e.g., investments, loans, etc.) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity's financial statements.
- B. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence <sup>fn 46</sup> over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.
- C. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.
- D. Except as noted in C above, Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

## Other Matters

1. An example, using the chart below, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.
2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an attest engagement for PublicCo or any of its subsidiaries or divisions.
3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence<sup>fn 47</sup> over PublicCo.
4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation 102-2, Conflicts of Interest [ET section 102.03]

## Alternative Practice Structure (APS) Model



[Effective February 28, 1999; Revised, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## .17 101-15 — Financial relationships.

### Financial Interests

Interpretation 101-1 [ET section 101.02A.1] states that independence shall be considered to be impaired if, during the period of the professional engagement, a covered member had or was committed to acquire any direct or material indirect financial interest in the client. When reviewing this interpretation, the covered member should also refer to Interpretation 101-1 [ET section 101.02] for the application of rule 101 and its interpretations and rulings to the covered member's immediate family and close relatives. This interpretation provides definitions of direct and indirect financial interests and further guidance on whether various types of financial interests should be considered to be direct or indirect financial interests and provides certain limited exceptions under which a covered member could hold a direct or material indirect financial interest in an attest client without being considered to have impaired his or her independence.

## Definitions

A **financial interest** is an ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

A **direct financial interest** is a financial interest:

1. Owned directly by an individual or entity (including those managed on a discretionary basis by others); or
2. Under the control <sup>fn 48</sup> of an individual or entity (including those managed on a discretionary basis by others); or
3. Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary:
  - a. Controls the intermediary; or
  - b. Has the authority to supervise or participate in the intermediary's investment decisions.

An **indirect financial interest** is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions.

A financial interest is **beneficially owned** when an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

## Unsolicited Financial Interests

Independence would not be considered to be impaired if an unsolicited financial interest in a client is received, such as through gift or inheritance, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the covered member has knowledge of and the right to dispose of the financial interest. In addition, when the covered member becomes aware that he or she will receive or has received a material direct or material indirect financial interest in a client requiring independence but does not have the right to dispose of the financial interest, independence would be considered to be impaired unless the covered member does not participate on the attest engagement team and disposes of the financial interest as soon as practicable but no later than 30 days after the right to dispose exists.

## Mutual Funds

The ownership of shares in a mutual fund is considered to be a direct financial interest in the mutual fund. The underlying investments of a mutual fund are considered to be indirect financial interests.

If the mutual fund is diversified, <sup>fn 49</sup> a covered member's ownership of 5 percent or less of the outstanding shares of the mutual fund would not be considered to constitute a material indirect financial interest in the underlying investments.

If a covered member owns more than 5 percent of the outstanding shares of a diversified mutual fund, or if the mutual fund is not diversified, the covered member should evaluate the underlying investments of the mutual fund to determine whether the covered member holds a material indirect financial interest in any of the underlying investments.

For example, if a nondiversified mutual fund owns shares in attest client Company A, and

- The mutual fund's net assets are \$10,000,000;
- The covered member owns 1 percent of the outstanding shares of the mutual fund, having a value of \$100,000; and
- The mutual fund has 10 percent of its assets invested in Company A

The indirect financial interest of the covered member in Company A is \$10,000 and this amount should be measured against the covered member's net worth (including the net worth of his or her immediate family) to determine if it is material.

### **Retirement, Savings, Compensation, or Similar Plans**

Depending upon the facts and circumstances, investments held in a retirement, savings, compensation, or similar plan may be considered a covered member's direct or indirect financial interests as follows: <sup>fn 50</sup>

- Investments held by a retirement, savings, compensation, or similar plan sponsored by a covered member's firm would be considered direct financial interests of the firm.
- If a covered member or his or her immediate family member self-directs the investments in a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan's investment decisions, the investments held by the plan would be considered direct financial interests of the covered member. Otherwise, the underlying plan investments would be considered indirect financial interests of the covered member.
- Investments held in a defined benefit plan would not be considered financial interests of the covered member unless the covered member or his or her immediate family member is a trustee of the plan or otherwise has the ability to supervise or participate in the plan's investment decisions.
- Allocated shares held in an employee stock ownership plan (ESOP) would be considered indirect financial interests that are beneficially owned until such time as the covered member or his or her immediate family has the right to dispose of the financial interest. Once the participant has the right to dispose of the financial interest, the financial interest is considered a direct financial interest.
- Rights to acquire equity interests, restricted stock awards, or other share-based compensation arrangements are considered direct financial interests, regardless of whether such financial interests are vested or exercisable.

The following examples illustrate these concepts:

- If a covered member or his or her immediate family member is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan's investment decisions (including through the selection of investment managers or pooled investment vehicles), the underlying investments would be considered to be direct financial interests of the covered member.
- If investments in a defined contribution plan are participant directed, whereby a covered member or his or her immediate family member selects his or her underlying plan investments or selects from investment alternatives offered by the plan, the underlying investments would be considered to be direct financial interests of the covered member.
- If investments in a defined contribution plan are not participant directed and the covered member or his or her immediate family member has no authority to supervise or participate in the plan's investment decisions, the underlying investments would be considered to be indirect financial interests of the covered member.

Also refer to ethics ruling No. 107 (ET section 191.214–.215), and the “Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated with a Client,” “Application of the Independence Rules to a Covered Member's Immediate Family,” and “Application of the Independence Rules to Close Relatives” sections of Interpretation No. 101-1 (par. .02).

### **Effective Date**

The revisions to the “Retirement, Savings, Compensation, or Similar Plans” section of Interpretation No. 101-15 (par. .17) are effective May 31, 2010.



## Section 529 Plans <sup>fn 51</sup>

Section 529 plans are sponsored by states or higher education institutions, and may be prepaid tuition plans or savings plans. Both types of plans are established by an account owner for the benefit of a single beneficiary. The account owner may change the beneficiary at any time to another individual who is related to the previous beneficiary.

A covered member who is the account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan but not in the investments of the plan because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the investment performance of the plan or the cost of the education at the future date.

A covered member who is the account owner of a Section 529 savings plan is considered to have a direct financial interest in both the plan and the investments of the plan because he or she decides in which sponsor's Section 529 savings plan to invest and prior to making the investment has access to information about the plan's investments.

If a covered member invests in a Section 529 savings plan that does not hold financial interests in an attest client at the time of the investment, but the plan subsequently invests in an attest client, the covered member should (1) transfer the account to another sponsor's Section 529 savings plan or (2) transfer the account to another account owner who is not a covered member. However, when the transfer of the account will result in a penalty or tax that is significant to the account, the covered member may continue to own the account until the account can be transferred without significant penalty or tax, provided the covered member does not participate on the attest engagement team and is not in a position to influence the attest engagement.

A covered member who is a beneficiary of a Section 529 account is not considered to have a financial interest in the plan or the investments of the plan because he or she does not own the account or possess any of the underlying benefits of ownership and the beneficiary's only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

Before becoming engaged to perform an attest engagement for a government or governmental entity that sponsors a Section 529 plan, covered members that are account owners of a Section 529 plan should consider the guidance in Interpretation 101-10, The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements [ET section 101.12].

## Trust Investments

When a covered member is a grantor of a trust, the trust and the underlying investments held by the trust are considered to be direct financial interests if the covered member retains the right to amend or revoke the trust, or otherwise has the authority to control the trust or to supervise or participate in the trust's investment decisions. However, where the covered member does not have the authority to amend or revoke the trust or to supervise or participate in the trust's investment decisions, he or she is not considered to have a financial interest in the trust or the underlying investments held by the trust.

When a covered member is a beneficiary of a trust, the trust is considered to be a direct financial interest of the covered member and the underlying investments held by the trust are considered to be indirect financial interests of the covered member. However, if the covered member controls the trust or supervises or participates in the investment decisions of the trust, the underlying investments held by the trust are considered to be direct financial interests of the covered member.

In a blind trust, the grantor is also the beneficiary, but does not supervise or participate in the trust's investment decisions during the term of the trust. However, the investments will ultimately revert to the grantor, and the grantor usually retains the right to amend or revoke the trust. Therefore, both the blind

trust and the underlying investments held in a blind trust are considered to be direct financial interests of the covered member.

See Interpretation 101-1 [ET section 101.02A.2] and ethics ruling No. 11 [ET section 191.021–.022] for additional guidance on trustee relationships.

## **Partnerships**

The ownership of a general or limited partnership interest is considered a direct financial interest in the partnership.

The financial interests held by a partnership are considered to be direct financial interests of a covered member that is a general partner because the covered member is in a position to control the partnership or to supervise or participate in the partnership's investment decisions.

The financial interests held by a limited partnership are considered to be indirect financial interests of a covered member who is a limited partner as long as the covered member does not control the partnership or supervise or participate in the partnership's investment decisions. However, if the covered member has the ability to replace the general partner or has the authority to supervise or participate in the partnership's investment decisions, the financial interests of the partnership would be considered to be direct financial interests of the covered member.

See Interpretation 101-1 [ET section 101.02A.3] for additional guidance on joint closely held investments and Interpretation 101-8 [ET section 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

## **Limited Liability Companies**

The ownership of an interest in a limited liability company (LLC) is considered a direct financial interest in the LLC.

In an LLC, members who are managers control the LLC and have the authority to supervise or participate in the LLC's investment decisions. Accordingly, if a covered member is a manager of the LLC, the financial interests of the LLC are considered to be direct financial interests of the covered member. If a covered member is a member but not a manager of the LLC, the covered member should look to the operating agreement of the LLC to determine whether he or she can control the LLC or has the authority to supervise or participate in the investment decisions of the LLC. If the covered member does not control the LLC, or have the authority to supervise or participate in the LLC's investment decisions, the financial interests held by the LLC would be considered to be indirect financial interests of the covered member.

## **Insurance Products**

An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered to be a financial interest. Accordingly, if a covered member owns an insurance policy issued by an attest client, independence is not considered to be impaired, provided the policy does not offer the policy holder an investment option and the policy was purchased under the insurance company's normal terms, procedures, and requirements. If a mutual insurance company begins the demutualization process, covered members who hold an insurance policy from the company should refer to the guidance contained in the "Unsolicited Financial Interests" section of this Interpretation.

Some insurance policies offer an investment option whereby the policy owner may choose to invest part of the cash value in a variety of underlying investments. The underlying investments of this type of insurance policy are considered to be a financial interest, and the covered member should apply the guidance in this interpretation to determine whether the underlying investments are direct or indirect

financial interests. For example, if the covered member has the ability to select the underlying investments or the authority to supervise or participate in the investment decisions and the cash value of the insurance policy is invested in a mutual fund, the mutual fund is considered to be a direct financial interest and the underlying investments of the mutual fund are considered to be indirect financial interests.

See Interpretation 101-1 [ET section 101.02A.3] for additional guidance on joint closely held investments and Interpretation 101-8 [ET section 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

[Effective December 31, 2005.]

## **Interpretation No. 101-17, "NETWORKS AND NETWORK FIRMS"<sup>52</sup>**

### **General**

To enhance their capabilities to provide professional services, firms frequently join larger groups, which typically are membership associations that are separate legal entities that are otherwise unrelated to their members. The associations facilitate their members' use of association services and resources; they do not themselves typically engage in the practice of public accounting or provide professional services to their members' clients or to other third parties. Firms and other entities in the association cooperate with the firms and other entities that are members of the association to enhance their capabilities to provide professional services. For example, a firm may become a member of an association in order to refer work to, or receive referrals from, other association members. That characteristic alone would not be sufficient for the association to constitute a network or for the firm to be considered a network firm. However, an association would be considered a network under this interpretation if one or more additional characteristics of a network are shared, in addition to cooperation among member firms [ET section 92.28]. These additional characteristics are discussed further in this interpretation.

A network firm is required to be independent of financial statement audit and review clients of the other network firms if the use of the audit or review report for the client is not restricted, as defined by professional standards. For all other attest clients, consideration should be given to any threats the firm knows or has reason to believe may be created by network firm interests and relationships. If those threats are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. The independence requirements apply to any entity within the network that meets the definition of a *network firm* [ET section 92.29].

Whether an association is a network and whether an entity is a network firm should be applied consistently by all members of the association. Due consideration should be given to what a reasonable and informed third party would be likely to conclude after weighing all the specific facts and circumstances. The determination that a firm or other entity or an association of firms or other entities meets the definition of a *network firm* and a *network*, as herein defined, is solely for purposes of this interpretation and should not be used or relied upon in any other context. In particular, the determination of whether a firm or other entity is a network firm or an association of firms or other entities is a network for purposes of defining legal responsibilities from one firm to the other, or to third parties, is beyond the scope of this interpretation. The definitions contained herein should not be used or relied upon for that purpose.

### **Characteristics of a Network**

#### ***Sharing Common Brand Name***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the members of the association or entities controlled by members

of the association share the use of a common brand name or share common initials as part of the firm name, the association is considered to be a network.

A firm that does not use a common brand name as part of its firm name but makes reference in its stationery or promotional materials to being a member of an association of firms should carefully consider how it describes that membership and take steps to avoid the perception that it belongs to a network. The firm may wish to avoid such a 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."

### ***Sharing Common Control***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association are under common control (as defined by generally accepted accounting principles in the United States of America) with other firms in the association through ownership, management, or other means (for example, by contract), it is considered to be a network. However, compliance with association requirements as a condition of membership does not indicate that members are under common control; rather, it reflects the type of cooperation that is expected when an entity joins the association.

### ***Sharing Profits or Costs***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the firms share profits or costs, the association is considered to be a network. However, the sharing of immaterial costs or costs related to operating the association does not by itself create a network. In addition, the sharing of costs related to the development of audit methodologies, manuals, and training courses does not by itself create a network. Further, an arrangement between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not by itself create a network.

### ***Sharing Common Business Strategy***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association share a common business strategy, the association is considered to be a network. Sharing a common business strategy involves ongoing collaboration amongst the firms whereby the firms are responsible for implementing the association's strategy and are held accountable for performance pursuant to that strategy. An entity's ability to pursue an alternative strategy may be limited by the common business strategy because, as a member, it must act in accordance with the common business strategy and, therefore, in the best interest of the association. An entity is not considered to be a network firm merely because it cooperates with another entity solely to market professional services or respond jointly to a request for a proposal for the provision of a professional service.

### ***Sharing Significant Professional Resources***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association share a significant part of professional resources, it is considered to be a network.

Professional resources include:

- common systems that enable firms to exchange information, such as client data, billing, and time records;
- partners and staff;
- technical departments to consult on technical or industry specific issues, transactions, or events for assurance engagements;

- audit methodology or audit manuals; and
- training courses and facilities.

The determination of whether the shared professional resources are significant should be made based on both qualitative and quantitative factors.

When the entities within the association do not share a significant amount of human resources or significant client information (for example, client data, billing, and time records) and have the ability to make independent decisions regarding technical matters, audit methodology, training, and the like, the entities are not considered to be sharing a significant part of professional resources.

When the shared professional resources are limited to a common audit methodology, audit manuals, training courses, or facilities, and when they do not include a significant amount of human resources or client or market information, the shared professional resources are not considered significant. However, when the shared professional resources involve the exchange of client information or personnel, such as when staff are drawn from a shared pool, or a common technical department is created within the association to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared professional resources are significant. An entity generally is not deemed a network because it occasionally uses personnel of another member firm to assist with an engagement, such as observing a client's physical inventory count.

### ***Sharing Common Quality Control Policies and Procedures***

When the association is formed for the purpose of cooperating to enhance the firms' capabilities to provide professional services and when the entities within the association are required to follow common quality control policies and procedures monitored by the association, it is considered to be a network. *Monitoring* is the process comprising an ongoing consideration and evaluation of the firms' systems of quality control, the objective of which is to enable the association to obtain reasonable assurance that the firms' systems of quality control are designed appropriately and operating effectively. [Effective for engagements covering periods beginning on or after July 1, 2011.]

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Footnotes (ET Section 101 — Independence):

<sup>fn \*</sup> Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, Definitions. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

<sup>fn 1</sup> This provision applies once the individual has terminated his or her relationship with the client and is no longer employed by, or otherwise associated with, the client. See Interpretation No. 101-1(C) (par. .02) for matters involving a partner or professional employee who is simultaneously employed by, or otherwise associated with, the client and the firm. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 2</sup> As defined in the Financial Accounting Standards Board *Accounting Standards Codification* glossary under the term *share-based payment arrangements*. [Footnote moved and revised by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 3</sup> When the member is a former employee of a governmental unit that is one of the sponsors of an employee benefit plan, the member may continue to participate in the governmental plan if his or her current employer is also one of the sponsors of the plan. In such circumstances, a covered member's participation in the plan will not impair independence, provided that the plan is offered to all employees in comparable employment positions and the covered member has no influence or control over the investment strategy, benefits or other management activities associated with the plan and is required to continue his or her participation in the plan as a condition of employment. See Ethics Ruling No. 107 (ET section 191.214–.215) for further information. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 4</sup> A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed, or market losses that may be incurred, as a result of the liquidation or transfer. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 5</sup> Excluding share-based compensation arrangements and nonqualified deferred compensation plans. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 6</sup> *Unavoidable consequence* means that the immediate family member has no investment options available for selection, including money market or invested cash options, other than in an attest client. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 7</sup> When legal or other similar restrictions exist on a person's right to dispose of a financial interest at a particular time, the person need not dispose of the interest until the restrictions have lapsed. For example, a person does not have to dispose of a financial interest in an attest client if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not fall within this exception. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 8</sup> See Interpretation No. 101-15 (par. .17) for an explanation of when a financial interest is beneficially owned. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 9</sup> See footnote 7. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 10</sup> See Interpretation No. 101-15 (par. .17) for guidance on stock option plans. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 11</sup> See footnote 7. [Footnote added by the Professional Ethics Executive Committee, March 2010.]

<sup>fn §</sup> In April 2006, the Professional Ethics Executive Committee (PEEC) of the AICPA issued the *Conceptual Framework for AICPA Independence Standards (Conceptual Framework)* [ET section 100.01], which describes the risk-based approach to analyzing independence matters that is used by PEEC when it develops independence standards. Consequently, this interpretation has been revised in the "Other Considerations" section to reflect the issuance of the *Conceptual Framework*. Because the *Conceptual Framework* [ET section 100.01] is effective April 30, 2007, with earlier application encouraged, the revisions made in the "Other Considerations" section of this interpretation are also effective April 30, 2007, with earlier application encouraged.

<sup>fn 12</sup> A failure to prepare the required documentation would be considered a violation of Rule 202, *Compliance With Standards* [ET section 202.01], of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 13</sup> An inadvertent and isolated failure to meet conditions 4, 5, and 6 would not impair independence provided that the required procedures are performed promptly upon discovery of the failure to do so and all other provisions of the interpretation are met. [Footnote added, effective April 30, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 14</sup> A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* [AR section 100.19]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 15</sup> A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202, *Compliance With Standards* [Rule 202.01], provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote revised, January 2005, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 16</sup> However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client. [Footnote added, effective October 31, 2004, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 17</sup> Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered

and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 18</sup> Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time, and is built into the normal recurring activities of an entity; these activities include regular management and supervisory activities. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 19</sup> [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September, 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote deleted by the Professional Ethics Executive Committee, February 2007. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 20</sup> When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 21</sup> For purposes of this interpretation, a tax return includes informational tax forms (for example, estimated tax vouchers, extension forms, and Forms 990, 5500, 1099 and W-2) filed with a taxing authority or other regulatory agencies. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 22</sup> Making electronic tax payments under a taxing authority's specified criteria or remitting a check payable to the taxing authority and signed by the client would not be considered having custody or control over a client's funds. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 23</sup> The term *court* encompasses a tax, district, or federal court of claims, and the equivalent state, local, or foreign forums. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 24</sup> Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 25</sup> The definitions of the specific services identified in this interpretation are solely for purposes of this interpretation and are not intended to be used for any other purpose. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 26</sup> In determining whether the member's services are considered to be expert witness services or fact witness testimony, members should refer to the Federal Rules of Evidence, Article VII, Opinions and Expert Testimony (Rules 701, 702 and 703), and other applicable laws, regulations, and rules. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 27</sup> See advocacy threat as defined in the Conceptual Framework for AICPA Independence Standards (ET section 100-1). However, even though there is an appearance of advocacy, when providing expert witness services, a

member must comply with Rule 102, *Integrity and Objectivity*, which requires that a member maintain objectivity and integrity and not subordinate his or her judgment to others. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 28</sup> The client in this case refers to the party to the litigation on whose behalf the member is providing testimony and not to the law firm that engaged the member on the client's behalf. If the law firm that engaged the member on behalf of the client is also an attest client of the member, the member should consider the applicability of Interpretation 101-12, "Independence and Cooperative Arrangements with Clients." [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 29</sup> A fact witness is also referred to as a percipient witness or a sensory witness. Fact witness testimony is based on the member's direct knowledge of the facts or events in dispute. A fact witness may have obtained his or her direct knowledge of the facts or events in dispute from the performance of prior professional services for the client. As a fact witness, the member's role is to provide factual testimony to the trier of fact. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 30</sup> For purposes of complying with general requirement 2, the client may designate its attorney to oversee the litigation consulting services. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 31</sup> However, the member should consider the requirements of Interpretation 102-2, "Conflicts of Interests" [ET section 102.03]. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 32</sup> For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 33</sup> [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote deleted and subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 34</sup> [Footnote deleted by the Professional Ethics Executive Committee, January 2005. Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn †</sup> Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, *Definitions*.

<sup>fn 35</sup> The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered member's net worth. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 36</sup> Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral or revised or waived covenants. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of



interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 37</sup> Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment. [Footnote renumbered and revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 38</sup> See footnote 37. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently revised and renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 39</sup> See footnote 37. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently revised and renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 40</sup> Except for a financial reporting entity's basic financial statements, which is defined within the text of this Interpretation, certain terminology used throughout the Interpretation is specifically defined by the Governmental Accounting Standards Board. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 41-42</sup> [Footnotes deleted by the Professional Ethics Executive Committee, March 2003. Footnotes renumbered by the revision of interpretation 101-2, April 2003. Footnotes subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnotes subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnotes subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnotes subsequently renumbered by the revision of interpretation 101-3, February and July 2007. Footnotes subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 43</sup> As defined in the SSAEs. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn ‡</sup> Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, Definitions. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. ]

<sup>fn 44</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently

renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 45</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 46</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 47</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 48</sup> When used herein, the term *control* includes situations where the covered member, individually or acting together with his or her firm or with other partners or professional employees of his or her firm, has the ability to exercise such control. [Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 49</sup> To determine if the mutual fund is diversified, the covered member should refer to (1) the mutual fund's prospectus to see if the prospectus discloses that the fund is *not* diversified or (2) Section 5(b)(1) of the Investment Company Act of 1940. [Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

[<sup>fn 50</sup>] [Footnote deleted and renumbered by the Professional Ethics Executive Committee, March 2010.]

<sup>fn 51</sup> However, a covered member who is an employee of a governmental organization that is required by law or regulation to audit a Section 529 plan sponsored by a governmental unit will be permitted to be an account owner in

the plan for a period not to exceed one year from the effective date of this Interpretation. [Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote subsequently renumbered by the revision of interpretation 101-1, March 2010.]

<sup>fn 52</sup> Members may review the implementation guidance issued by the Ethics Division regarding this Interpretation No. 101-17. This guidance may be found on the AICPA website.

# Case Study Questions

In all of these scenarios, “you” are assumed to be a CPA licensed in Virginia. Unless specific questions are presented at the end of each scenario, please review and answer the following questions in each case:

- What is the ethical dilemma?
- How does consideration of the ethical model steps and questions help?
- Is there an overriding issue that bothers you about the scenario?
- What can you do? What should you do? What are you obligated to do?

1. You are a manager at a public accounting firm. You proposed on a new review engagement and created a budget of the engagement to help in creating the proposed fees that are fixed. The partner cut 20 percent off the price that was created based on the budget to “win the job,” which you did. She now instructs you to take the budget you created and cut 20 percent of the related budgeted hours in each area. This is not uncommon with her.

Your firm is meticulous about creating budgets, recording actual time spent based on the detailed budget breakdown and measuring “realization” on engagements. Additionally, realization is one of the metrics your firm uses in evaluating its professionals and is a factor in determining promotions and raises. Also, many managers use “budget to actual” as a supervision tool, as they receive very timely reports on all of their jobs. If a job’s realization is low, they investigate.

The staff who typically work with you (and this partner) sometimes get discouraged about the budget practices, and you hear rumblings of a few staff “eating time,” which, ironically if true, helps your jobs look better in terms of realization. When you confronted one staff member about it, he did not want to talk about it, but did say he did not see the downside of eating time and did not see how it would hurt the firm. You feel something is wrong here and want to do “the right thing.”

2. You are supervising a compliance audit, and the staff person who will be working with you joined the organization just two months ago. Typically, when you supervise a brand-new staff who is both new to you and relatively new to the organization, you supervise them very closely and your review is exhaustive to ensure the quality of their work is up to the audit standards, your organization’s standards and your personal standards of quality.

In this case, because of poor time management and scheduling by the entire team, you do not have enough time to review all of the staff’s work in a detailed manner, and you mention this to your supervisor. She says that she has worked with this staff on his first two audits and that the staff does “excellent” work, and advises you to just do a more general review because of the timing of the project.

3. You are supervising an audit on a manufacturing client, and the staff is new to your firm and the engagement. You work at a national accounting firm. Typically, when you supervise a brand-new staff who is both new to you and relatively new to the firm, you supervise them very closely and your review is exhaustive to ensure the quality of their work is up to the audit standards, your firm’s quality control standards and your personal standards of quality.

In this case, because of poor time management and scheduling by the entire team, you do not have enough time to review all of the staff’s work in a detailed manner, and you mention this to the manager on the job. The manager says that he has worked with this staff on his first two jobs and that the staff does “excellent” work, and advises you to just do a more general review because of the timing of the project.

4. You are a manager working on a small audit engagement. Only you, the partner and a staff (unknown at this time) will work on the engagement. Your firm has served this client for many years. The partner wants the planning, which is all done by you, completed as soon as possible, and he says that he will not participate in the "fraud brainstorming" session. It is obvious he is a key team member, and his participation is required under the SASs. You have reminded him of this requirement, and he tells you everything that he would add is already in last year's work papers and that he will sign off on the work. It is obvious he will not budge. He says he understands your desire to take a new look, but that he does not have the time to participate and doesn't see the need. He also says this is "between you and me." This type of action is very unusual for this partner, as you have always known him to encourage high-quality work.
5. You work for an internal audit department, and the Chief Internal Auditor has approved the audits and scopes for 2011. Your organization acquired a smaller company a few years back and you know the two people who comprise the accounting staff who work for that division. You know them because each had interviewed to work for another organization where you had previously worked. In both cases, they were not hired because "through the grapevine," some negative rumors were circulating, including questions about their "moral fiber." Later, you learn that the CIA is dating one of these two people. During the discussions of the new year's audit scopes, you were taken back how this division was not going to be made part of any type of audit despite being informally "flagged" by your team.
6. You and a friend have decided to create a CPA firm that will be providing accounting, attest and tax services. Some of the names you are considering are:

Clean Opinions, Inc.  
Bourne and Webb, CPAs  
National Accountants, LLP

What considerations should be made with each, and are they acceptable based on the Code?

7. You are extremely well versed on the Code of Professional Conduct and are the CFO of a small start-up company that is performing really well. You are asking for bids on an audit that will be needed for your next round of funding. You notice one of the proposing firms labels itself as "Member AICPA," but you remember one of the partners joking with you that he had to fire his secretary because she was bad at remembering important things for him, such as renewing his AICPA membership and state licenses, and now he has "to get out from under what she forgot and become current on his memberships."
8. You are a financial auditor and are assigned to an audit of a new software development company and have been asked by the team to complete the information technology (IT) risk assessment forms and checklists. You know little about IT, but you know more than anyone else on your team. The partner tells you to do the best you can and she'll make sure it gets reviewed by the right people. There is one manager in your firm who understands IT risks well and the partner usually gets him to review the work, but you heard from another of your colleagues that this manager and partner have been at odds lately because the firm will not hire more employees who are trained in information systems and is unwilling to outsource any of the work or hire a specialist. You are extremely frustrated because you know this will not be easy and you will have to learn a lot on the go. You know you will not be able to adequately assess the total impact of IT on this client so you talk to the manager about getting some assistance, and he starts to complain about your partner immediately and says he will look at your work "if he can get to it."
9. You are reviewing some work a colleague has performed and one of the audit steps involved comparing an investment price to an outside source. You double-check the price against the outside source and notice that the work was incorrect, so you ask your colleague about it during your review. After some thought, he tells you he forgot to do the step that was in question.

You have never known this person to do unsatisfactory work in the past. However, upon further review, you notice other steps in the review that could not have possibly been done in the manners described in the review program and memos signed off by this staff.

10. You work at a nonprofit as the only member of their small accounting department, and you were just hired last month. The organization has a very small board of directors and a very small staff. The board only meets once a quarter and the meetings are very short and completely run by the executive director. This nonprofit owns a small thrift store with two employees, which is profitable and provides the organization with a few benefits. It serves as a source of additional funding, providing about 10 percent of total revenues for most years. It also provides training opportunities for clients of the organization, which provides training and work for those who are victims of domestic violence.

You notice that the executive director, who visits the store on occasion, takes some of the nicest clothes home with her. You questioned her about it and asked how that should be accounted for and she said it is "immaterial" and "customary."

11. During the planning of an audit of a small finance company, you calculate materiality based on a percentage of assets, which is the typical way it is done both at your firm and in the industry. This client has a loan with a small local bank and they are extremely tight with their debt covenant calculations. Almost any proposed adjusting journal entry that would negatively impact earnings would affect key ratios and cause the client to miss their debt covenants and potentially default on their loan. How should this affect your approach, both in terms of the materiality calculation, the extent of work you will do, and the fees you may charge?

Additionally, assume your team calculated materiality last year in the standard way and reviewed materiality at the end of the audit and concluded planning materiality was sufficient. However, you have uncovered along with the client some adjustments that should have been booked last year. (Neither party discovered them last year.) Such adjustments may have pushed the company closer to non-compliance with their debt covenants and "may" have affected your final review of materiality as insufficiently high. The CFO is a seasoned CPA and knows that an adjustment to materiality this year may cause the company to slightly miss compliance. She is strongly abdicating a similar approach this year despite you both knowing that is not a judgment in which she has any say.

12. You are an entrepreneur with an interest in several businesses. One thing you do is provide tax return services for individuals during tax season. During the preparation of a simple tax return, you learn that one individual client is a bookie. When you confront him about it, he confesses and says he has just started it this year and wants to report the income from this new business on his tax return.

You have zero experience in dealing with something like this from a tax or legal standpoint. Where should you go, what resources should you utilize and what is your responsibility here?

13. You work at a federal government agency in the Inspector General's (IG) office and you were assigned to audit a large contract (more than \$5 million) that was awarded to a local government contractor. Under the Federal Acquisition Regulations (FAR), the company under audit must have their own internal formal codes of business ethics where they must establish a business ethics awareness program within 90 days after award. Everything goes smoothly in the audit. However, several weeks after you completed your work on that audit, you receive an anonymous call on your cell phone where an obviously upset employee of that contractor makes a complaint about the CEO, saying he did not attend the program training and instead had someone else sign in for him. This person did not leave their name, and you have no idea how he got your cell phone number. Your last day at this government agency was last Friday and you are now retired.

14. You are at a happy hour and you are introduced to someone by a friend of yours. You talk to this new person for a few minutes and notice that he has been drinking (alcohol) at a very fast rate. He learns you are a CPA and starts to fill you in about a scam that he has been perpetrating. He is on the Board of Directors of his condo association and he created a letter which was addressed to tenants that levied an additional "special assessment" condo fee to fix the roof for the large amount of snow that was on the roof in the prior year. He said he only delivered the letter to the tenants he thought he could dupe and the checks are being mailed to a P.O. Box he created. He is excited about it and asks you for your opinion about how he can ensure he is careful not to get caught. You are absolutely flabbergasted for a number of reasons. While you have your doubts about his scam, you wonder what you should do.

15. You are the manager on an audit of a small client, and the CFO approaches you one day and says:

(NOTE: The following statements are mutually exclusive, meaning we'd like you to consider them on their own and separately from the other two statements.)

"It would be great if I could get someone like you to work here and help me out."

"If you were ever interested in coming to work here, all you would have to do is let me know and I would make it happen."

"I am not offering formally, but informally, I would love to know if you would ever be interested in working here. I don't want to lose you on the audit team, so I know the rules say we can't talk numbers, but what kind of number would it take to get you to work here?"

Based on the statement, do you feel independence might be impaired?

16. You are a controller at a private organization, and the CFO approaches you about the opening you have for assistant controller. There is a senior who works on your external audit and you both think highly of her. The CFO wants you to approach her about coming to work for you, but he does not want to lose her on the engagement if she is not interested. (The CFO believes there could be an independence impairment that might force her to leave the job if this is not done right.)

What do you do? What options are available to you?





# VBOA Handouts



<p style="text-align: center;"><b>Virginia-Specific Ethics Course 2011 Outline</b></p>
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**A. Updates on regulatory developments**

(45-60 minutes\*)

1. Virginia Board of Accountancy (VBOA) Regulatory update
  - New Accountancy Regulations
    - ◊ Summary of Key Changes (handout from the VBOA will be provided)
  - Practical aspects for maintaining licensure (handout from the VBOA will be provided)
    - ◊ CPE requirements
    - ◊ License renewal
    - ◊ Providing updated contact information
  - Handouts of actual VBOA enforcement cases (relevant cases)
2. SSARS Codification effective December 15, 2010
3. Circular 230 – Registration requirement for tax preparers

**B. Core Content**

(60 - 75 minutes\*)

These topics should be covered by referring to relevant AICPA Code of Professional Conduct sections. Practical situations and potential solutions must be included and illustrated with short scenarios or simulations.

1. Required:
  - Planning and Supervision – ET Section 201, Rule 201.01 (C) of the AICPA Code of Professional Conduct
  - Form of Organization and Name – ET Section 505, Rule 505.01 of the AICPA Code of Professional Conduct
2. One of following three is required:
  - Due Professional Care – ET Section 56, Article V and ET Section 201, Rule 201.01 (B) of the AICPA Code of Professional Conduct
  - Public Interest – ET Section 53, Article II of the AICPA Code of Professional Conduct
  - Independence – ET Section 100, Rule 101 of the AICPA Code of Professional Conduct

**C. Process for ethical decision-making**

(5 minutes)

Handout should be provided – suggested resources. \*\*

<p style="text-align: center;"><b>Virginia-Specific Ethics Course 2011 Outline</b></p>
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**For Participants:**

If the participant is not satisfied with the content of this course, the instructor, or does not believe that the course satisfies the requirements of this outline, the participant is encouraged to contact the VBOA at [boa@boa.virginia.gov](mailto:boa@boa.virginia.gov), or by calling (804) 367-0728.

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**For CPE Providers:**

**Note:** CPE providers must provide a copy of this outline to each participant. It is recommended that CPE providers make cases and other materials available to participants in advance, e.g., by posting them on provider websites.

\*Time allocations are suggestions only. However, for 2011 an emphasis on the VBOA's regulatory changes must be a top priority of this course. Times allocated to the Core Content subjects may vary depending on the appropriate emphasis for the target audience (e.g., CPAs in public practice versus CPAs in private industry or government).

\*\*Links to ethical decision-making models:

[www.ethics.org](http://www.ethics.org)

[www.rotaryfirst100.org/history/headings/4-way\\_ethics.htm](http://www.rotaryfirst100.org/history/headings/4-way_ethics.htm)

[www.ethicsworld.org](http://www.ethicsworld.org)

[www.scu.edu/ethics/practicing/decision](http://www.scu.edu/ethics/practicing/decision)

**Important:** CPE providers should urge participants to monitor the VBOA website for updates and information regarding the VBOA. CPE providers should also urge licensees to register with the Virginia Town Hall to receive automated VBOA regulatory updates ([www.townhall.state.va.us/index.cfm](http://www.townhall.state.va.us/index.cfm)).

A copy of this outline must be presented to each participant prior to the class.

# Virginia Board of Accountancy (VBOA)

## Practical Aspects for Maintaining Licensure

### CPE Requirements

A licensee's CPE requirements depend on how he is using or plans to use the CPA designation. There are three basic categories of CPE requirements.

The three categories are:

1. **Any person using the CPA title to provide services to the public** must complete a minimum of 120 CPE credit hours over each 3-year rolling-cycle, with a minimum of 20 CPE credits per year *(including an ethics course of at least two hours for each of the calendar years in that period)*.
2. **Any person using the CPA title to provide services for an employer or other organization and not for the public (or is employed as an educator in the field of accounting)** must complete a minimum of 120 CPE credit hours over each 3-year rolling-cycle, with a minimum of 20 CPE credits per year *(including an ethics course of at least two hours for each of the calendar years in that period)*.
3. **Any CPA licensee who is not performing or offering to perform any of the services described in VBOA regulations is not required to meet CPE requirements (if not performing or offering to perform for the entire year)**. However, any CPA that chooses to resume work and perform services as described in the VBOA regulations must complete the required CPE prior to providing such services and to continue use of the CPA designation.

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Will the VBOA accept this class/certification/prep course as CPE?

- Effective 10/6/99 the VBOA no longer required CPE providers to obtain approval to conduct CPE classes in Virginia.
- The subject matter of the CPE is left up to the individual CPA. As long as the CPA receives a certificate of completion that clearly shows the name of the course provider, name of the course, date(s) of the course and the number of CPE credits awarded, it will qualify as valid CPE credit.
  - The VBOA conforms to the nationally generally accepted guideline that one credit hour of continuing professional education consists of 50 minutes of instruction.
  - When selecting CPE classes, it is important to remember that the VBOA defines CPE as: **the education that a person obtains after passing the CPA examination and that relates to services provided to an employer in academia, government, or industry using the CPA title or to services provided to the public using the CPA title.**

The provider does not issue CPE credits for the course; will the VBOA grant CPE credit?

Please be aware that the VBOA itself does not pre-approve, or verify, any course or seminar as qualifying for CPE at this time. The certificate of completion must include the number of CPE credits awarded by the provider.

# Virginia Board of Accountancy (VBOA)

## Practical Aspects for Maintaining Licensure

### License Renewal

Do I have the correct amount of CPE to renew my license?

When renewing your license you must attest to the fact that you met your CPE requirements for the CPE reporting cycle in question. The CPE reporting cycle is ALWAYS the three CPE reporting years immediately preceding the current year – therefore, at renewal, you must have already obtained the required number of CPE. The CPE reporting year is based on a calendar year – you have between January 1 and December 31 of each year to obtain the required minimums; however, you must have the total required CPE at the end of each three-year rolling cycle (including 2 hours of Virginia specific Ethics CPE each year).

I did not receive my renewal notice, what should I do?

The VBOA sends courtesy renewal notices 30 days prior to your license expiration; however, ***failure to receive notice does not relieve the regulant of the requirement to renew and pay the required fee.*** The date the VBOA receives the renewal fee shall determine whether other fees are payable. Late fees or reinstatement fees shall not be refunded or waived.

### Providing Updated Contact Information

Each regulant shall notify the VBOA in writing within 30 days of any change of physical address, email address or name. Failure to provide updated contact information could result in your inability to receive any critical email notices (e.g., CPE audit selection notification, renewal notices, etc.) from us.

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Lastly, it is **important** to note that ultimately the CPA is responsible for his compliance by adhering to the VBOA statutes and regulations. Familiarize yourself with the VBOA regulatory requirements!

## Enforcement Cases 2011 Outline for Virginia-Specific Ethics Course

The following cases were adjudicated by the Virginia Board of Accountancy (VBOA) as a result of the Board's enforcement process:

SUMMARY OF VIOLATIONS	RATIONALE	BOARD ACTION	DATE CLOSED
<p><b><u>CASE #1</u></b>  <u>CONSENT ORDER</u>  <u>\$54.1-4413.3 and 18VAC5-21-120 (A), (C), (M)</u></p> <p>Fraud, embezzlement, and criminal activity against the firm of which the Respondent was a member.</p>	<p>The Respondent diverted \$294,000 in payments intended for his firm for personal use through a personal bank account. The Respondent deceived the firm's clients into thinking they were retaining the firm and proceeded to set up files and worked clients "off the books" of the firm by diverting, endorsing and cashing payments from these clients which were made payable to the firm.</p> <p>The firm learned of this criminal act while the Respondent was on vacation. A check made payable to the firm was hand-delivered by the client. An investigation revealed the check was from a party who did not appear in their client records; however, it referenced a firm invoice number and instructed the individual to forward payment to a PO Box. Upon further investigation, the firm learned that the client had been led to believe they were engaging the firm for services. This client ignored the directive to mail the payment to the PO Box because it was aware of the firm's business address.</p>	<p>The Board suspended the Respondent's license for 5 years and imposed the following terms and conditions by way of Consent Order:</p> <ol style="list-style-type: none"> <li>1. Return the wall certificate.</li> <li>2. Provide proof to the Board in writing that all clients have been notified that the VBOA has suspended the CPA license for a period of no less than five years.</li> <li>3. Remove all indications of the CPA designation.</li> <li>4. Pay a monetary penalty of \$25,000 within 90 days.</li> </ol>	<p>9/11/2009</p>

## Enforcement Cases 2011 Outline for Virginia-Specific Ethics Course

SUMMARY OF VIOLATIONS	RATIONALE	BOARD ACTION	DATE CLOSED
<p><b><u>CASE #2</u></b>  <u>CONSENT ORDER</u>  <u>18VAC5-21-170 B (1)</u>            CPE deficiency.</p>	<p>The Respondent was selected for CPE Audit and submitted 6 hours of CPE credits for the 2006-2008 reporting cycle. The Respondent was practicing and providing services for an employer in California using his Virginia CPA license.</p>	<p>The Board imposed a monetary penalty of \$2,500 to be paid in 90 days, completion and submission of the missing 84 CPE hours, certify having read and understood the regulations and statutes, submission of a 1,000 word essay entitled "How Continuing Professional Education Protects the Public in Virginia" and understanding that failure to comply with the provisions of the Consent Order will result in the automatic suspension of the CPA License.</p>	<p>9/25/2009</p>
<p><b><u>CASE #3</u></b>  <u>CONSENT ORDER</u>  <u>§54.1-4413.3 (1-4)</u>            Respondent admitted to committing an act that is discreditable to the profession by transferring \$20,000 into a personal bank account without the required authorization from the executive staff of the employer.</p>	<p>A self reported violation of a CPA operating as Treasurer of a non-profit organization. The CPA electronically transferred funds into a personal bank account due to financial hardship. The CPA believed her actions were justified because it was common practice among the staff members to obtain "loans." The intent was to repay the "loan" before management became aware. A partial payment was made; however, the Respondent's financial situation worsened and she was unable to make any additional repayments.</p> <p>In August 2008, the Respondent gave notice to the organization that she could no longer continue employment with the firm because the personal ethics of the Respondent had been compromised.</p>	<p>For the failure to uphold the standards of conduct for Respondents by committing acts discreditable to the profession and by the Respondent's own admission of compromising personal ethics, the Board determined the Respondent's license should be suspended for a period of not more than five (5) years. The Respondent shall provide proof of repayment in full prior to applying for reinstatement of the CPA License.</p>	<p>10/05/2009</p>



## Enforcement Cases 2011 Outline for Virginia-Specific Ethics Course

SUMMARY OF VIOLATIONS	RATIONALE	BOARD ACTION	DATE CLOSED
<p><b><u>CASE #4</u></b>  <u>CONSENT ORDER</u>  <u>\$54.1-4413.3 and 18VAC5-21-120 (A), (C), (M)</u>            Fraud, embezzlement, and criminal activity against the firm of which the Respondent was an employee.</p>	<p>The Respondent was employed as Director of Finance with access to all bank accounts and financial info for her employer. In addition, she was granted check writing privileges and signatory authority. The Respondent wrote unauthorized checks totaling \$15,347.02 payable to a personal AMEX account using the firm's monies. The Respondent was charged with "Embezzlement deemed Larceny" and indictment of an unclassified felony.</p>	<p>The Board ordered the immediate surrender of the Respondent's CPA License and be subject to the following terms and conditions:</p> <ol style="list-style-type: none"> <li>1. Return the wall certificate.</li> <li>2. Pay a monetary penalty of \$1,500 within 90 days.</li> <li>3. License placed on suspension for a period of 5 years.</li> <li>4. Remove all indications of the CPA designation.</li> </ol>	<p>10/15/2009</p>
<p><b><u>CASE #5</u></b>  <u>CONSENT ORDER</u>  <u>\$54.1-111, \$54.1-4409.1 and \$54.1-4414</u>            Unlicensed Activity - Use of the CPA designation by an individual with an expired license.</p>	<p>The expired license holder used the CPA designation on his employment application and on the company website. The expired license holder stated he called the VSCPA in 1987 and was told as long as he kept up his CPE and did not actively provide any public accounting services he could use the designation, as he would be in an "inactive status."             He contacted the wrong entity and received incorrect information (according to him). He should have familiarized himself with the VBOA regulations and contacted the VBOA with any additional questions.</p>	<p>The Board found the Respondent in violation and imposed a monetary penalty of \$5,000. Respondent was instructed to remove all signage and designations until he was duly licensed by the Board. The Respondent is currently licensed.</p>	<p>11/28/2009</p>

## Enforcement Cases 2011 Outline for Virginia-Specific Ethics Course

SUMMARY OF VIOLATIONS	RATIONALE	BOARD ACTION	DATE CLOSED
<p><b><u>CASE #6</u></b>  <u>CONSENT ORDER</u>  <u>\$54.1-4413.3 (4)</u></p> <p>Inappropriate and improper actions in the preparation of the client's tax returns.</p>	<p>The Respondent filed an incorrect tax return on behalf of a client. Enclosed in the package with the client's returns were copies of Federal and State returns for another individual. In addition, the following errors were determined: omission of investment management fees, the omission of one of two solar rebates, and errors filing the client's out of state tax return.</p>	<p>The Board imposed a reprimand, a monetary penalty of \$500 and proof of completion of not less than 8 hours of CPE training in "Tax Administration".</p>	<p>12/15/2009</p>
<p><b><u>CASE #7</u></b>  <u>CONSENT ORDER</u>  <u>\$54.1-111, \$54.1-4409.1 and</u>  <u>\$54.1-4414</u></p> <p>Unlicensed Activity - The Respondent continued to practice on an expired CPA license while practicing and providing service for the public.</p>	<p>The Respondent was using the CPA title by referring to herself as a CPA on business cards to practice and provide service for the public after her license expired on April 30, 2005. A cease &amp; desist was forwarded to the Respondent and was immediately signed and hand delivered to the VBOA office. The Respondent stated she had relied on the email notification from the Board as a renewal reminder and when her firm changed its email format and domain name, she failed to update her contact information with the VBOA. As a result, she did not receive the courtesy renewal reminder and failed to renew her CPA license prior to its expiration.</p>	<p>The Board found the Respondent in violation and imposed a monetary penalty of \$6,000. Respondent was instructed to remove all signage and designations until she was duly licensed by the Board. The Respondent is currently licensed.</p>	<p>12/15/2009</p>



# New Accountancy Regulations

Effective September 16, 2010

## Summary of Key Changes

*Virginia Board of Accountancy (VBOA)*



### Accountancy Statutes

- Chapter 44 (§ 54.1-4400 et seq.) of Title 54.1, Code of Virginia
- Comprehensively revised effective July 1, 2007

### Accountancy Regulations

- To conform with the 2007 revisions of the accountancy statutes, the regulations were replaced with new regulations effective September 16, 2010.
- The new regulations are in Chapter 22 of Agency 5, Title 18 of the Virginia Administrative Code (18VAC5-22).

January 2011

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## Changes to the Regulations

- Made compliance easier and provide flexibility.
- Reduced the regulations from 26 pages to 9.
- Conformed the language of the regulations to the revised accountancy statutes.
- Clarified guidance in prior regulations carried forward.
- Eliminated outdated wording and inconsistencies.
- Eliminated definitions: all definitions are contained in one place in the accountancy statutes.
- Did not change fees.

January 2011

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## Changes to the Regulations, continued

- Summary of Key Changes only looks at some of the new regulations.
- A separate Overview of the Accountancy Regulations that became effective September 16, 2010:
  - Presents each of the 17 sections of the new regulations and a general explanation of each section and
  - Provides in an appendix the framework for determining when a holder of a Virginia license is required to obtain continuing professional education, including a roadmap and practical illustrations.

January 2011

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## When a License Is Required

- A person uses the CPA title in Virginia, or
- Attest services or compilation services are provided to persons or entities located in Virginia.
  - Only a firm can provide attest or compilation services to persons or entities located in Virginia per § 54.1-4412.1, Code of Virginia.
  - A firm can be comprised of one person (i.e., sole proprietor). If providing attest or compilation services, the person must have both an individual and a firm license.

January 2011

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## Persons or Entities Located in Virginia 18VAC5-22-30

- A person is considered to be located in Virginia if his primary residence for federal income tax reporting is located in Virginia.
- An entity is considered to be located in Virginia if it conducts any activities in Virginia.

January 2011

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## Providing Services While Using the CPA Title 18VAC5-22-40

- A person must have a license to use the CPA title.
- If a person uses the CPA title, the public has the expectation that the CPA is currently licensed.
- Passing the CPA examination without obtaining a license does not allow a person to use the CPA title. To do so is considered unlicensed activity and subject to enforcement actions (including monetary penalties) by the Board.
- Persons using the CPA title in Virginia must comply with the standards of conduct and practice prescribed by § 54.1-4413.3, Code of Virginia.
- Holding a Virginia license constitutes using the CPA title in Virginia.

January 2011

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## Providing Services While Using the CPA Title, continued

- A person who holds a Virginia license:
  - Is providing services to the public using the CPA title if he provides services that are subject to the guidance of the standards-setting authorities listed in the standards of conduct and practice in § 54.1-4413.3, subdivisions 5 and 6, Code of Virginia.
  - Is providing services to an employer using the CPA title if he provides to an entity services that require the substantial use of accounting, financial, tax, or other skills that are relevant, as determined by the Board.
- Whether a person who holds a Virginia license is subject to the continuing professional education requirement depends on whether he provides services, rather than whether he tells the person or entity for whom he provides services that he is a CPA.

January 2011

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## Principal Place of Business 18VAC5-22-50

- Reasonable judgment is required to determine whether Virginia is the principal place of business.
- The determination:
  - Should be based on facts and circumstances;
  - Can be based on quantitative or qualitative assessments;
  - Can be based on revenues, number of clients, or other factors; and
  - Does not change due to temporary fluctuations.
- An individual is subject to the accountancy statutes and regulations if:
  - His principal place of business is not in Virginia and
  - He provides services to persons or entities in Virginia.

January 2011

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## Required Education 18VAC5-22-70

- New regulation makes permanent the temporary regulation that was effective May 14, 2009.
- Taking the CPA examination requires obtaining from an accredited institution or the National College:
  - At least 120 semester hours of education;
  - A baccalaureate or higher degree; and
  - An accounting concentration or equivalent.
- Licensure requires 150 semester hours of education.

January 2011

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## Continuing Professional Education (CPE) 18VAC5-22-90

- There is no change to:
  - Total number of hours of CPE required;
  - Amount of CPE that may be obtained from preparing and making presentations - maximum of 30 hours for each 3 calendar-year period;
  - Amount of CPE that may be obtained through writing material that is relevant, formally reviewed, and published (no limit); and
  - An hour of CPE is generally accepted nationally to consist of 50 minutes.
- New 18VAC5-22-140 requires persons who release or authorize the release of reports on attest services or compilation services to obtain at least 8 hours each year of CPE related to attest services or compilation services (beginning in calendar year 2011). This does not increase the total number of hours of CPE required.

January 2011

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## CPE, continued

- Whether a person who holds a Virginia license is subject to the CPE requirement depends on whether he provides services, rather than whether he tells the person or entity for whom he provides services that he is a CPA.
- A licensee who did not provide services to the public using the CPA title or to an employer using the CPA title during the current calendar year, for example, because of retirement or a career “break”:
  - Is not required to have obtained CPE during the 3 calendar-year period ending with the current calendar year;
  - Can still use the CPA title; and
  - Is subject to a catch-up provision before beginning to provide services.

January 2011

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## CPE, continued

- Depending on the facts and circumstances, taking the annual ethics course acceptable to the board of accountancy of another state in which the individual holds a license may be sufficient.
- When in doubt regarding CPE, consult with the VBOA staff.

January 2011

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## Experience Qualifications

### 18VAC5-22-100

- Requires that experience be obtained over a period that is the full-time equivalent of one year and does not specify a minimum number of hours over a prescribed period.
- Clarifies the Board's intention that the experience must involve the substantial use of accounting, financial, tax, or other skills that are relevant.
- Clarifies the Board's intention that experience be obtained through mentoring and that self-employment experience of any type does not qualify.

January 2011

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## Owners of Firms Who are Not Licensed 18VAC5-22-130

- Must participate in the firm's activities on a regular, continuous, and substantial basis.
- Determination should be based on facts and circumstances.

January 2011

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## Persons Who Release or Authorize the Release of Reports on Attest Services or Compilation Services 18VAC5-22-140

- Eliminates the previous additional one-year experience requirement.
- Requires these persons to obtain at least 8 hours each year of CPE related to attest services or compilation services. This does not change the amount of CPE required. The hours obtained are considered in determining whether the person has complied with the CPE requirements of 18VAC5-22-90.

January 2011

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## Persons Who Release or Authorize the Release of Reports on Attest Services or Compilation Services, continued

- Firms must establish policies and procedures regarding competencies these persons should possess:
  - Technical proficiency;
  - Familiarity with the industry and the person or entity;
  - Skills that indicate sound professional judgment; and
  - Other competencies necessary under the circumstances.

January 2011

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## Monitoring Program and Peer Review 18VAC5-22-150

- Requires the firm to comply with all components of the monitoring program in which it is enrolled.
- When requested, firms must provide proof of enrollment in a monitoring program and copies of reports and other documentation related to acceptance of their peer reviews (18VAC5-22-170).

January 2011

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## Confidential Consent Agreements 18VAC5-22-160

- The Board has the option of entering into a confidential consent agreement if the violation:
  - Was not intentional misconduct;
  - Was not the result of gross negligence; and
  - Did not have a significant financial impact on persons or entities.
- There can be no more than two additional confidential consent agreements with the person or firm within ten years after the first confidential consent agreement.
- The Board is not required under any circumstances to enter into a confidential consent agreement.

January 2011

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## Communication Between the Board and Licensees 18VAC5-22-170

- Establishes 3 categories of requests for information that require compliance:
  - Support for the conclusion that the person or firm has complied with the requirements of applicable statutes and regulations;
  - Proof of a firm's enrollment in a monitoring program and copies of reports and other documentation related to acceptance of its peer review; and
  - Documents related to the Board's investigation of the possible violation by a person or firm of provisions of the accountancy statutes or regulations.

January 2011

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## Communication Between the Board and Licensees, continued

- Establishes the presumption that renewal notices will be transmitted electronically unless a person is unable to communicate electronically.
- Clarifies that the accountancy statutes place the responsibility for renewing a Virginia license on its holder and that responsibility is not affected by whether the holder receives a license renewal notice.

January 2011

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## VBOA Contact Information

- 9960 Mayland Drive, Suite 402, Henrico, Virginia 23233
- (804) 367-8505 (office)
- (894) 527-4409 (fax)
- [boa@boa.virginia.gov](mailto:boa@boa.virginia.gov) (email)
- [www.boa.virginia.gov](http://www.boa.virginia.gov) (website)
- Office hours are 8:15 AM to 5:00 PM, Monday through Friday, with the exception of state holidays

January 2011

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# PowerPoint Presentation





# Ethics 2011 — Your License Depends on It!

 Virginia Society of  
Certified Public  
Accountants



December 20, 2010



***Auditors Face  
Fraud Charge  
New York Set to Allege  
[Auditors] Stood By as  
Lehman Cooked Its Books***  
*From The Wall Street Journal*



August 7, 2010

***H-P Chief  
Quits in  
Scandal***

*From The Wall  
Street Journal*



December 1, 2010



***[Public  
Accounting Firm]  
Partner, Wife Face  
Insider-Trading  
Charges***

*From The Wall Street Journal*



August 16, 2010

***Cleansing the  
People's House  
2 Senior Members  
Facing Ethics Trials***  
*From Time magazine*



**October 26, 2010**



*One whistleblower  
gets \$96 million  
in connection with  
GlaxoSmithKline  
\$750 million  
settlement with U.S.  
Justice Department*



**What Is  
Ethics?**



**“Sometimes you have to do  
the right thing even when  
doing the wrong thing would  
be a whole lot easier.”**

— *30 Rock*, NBC

## ***Let's Get Ethical!***

**“Ethics is a real discussion  
of the competing  
conceptions of the good.”**

— Oscar, *The Office*, NBC

## Defining Ethics

- CPAs must use judgment in performing their jobs.
- Everyone has a different definition of ethics and what is “morally correct.”
- We cannot give you “ethics,” but we can update you on the “principles” and “rules” and challenge you to ask ethically-based questions and make the best (educated) decisions you can.



## Ethics

- Rules
- Principles
- Moral dilemmas that may or may not be covered in the rules and principles
- Regulatory updates (license)



## Outline of Class

- Review new regulations from the VBOA
- Review requirements for maintaining your licensure
- Review recent VBOA enforcement cases
- Update on:
  - SSARS Codification, Circular 230, and other recent developments
- Participate in case studies referenced from the AICPA *Code of Professional Conduct*



## New Virginia BOA Regulations

- All BOA Regulations were replaced with new regulations effective September 16, 2010.
  - 18VAC5-21 was repealed.
  - 18VAC5-22 became effective on September 16, 2010.
  - New regulations are shorter in length because of new references to statutes.





## Clarification of Certain Definitions

- Certain issues further clarified:
  - Persons or entities (clients) located in Virginia
  - The distinction between providing services to the public using the CPA title and providing services to an employer using the CPA title
  - If a principal place of business (individual or firm) is in Virginia
  - If a college or university is an accredited institution.



## New Regulations Breakout

- Regulations now have separate sections for:
  - Education                    **18VAC5-22-70**
  - Examination                **18VAC5-22-80**
  - CPE                            **18VAC5-22-90**
  - Experience                  **18VAC5-22-100**





## New Regulations — Experience

- Self-employment will not meet the experience requirement.
- Experience does not need to be verified by a licensed CPA.



## Additional Highlights

- CPAs practicing under substantial equivalency do not need to notify the VBOA.
- Firms are now provided latitude to establish their own policies to provide the firm with reasonable assurance about the competency of those persons who release or authorize the release of reports (attest and compilation).
  - Such persons must annually obtain a minimum of 8 CPE hours related to attest and compilation services.



# Licensing Requirements

**License**

1. DEFINITION  
permission

## John Paul Video



Virginia Society of  
Certified Public  
Accountants



## Using the CPA Title

- Per 18VAC5-22-40, by virtue of the public information contained on the VBOA website about licensees, you are “using the CPA title” if you are licensed and provide services that are either:
  - subject to standard setting authorities recognized by the VBOA, or
  - at a job that requires the substantial use of accounting, financial, tax, etc. skills



## Additional Highlights

- VBOA has been granted authority to waive peer review requirement or grant additional time to comply.
- Regulations define “minor” violations under the Confidential Consent Agreements (allowed under § 54.1-4413.5 in lieu of disciplinary action).
- Regulations consolidate into one section all information that may be requested/required by CPAs/firms from VBOA.



## Wendy Video



## Circular 230 — History

- IRS placed all signing and non-signing tax return providers under Treasury Circular 230.
- IRS required all individuals who sign a federal tax return as a paid tax return preparer to register, obtain a PTIN and pay a registration fee.
- New tax CPE requirements will not apply to CPAs (exempted) or to anyone employed by a CPA who has a valid PTIN.



## Circular 230 Update

- IRS issued Notice 2011-6 in December 2010 that allows non-CPAs (“supervised nonsigning preparers”) to obtain a PTIN and prepare a tax return or claim for refund if the individual:
  - Is supervised by a registered CPA who signs the tax returns
  - Employed at the CPA firm
  - Passes the forthcoming IRS required tax compliance check and suitability check



## e-File Mandate

- Effective for 2011 filings, all tax preparers that, in aggregate (as an organization), anticipate filing 100 or more 1040, 1040A, 1040EZ and 1041s during the year must e-file OR
- Request an undue hardship waiver (Form 8944) OR
- Have clients who don't want to e-file check box 1 and send in Form 8948 with their return.



## SSARS

An accountant must perform a compilation or review of a nonpublic entity in accordance with Statements on Standards for Accounting and Review Services (SSARS) as issued by the Accounting and Review Services Committee (ARSC).



## SSARS 19 and Codification

- SSARS 19 became effective for periods ending on or after December 15, 2010.
  - This includes “SSARS Codification,” which revised, reorganized and superseded various sections of the existing SSARS and is designed to make the guidance more friendly.
  - Codification, along with the various changes to be implemented from SSARS 19, will first be “used” during busy season 2011.



## SSARS Codification

“New” SSARS separates reviews and compilations:

- Section 60: SSARS Framework
- Section 80: Compilations
- Section 90: Reviews

SSARS 19 integrated within these sections.





## AICPA (PEEC) Ethics Codification

- Launched initially in December 2008 and expected to take three to five years
- Expected to have topical layout and new numbering sequence, and improved search functions (technology)
- Expected to include ongoing “convergence” with *Code of Professional Accountants* (IESBA)



## AICPA (PEEC) Ethics Codification

- Expected to utilize more of a conceptual framework approach, similar to:
  - Conceptual Framework for AICPA Independence Rules adopted in 2006 (ET 100-1)
  - IESBA *Code of Professional Accountants*





## AICPA (PEEC) Ethics Codification

- During the November 2010 meeting, the PEEC:
  - Approved a proposed framework that will form the basic structure of the codification
  - Targeted September 2012 as the completion date of the codification project



## Other PEEC Activities Planned for 2011

- Clarify the meaning and intent of “establishing or maintaining internal controls” as used in Interpretation 101-3 and the Independence Conceptual Framework.
- Monitor IFAC Code and consider additional guidance for members in business and industry regarding whistle-blowing and illegal/fraud acts.



## Other PEEC Activities Planned for 2011

- Define “an affiliate” of an attest client.
- Modernize confidential client information guidance (rule 301).



## International Ethics

- Revised Code of Ethics for Professional Accountants is effective January 1, 2011.
  - Certain exceptions where Code provisions are effective later: public interest entity definition, certain partner rotation guidelines, etc.



## GAO “Yellow Book” Changes

- Government Audit Standards 2010 Exposure Draft (GAO-10-853G) makes changes to the last “Yellow Book” revision issued July 2007.
  - Comment period ended November 22, 2010.
  - Includes a conceptual framework for independence (threats and safeguards), reordering of the “book,” and other changes
  - [www.gao.gov/yellowbook](http://www.gao.gov/yellowbook)



## SEC/PCAOB

- Current focus is on regulation of broker-dealers
  - Proposed temporary rule for an interim inspection program



## Ethical Decisions

- ***Making an Ethical Decision***
  - An ethical decision-making model provided by Santa Clara University (Markkula Center for Applied Ethics)



## Making an Ethical Decision

- Recognize an ethical issue
- Get the facts
- Evaluate alternative actions
- Make a decision and test it
- Act and reflect on the outcome



## Case Study Topics

- Required:
  - Planning and Supervision ET Section 201, Rule 201.01(c) of AICPA Code of Professional Conduct
  - Form of Organization and Name — ET Section 505, Rule 505.01 of AICPA Code



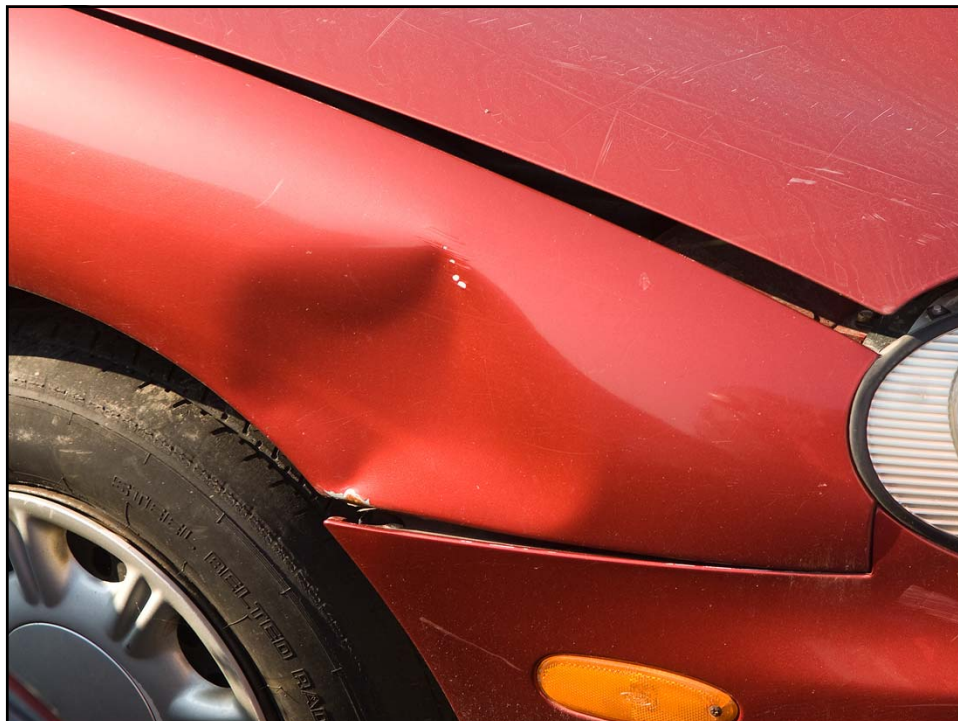
## Case Study Topics

- One of the following three is required:
  - Due Professional Care — ET Section 56, Article V and ET Section 201, Rule 201.01(b) of AICPA Code
  - Public Interest — ET Section 53, Article II of AICPA Code
  - Independence — ET Section 100, Rule 101 of AICPA Code



## When facing an Ethical Dilemma

- What is your state of mind or mood?
- How are you viewing the situation?
  - Examples:
    - Are you seeing only two answers?
    - Are you in a place where you see the world as abundant or do you see scarcity?
    - Is there an emotion that you can name when you think about options?





## Ethical Actions

- To sense an ethical dilemma and dismiss it
- To stick up for something you believe in when others are dismissing the situation as “not a big deal”
- To state a truth, even when it makes you look bad
- To hope it “goes away”

**“The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.”**

— ET 51.02

**“Even the most rational approach to ethics is defenseless if there isn't the will to do what is right.”**

— Alexander Solzhenitsyn



## Closing Comments

- Ensure your license is up to date at: [boa.virginia.gov](http://boa.virginia.gov).
- Reference page 5 of the participant manual to contact the appropriate organization if you have further questions.
- Check for new updates at [www.vscpa.com/ethicscourseupdates](http://www.vscpa.com/ethicscourseupdates) or [townhall.virginia.gov](http://townhall.virginia.gov).
- Complete the evaluation that will be e-mailed to you shortly. We appreciate all feedback!



## The End

**Since this is an Ethics Class,  
we should point out that  
John Paul and Wendy are not  
real accountants. They are  
actors playing accountants.**



# Conclusion

Ensure you have checked the status of your personal CPA license (and firm license, if applicable) at the VBOA website at [boa.virginia.gov](http://boa.virginia.gov).

If you have any additional questions, contact one of the organizations listed on page 5.

Please complete the related evaluation that will be sent to you via e-mail. We appreciate any and all feedback you can provide about this class. Your feedback helps us to make improvements in subsequent classes.

Check for new updates at [www.vscpa.com/ethicscourseupdates](http://www.vscpa.com/ethicscourseupdates).

# Appendix I



>> QUICK QUESTIONS

DOES EVERYONE UNDERGO A CPE AUDIT?

Nope. Audits are randomly selected by the VBOA each month. If selected, you will receive an electronic notification requesting CPE certificates for your three-year reporting cycle.

IS THERE ANY EASY WAY TO KEEP TRACK OF MY COMPLETED CPE COURSES?

Definitely. Use the "CPE History" tool under "CPE" at [www.vscpa.com](http://www.vscpa.com). The VSCPA will automatically track all courses you take from the VSCPA, including Virginia ethics. To keep a complete history, you can add other, outside courses or self-study programs to your personalized "CPE History" tool. The "CPE History" system is approved by the VBOA as proof of attendance for VSCPA events.

WHAT IF MY EMPLOYER KEEPS TRACK OF MY IN-HOUSE CPE FOR ME? WILL THE VBOA ACCEPT THIS REPORT INSTEAD OF CERTIFICATES?

Yes. An employer's report on in-house CPE is acceptable if it contains all required information: name of course provider, title and description of course, date of program and number of CPE credits awarded.



## Pass your CPE audit with flying colors

Did you know that many CPAs who undergo a CPE audit from the Virginia Board of Accountancy (VBOA) are reprimanded for failure to obtain the required Virginia ethics course and/or failure to maintain the required documentation? Usually, the Virginia ethics course requirement is CPAs' Achilles' heel — many forget about it or take a course that didn't qualify.

Don't let this happen to you! Follow the below suggestions:

**KNOW YOUR REQUIREMENTS:** Your CPE requirement depends on how you are using or plan to use the CPA designation regardless of public or private practice. Visit the VBOA website at [www.boa.virginia.gov](http://www.boa.virginia.gov) to make sure you know your CPE requirements.

**SATISFY YOUR ETHICS REQUIREMENT:** All active, licensed CPAs who provide services to the public or to an employer using the CPA title must sit for the 2-hour Virginia ethics course every year. It is the responsibility of the CPA to ensure the course meets the VBOA's content outline. Visit the "Ethics" section under "CPE"

at [www.vscpa.com](http://www.vscpa.com) for information on the VSCPA's course, which does meet the VBOA outline.

**KNOW YOUR CPE REPORTING CYCLE:** Every CPA's CPE reporting cycle is the three calendar years immediately preceding the current year. Example: For the 2011 CPE reporting cycle, make sure you have records of CPE taken in 2008, 2009 and 2010.

**KEEP YOUR CERTIFICATES:** If you are selected for a CPE audit, you must send the VBOA copies of the certificates you received after completing CPE courses for the three-year reporting cycle. ■



# Appendix II





# Scripts for Videos

INT. OFFICE-DAY

JOHN PAUL (30's) sits at a desk drinking a cup of coffee.

Hi there, my name is John Paul, my friends call me John Paul!!!!!! 'Cause they're goofy like that. I'll tell you a little bit about myself. I was in public accounting earlier in my career. Before that I did some catalogue modeling for Costco. That's not really relevant to this, but I think it creates a more three-dimensional picture of who I am. Anyway, I'm off topic.

So I was in public accounting and now I'm a controller at a real estate project. I know, it's kind of a big deal. I'm definitely going places in life. The thing is, I don't use my CPA title anywhere! I don't put it on my business card, or on my resume. Heck, I don't even take the certificate out from under my water bed.

My question is, I want to keep my license renewed but I don't want to take the required CPE since I am not using my title. Is that okay?

INT. OFFICE-DAY

Same desk.

WENDY

Let's say, hypothetically speaking, if someone were to make a complaint to the Board of Accountancy about me.

Maybe I forgot to send this tax return in for an ex-boyfriend — I mean client, ex-client, who paid me to do their taxes. Although, I'm not sure if a trip to Applebee's constitutes payment, but he did let me order whatever I wanted, which was nice for a change. We didn't really date, to be honest. It was a more of a one-time thing, two-time thing. Anyway, the complaint obviously has no merit.

TEXT: If someone makes a complaint to the VBOA against you, does it become part of your record no matter what?



# Appendix III



# “Law” v. “Regulations” — Background for Trainers

## Understanding the difference and relationship between the Law and the Regulations that are applicable to Virginia CPAs.

### The Law

The Virginia General Assembly passes laws under the Code of Virginia, also known as the statutory law. They are currently presented as Titles 1 through Title 67, though some are superseded.

The applicable title here is: *Title 54.1 PROFESSIONS AND OCCUPATIONS*.

Under Title 54.1, the last chapter is *Chapter 44 Public Accountants*.

Currently, this Chapter is composed of many sections (“§”):

§ 54.1-4400 Definitions — § 54.1-4423 Use of consultants in investigations

These can be found on the Virginia General Assembly Legislative Information System website:  
<http://leg1.state.va.us/>

The Virginia Board of Accountancy (“VBOA”), 7 members appointed by the Governor for four year terms, was established under this law and is provided many responsibilities, powers, duties, etc., including:

- Restricting the practice of public accounting and the use of the CPA title in Virginia
- Enforcing the chapter (54.1) and by regulation, establishing rules and procedures for the implementation of the chapter (54.1).

Thus, the VBOA creates the Board of Accountancy Regulations (“Regs”). The VBOA also has input into statutory changes.

### The Regs

The most current regulations became effective September 16, 2010, and are located on the VBOA website at [boa.virginia.gov](http://boa.virginia.gov).

Regulations that are set up in Virginia are done so under the Virginia Administrative Code, organized into 24 titles. The applicable title is Title 18: Professional and Occupational Licensing

Title 18 is organized into many different agencies. The applicable agency is Agency 5: Board of Accountancy

Under Agency 5, there are only two active Chapters:

- Chapter 11: Public Participation Guidelines
- Chapter 22: Board of Accountancy Regulations

The applicable regulations are organized as 18VAC5-22. A copy of the regulations is provided to you in the file: “Instructor 1 — VBOA regulations 18VAC5-22.pdf”

Many times, the regulations are created as a stipulation in the Law where certain powers or duties are provided to the VBOA and the specifics are then promulgated in the regulations. For example, § 54.1-4403: General powers and duties of the Board grants the VBOA with the power to “Levy and collect fees for the issuance, renewal, or reinstatement of Virginia licenses that are sufficient to cover all expenses of the administration and operation of the Board.” Thus, the specific fees are provided in the VAC, specifically in this case: **18VAC5-22-20. Fees.**

CPAs are always responsible for complying with both the Code and the Regulations. Also, statute trumps regulations when the regulations have not caught up yet. The new regulations (September 2010) were voluminous, but not necessarily substantive. Though it took a while, they were actually part of the “fast-track” process.

Regulations can be passed in one of three forms:

- Standard Regulatory Process — for substantive changes
- Emergency Regulations — Promulgated if there is an “emergency situation” and typically will be replaced with a permanent regulation later; effective upon filing with the Registrar for Regulations. On May 21, 2009, for example, emergency regulations were passed to lower the hours of education needed to sit for the exam from 150 to 120 to “Commonwealth remain competitive.”
- Fast Track Regulations — for proposed regulations that are expected to be non-controversial

See more details at <http://townhall.virginia.gov/um/charts.cfm>

## Ice-Breakers

### Jokes

#### MOM AND POP ACCOUNTING FIRM

So there is a small accounting firm. A mom and pop shop, literally. A husband and wife provide personal income tax services to their clients and on this day their only son, Johnny Jr, is coming to the office for the first time to see what Mommy and Daddy do! So he is all excited, only six years old and he gets dressed up in his little suit and travels into the office with Dad. Mom had to visit a client for the morning, so she is out of the office.

A few minutes into his office visit, a nice elder lady comes into the office because she likes to personally pick up her hardcopy tax return and mail it. So she gets introduced to Johnny Jr and when she is exiting she writes the check and hands it over to the little boy as she leaves.

Johnny Jr looks at the check in a concerned way and his Dad asks him, “What is the matter?”

Johnny Jr. says, “Daddy, Daddy, that nice lady gave us a check and I think she messed up.”

Johnny Sr says, “What do you mean?”

And Johnny Jr replies, “This check was made for \$3,000 when I think she was only supposed to pay us \$300.”

Johnny Sr grabs the check and immediately responds, “You are correct Johnny. I am proud that you noticed that. You are so smart, and you know what? We have an ethical dilemma here. Do you know what an *ethical dilemma* is?”

Johnny Jr responds, “Uhh I am not sure Daddy but I know we have to get that lady her money back.”

Johnny Sr. responds, “No the ethical dilemma is a question we have to ask ourselves. So do you know what that is, what the question is?”

Johnny Jr: “How do we get the check back to the lady?”

Johnny Senior takes off his glasses, kneels down to his son, pauses, and says, “No Johnny, the ethical dilemma is: Do we tell your mother?”

By the way, in case any of you tax folks out there were listening carefully, if this firm does more than 100 returns, they will need to make sure they include a Form 8948, Preparer Explanation for Not Filing

Electronically, if this firm is an e-File. And of course, they'll need a signed statement from the client about her desire to file it manually for their files.

But this story is about at least two points to make:

- 1.) This is clearly an ethics violation — knowingly overcharging a client by accepting their obvious mistake. There are rules we can reference where this one will be pretty black and white. But not all issues we'll review today will be so black and white. Sure, we'll review updates to the regulations which are rules we must abide by, but there will also be dilemmas, and just maybe we'll gain some value by reflecting on different alternatives when the answer might not be so black and white.
- 2.) The second point is sometimes the most important part of an ethical dilemma is identifying it as one, and framing the ethical dilemma as a question.

## **DEAD RABBIT**

There is a set of couples that live on a cul-de-sac in the suburbs of city on Virginia. They are very tight and on many summer weekends, one couple will grill out and invite the other couple over.

One of these couples is a dog owner. The other is a rabbit owner. On this weekend the rabbit owner couple has gone out of town on vacation and asked the other couple to watch over their rabbit that is in a cage in their basement.

It's Sunday morning and the one husband is reading his paper in his kitchen, and through the window he sees his dog approaching and it's apparent he has something in his mouth. He goes outside and to his horror he sees the rabbit in his dog's mouth. He grabs the rabbit and notices it is dead, and has been really beaten up and is real dirty. So he cleans off the rabbit as best he can, goes over to this neighbor's house and gently puts it back in the cage just before they get back home that day.

So the next weekend when they are grilling out together the wife of the vacationers says to the other couple: "You are not going to believe this, we came home last weekend and found our rabbit dead in its cage."

The other couple offers its condolences and the wife interrupts:

"That was not the unbelievable part. The unbelievable part was our son came over on Saturday, found the rabbit dead and buried him in our back yard."

So what do you think about the actions of the husband who noticed his dog?

The point here is that many times we do something that we think is right, but many times, it's about protecting ourselves.

How many people get into more trouble not because of the first thing that did, but because they tried to cover it up? Roger Clemens. Mark McGwire. Usually, when there is a tough ethical dilemma, it is because there is perceived cost to all the alternatives.

Do I enforce this rule and risk losing a client?

Do I stick up for what I believe in and risk alienating my boss?

Do I mention there may be a problem here when I am not totally confident I know what I am talking about?

## Get to Know the Audience

**Questions that could be asked: (some will make more sense than others depending on the type of class — public, in-house, etc.)**

- Who in here is a CPA?
- Who in here is licensed in Virginia? In another state? What states?
- Who in here works in Government? Corporate? Non-profit? Public accounting? Did I leave any out?
- Who in here is taking an Ethics class for the first time? Anyone taking it for the last time? (retirees, attempt at humor)

## Frequently Asked Questions

Note there are additional FAQs located at <http://www.boa.virginia.gov/faqs.asp> which answer questions on topics such as the CPE supporting cycle and the length of time required to retain CPE records.

### Using the CPA Title

Q: A CPA works as an employee at a company utilizing his accounting skills, and he lives in Maryland, are licensed in Maryland, and uses his CPA title. Is that permissible?

A: Yes, because under § 54.1-4409.1., he are not “providing services to the public” **and** Maryland complies with the substantial equivalency provisions. It is imperative in this case that he meets the substantial equivalency provision;

Q: A CPA works as a public accountant at a firm located in Virginia. She lives in West Virginia and is licensed in West Virginia. Can this person use the CPA title in Virginia (on her business cards with her firm name and firm’s Virginia address)?

A: No, because she is providing services to the public and her principal place of business is in Virginia. She must hold a Virginia license (individual and firm). Principal place of business is not necessarily based on address, but a firm with an office in Virginia would have a difficult time making the case that Virginia is not the principal place of business.

Q: A CPA is not using his accounting skills. He is a comedian and wants to renew his license. Does he need to take CPE?

A: No, but he would have to catch up if he would wanted to start using his CPA.

### License Renewal

Q: Regarding § 54.1-4413.2: A CPA’s renewal month is October for her CPA title. The code stipulates that a license provides a holder with a 12-month privilege to use the CPA title and that the holder has an additional 12-month period to renew their license. If this CPA receives her notice in late September to renew for October 31, 2011 and doesn’t do it, does that mean she has until the following October to renew it (before it expires)?

A: Yes. Once a license is expired, a licensee must go through reinstatement. Otherwise, it’s considered a late renewal and subject only to a late fee.

Some of the classifications for a CPA license:

- Active
- Expired — License expired more than 12 months ago and reinstatement is required to get it back
- Expired — Late renewal; less than 12 months has passed since license should have been renewed



## **Permanent Marks, Complaints and Sharing of Complaints**

Q: At what point does a complaint made by someone to the VBOA against a CPA become part of his or her permanent record? The BOA website states that an “investigation will be closed when there is lack of evidence to indicate a violation has occurred.” In that scenario, is a permanent mark (about the initial complaint) still put on the CPA’s record?

A: If an investigation is opened, that will permanently remain on a CPA’s record even if the case is ultimately dismissed or has no findings. However, if a complaint is dismissed upon receipt and no investigation is opened, it does not become part of the record.

Q: What about in cases of remediation?

A: The record of the complaint is still public if it went through the disciplinary process.

Q: If a CPA has a permanent mark on their record, where does it show up?

A: Currently, it is produced upon request under the Freedom of Information Act, but is not posted to any public website.

Q: Would I find it under the “CPA lookup” under Licensure Services on the [boa.virginia.gov](http://boa.virginia.gov) website?

A: No, see above.

Q: Would I find it elsewhere?

A: No, see above.

Q: How much information is disclosed about cases before the BOA? For example, in a case closed on September 11, 2009, where there was \$294,000 in embezzlements from a person in a firm, where could we find out more information?

A: The BOA will not share information on ongoing investigations. Information only becomes available once an investigation is concluded. In most circumstances where there is a violation, the entire case file is available to the public.

## **CPE Requirements**

Q: I am in private industry and want to know how about the CPE requirements, which have seemed confusing to me. How much CPE do I need to take?

A: The simple answer is 120 hours for each three year reporting cycle, 2 hours of qualified ethics each year, and a minimum of 20 hours of CPE each year. Below is an explanation of the “phase-in” of CPE requirements:

Over the last 10 years, the VBOA has changed the CPE requirements for those CPAs licensed in Virginia.

A transition period has been in place to make the CPE requirements the same for those CPAs using the CPA title to provide services to the public (hereafter referred to as a “public CPA”) and those CPAs using the CPA title to provide services to an employer (hereafter referred to as an “employer CPA”).

Specifically, starting with license renewals in 2012, both groups must have obtained 120 hours of CPE during the three-calendar-year period ending on December 31, 2011, in order to renew their license in 2012.

Remember that when you sign off on your license renewal each year in the state of Virginia, you are affirming your compliance with the CPE requirements created by the VBOA, and the board's CPE reporting cycle is ALWAYS the three CPE reporting (calendar) years preceding the current year (in which renewal is taking place)

Additionally for **each** of the three years ending on December 31, 2011, the licensee shall have completed not just 120 CPE hours in total, but also at least 20 hours per year, including a VBOA-acceptable ethics course of at least 2 hours (in each year).

This is not a change from recent past years for public CPAs.

However, because the requirements for an employer CPA were different (less) in past years, there has been a "phase-in" period.

An employer CPA only needed to obtain 90 hours of CPE during the three-calendar-year period ending on December 31, 2010 (to renew during the calendar year 2011) and the three-calendar-year period December 31, 2009 (to renew during 2010), along with at least 15 hours of CPE in each year, including a VBOA-acceptable ethics course of at least two hours (in each year).

This may surprise some CPAs who have heard for a few years that all CPAs must obtain 120 and 20 and ethics.

However because the three year reporting period is continuous, there are cases where not obtaining the minimum 20 hours for a employer CPA may be acceptable for one reporting cycle but not acceptable for a future reporting cycle. This is because you cannot receive CPE requirements for past years to qualify for future year requirements. To make this clearer, we provide an example as follows:

Let's say that an employer CPA obtains 48 hours of CPE in 2008, 18 hours of CPE in 2009 and 56 hours of CPE in 2010. Assuming they also obtained the 2-hour ethics requirement during each of those respective years, they would have the following hours:

2008	48
2009	18
2010	56
Total	122

For the three-year reporting cycle of 2008 through 2010, this person will qualify to renew their license as an employer CPA in 2011, since they obtained (a) 90 hours of CPE for that cycle, (b) 15 hours of CPE in each year during that cycle, and (c) fulfilled the yearly ethics requirement for each of those three years.

However, once the required CPE requirements kick in for the next year, since they did not obtain a minimum of 20 hours in 2009, they will not hold the CPE hours needed for the three-year cycle 2009 through 2011, no matter how many hours they receive in 2011.

This example illustrates the issue with the phase in of these new CPE requirements for employer CPAs and explains why the 120 and 20 requirements have been emphasized to all CPAs recently.





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“The VSCPA is the most prominent and best-enabled organization in the state to promote and protect CPAs. The partners [at PBGH] believe very strongly that membership and participation enhance the skills and professionalism of our staff, which in turn serves each person’s career growth, results in better client service and assists us in attaining our firm’s goals.”

Brad Jones, CPA  
Partner at PBGH, LLP  
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	Dues
CPA (licensed 3 or more years) . . . . .	\$255
CPA (out-of-state) or Associate (unlicensed professional) . . . . .	\$210
CPA (licensed less than 3 years) . . . . .	\$150
Educator . . . . .	\$150
Retired, part-time or seasonal worker, unemployed or leave of absence . . . . .	\$70
CPA candidate . . . . .	\$45
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