Ethics 2014—
Your License Depends on It!

CPE presentation developed by:
Virginia Society of CPAs (VSCPA)

Edited by:
Jim Cole, CPA
Clare Levison, CPA
Chuck Overbey, CPA/PFS, CFP

Virginia Society of
Certified Public
Accountants

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Student Manual

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Disclaimer

This training has been created to help you meet the Virginia Board of Accountancy's (VBOA) annual 2-hour CPE requirement for 2014. In 2003, the Virginia General Assembly passed a law requiring all CPAs in Virginia to take an annual ethics CPE course. Each year, the VBOA provides an outline of topics to be included, which can be found at http://tinyurl.com/2014VBOAEthicsOutline, and this class has been designed to meet the objectives of the 2014 outline.

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

- Maryland: Group study, self study and in-house versions satisfy 2 hours
- North Carolina: Group study, self study and in-house versions satisfy 2 hours for CPAs licensed in Virginia and North Carolina who primarily work in Virginia
- Washington, D.C.: Group study and in-house versions satisfy 2 hours

Please refer to your state's regulations for more information.

Please note: This class was not designed to be an all-encompassing update. In addition, the information provided and scenarios presented are not intended to be official positions of the VBOA, the American Institute of CPAs (AICPA), the U.S. Internal Revenue Service (IRS), the International Ethics Standards Board for Accountants (IESBA) or any other standard-setting body. For specific advice or clarification, please research the applicable standards or seek advice from the appropriate governing/regulating organization.

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Resources

Publications (Professional Ethics)

Code of Virginia:
Title 54.1 Professions and Occupations; Chapter 44 — Public Accountants
http://tinyurl.com/6f9ucox

AICPA Code of Professional Conduct:
In standard form: http://tinyurl.com/2cyfzcw
In topical (indexed) form: http://tinyurl.com/4p64my2

Organizations

Virginia Board of Accountancy (VBOA)
www.boa.virginia.gov
Email: boa@boa.virginia.gov
CPA Licensing Services & General Information: (804) 367-8505
CPA Examination Services: (804) 367-1111

Virginia Society of CPAs
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
AICPA hotline: (888) 777-7077
Email: ethics@aicpa.org

Resources

AICPA Technical Hotline
http://www.aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx
(877) 242-7212

Financial Accounting Foundation (FAF)
http://www.accountingfoundation.org/home

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/

U.S. Government Accountability Office (GAO)
www.gao.gov
(202) 512-3000

Government Accounting Standards Board (GASB)
www.gasb.org
(203) 847-0700

International Accounting Standards Board (IASB)
www.ifrs.org
+44 (0)20 7246 6410

U.S. Internal Revenue Service (IRS)
www.irs.gov
(800) 829-1040
IRS Circular 230: http://www.irs.gov/pub/irs-utl/pcir230.pdf (PDF)

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, email addresses and phone numbers provided above and throughout this guide are subject to change.

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 (PCAOB), by the Auditing Standards Board or the Accounting and Review Services Committee of the American Institute of CPAs (AICPA), or by any successor standard-setting authorities.

Compilation services means compiling financial statements in accordance with standards established by the AICPA or by any successor standard-setting authorities.

Financial reporting framework (FRF) is the set of standards used to measure, recognize, present and disclose all material items within an entity's financial statements. Examples include U.S. Generally Accepted Accounting Principles (GAAP), International Financial Reporting Standards (IFRS) and special purpose frameworks (formerly OCBOA).

Financial Reporting Framework for Small- and Medium-sized Entities (FRF-SME) is a principle-based special purpose framework for preparing financial statements of privately held small- and medium-sized entities. It was developed under the guidance of the AICPA FRF for SMEs task force and is therefore nonauthoritative.

Financial Statement means a presentation of historical or prospective information about one or more persons or entities.

Licensee means a person or firm holding a Virginia license or the license of another state. However, for purposes of this document, licensee only refers to a person holding a Virginia license or the license of another state.

Mobility means a practice privilege that generally permits a licensed CPA in good standing from a substantially equivalent state to practice outside of his or her place of business without obtaining another license. (per www.cpamobility.org)

Owner-managed entities are closely held companies run by the individuals who own a controlling ownership interest; a stark contrast to public companies, which by definition have an obvious separation between ownership and the management. AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQs

Peer Review means a review of a firm's attest services and compilation services conducted in accordance with the monitoring program.

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.

Small- and medium-sized entities (SME). There is no standard definition in the United States or under the AICPA. AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQs.

Special Purpose Framework is a financial reporting framework for use in those situations where GAAP may not be required. Examples include tax and modified cash bases. The former term, OCBOA, was replaced with this term under SAS No. 122 section 800, effective Dec. 15, 2012. AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQs

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
- **AU-C** — Temporary section identifier (instead of "AU") to avoid confusion with references to "AU" sections. The AU-C identifier will become simply AU in 2014, at which time the audit documentation section of the codification will become fully effective for all engagements.
- **ET** — Ethics (topical index of the AICPA Professional Code of Conduct)
- **FAF** — Financial Accounting Foundation
- **FRF** — Financial reporting framework
- **GAO** — U.S. Government Accountability Office
- **GAAP** — Generally Accepted Accounting Principles
- **GAAS** — Generally Accepted Auditing Standards
- **GAGAS** — Generally Accepted Government Auditing Standards
- **IASB** — International Accounting Standards Board
- **IESBA** — International Ethics Standards Board for Accountants (independent standard-setting organization within IFAC)
- **IFAC** — International Federation of Accountants (established in 1977 to strength worldwide accountancy profession)
- **IFRS** — International Financial Reporting Standards
- **IQAB** — International Qualification Appraisal Board (a joint body of AICPA and NASBA)
- **IQEX** — International Qualification Examination
- **IRC** — U.S. Internal Revenue Code
- **IRS** — U.S. Internal Revenue Service
- **NASBA** — National Association of State Boards of Accountancy
- **OCBOA** — Other Comprehensive Basis of Accounting (now referred to as: special purpose framework)
- **PCAOB** — Public Company Accounting Oversight Board
- **PCC** — Private Company Council. After years of discussion, studies and committees, the Financial Accounting Foundation (FAF) established the PCC, a new body to improve the process of setting accounting standards for private companies.
- **PEEC** — Professional Ethics Executive Committee (of the AICPA)
- **PTIN** — Preparer Tax Identification Number
- **SME** — Small- and Medium-Sized Entity
- **SQCS** — Statement on Quality Control Standards
- **SSAE** — Statements on Standards for Attestation Engagements
- **SSARS** — Statements on Standards for Accounting and Review Services
- **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

Virginia-Specific Ethics Course 2014 Outline*

A. General Ethics — Required discussion and handouts.
- Myths/common misconceptions (see handout)
- Behavioral ethics (hierarchy)
  - o Legal aspects
  - o AICPA Code of Professional Conduct
  - o Moral stages of reasoning
  - o Social good

B. VBOA Update — Required discussion and handouts.
- Licensing and CPE
  - o Use of CPA title in Virginia
  - o What is the substantial use of accounting? (see handout)
- New VBOA statutes
  - o 54.1-4424. Certain information not to be made public.
  - o 54.1-4425. Time for filing complaints against CPAs or CPA firms.
- Board Policies
- Statutes vs. Regulations vs. Policies

C. Enforcement Cases — Required discussion and handout.

Virginia's Top 10 Issues for 2014 **

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2. Confidential client information
   - Email etiquette/encryption (see relevant enforcement cases)
3. Industry issues
   - Enforcement
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   - Public
   - Auditor independence
5. Tax transparency (see optional handouts)
6. AICPA comfort letters
7. AICPA Code of Professional Conduct update
   - Independence — ET Section 100, Rule 101 of the AICPA Code of Professional Conduct
   - Planning and Supervision — ET Section 201, Rule 201.01 (C) of the AICPA Code of Professional Conduct
8. Conflict of interest (see optional handouts)
   - Federal acquisition rules
9. AICPA — SSARS — Preparation vs. compilation
10. SEC whistleblower rules
    - AICPA ethics hotline — (888) 777-7077

Virginia-Specific Ethics Course 2014 Outline*

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, or by calling (804) 367-0728.

For CPE Providers/Course Instructors:

Notes: 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.

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.virginia.gov).

* Providers must check the Board's website periodically for changes to the Virginia-specific outline. The Board is currently discussing potential changes to licensee statuses, to include the CPE exemption.

** Virginia's Top 10 Issues for 2014 — Awareness of Regulatory Issues Relative to Virginia CPAs. Provider/Instructor may use discretion as to topic selection from the provided list. Practical situations, potential solutions and examples must be included and illustrated with short scenarios or simulations. Course content (topic selections) should be tailored to best suit the audience (private and/or public practice).

Introduction

You know what makes a CPA a CPA: Someone who has passed the Uniform CPA Examination and received state certification to practice accounting. This includes passing an ethics exam, because CPAs also have an obligation, both as human beings and as professionals, to act in an ethical manner. In fact, the Virginia Board of Accountancy (VBOA) requires all state-licensed CPAs to take an annual ethics CPE course.

Webster's Dictionary defines ethics as a system of principles governing morality and acceptable conduct. "Honest," "fair" and "law-abiding" may be a few words that come to mind when you think of someone who acts ethically. "Deceitful," "unscrupulous" and "greedy" could define unethical actions.

Instructor: Ask participants to write down a few words that come to their mind when they think of someone who acts ethically and unethically. Ask for volunteers to share what they've written with the class.

The trouble with ethics is that black-and-white rules are sometimes hard to establish for difficult ethical situations. Everyone knows that you shouldn't steal your employer's inventory, visit pornographic websites on your employer's computer system or create fraudulent expense reports. When Bernie Madoff, the Ponzi scheme king, scammed thousands of investors out of billions of dollars, it was clear that his actions were unethical, and he ended up with a 150-year prison sentence. But many situations are not that black and white.

What are the 10 myths of ethics?

1. **It's ethical if it's legal and permissible.** Loopholes, lax enforcement and/or personal moral judgment do not outweigh what's right or lawful.
2. **It's ethical if it's part of the job.** Separating personal ethics from work ethics can cause decent people to justify actions at work that they would never do at home. Everyone's first job is to be a good person.
3. **It's ethical if it's for a good cause.** People can be vulnerable to rationalizations when advancing a noble aim. This can lead to deception, concealment, conflicts of interest, favoritism or other departmental violations.
4. **It's ethical if no one's hurt.** Ethical values are not factors to be considered in decision-making; they are ground rules.
5. **It's ethical if everyone does it.** Treating questionable behaviors as ethical norms under the guise of "safety in numbers" is a false rationale.
6. **It's ethical if I don't gain personally.** Improper conduct done for others or for institutional purposes is wrong. Personal gain is not the only test of impropriety.
7. **It's ethical if I've got it coming.** Being overworked or underpaid doesn't justify accepting favors, discounts or gratuities. The same goes for abusing sick time, insurance claims, personal use of office equipment or fair compensation for one's services or underappreciated efforts.
8. **It's ethical if I'm objective.** By definition, if you've lost your objectivity, you don't know you've lost it. Gratitude, friendship or anticipation of future favors can subtly affect one's judgment.
9. **It's ethical if I fight fire with fire.** Promise-breaking, lying or other misconduct is unacceptable even if others routinely engage in them.
10. **It's ethical if I do it for you.** Committing white lies or withholding information in professional relationships (such as performance reviews) disregards the fact that most people would rather know unpleasant information than soothing falsehoods.

— Michael Josephson

Introduction

Instructor: Discuss each of the 10 myths starting with number 10, working backwards, and ending with number 1. Use some of the scenarios and questions below to get the audience involved and talking.

Let's look at each of these myths a little more closely.

10. "It's ethical if I do it for you," might also be stated as, "It's ethical if I do it to protect your feelings." Have you ever received an outstanding performance review and then been passed over for a promotion? How did that make you feel? Would you rather have received constructive criticism rather than empty compliments? Honesty is the best policy, even if it means having a difficult conversation.

9. Remember when your parents told you that two wrongs don't make a right? It's not okay to "fight fire with fire." CPAs can't sink to a low standard of ethical behavior. Instead, they need to be ethical leaders for those around them. What are some things you can do to be an ethical leader?

8. Anaïs Nin said, "We don't see things as they are. We see them as we are." It's very difficult to be completely objective, because we're often viewing the world through the eyes of our own knowledge, experience and beliefs. Think of the last time you put yourself in someone else's shoes. What are some of the things you did to try to see things from their perspective?

7. What if you feel you've "got it coming"? It's not okay to take matters into your own hands. If you feel you're being treated unfairly, use the appropriate channels within your organization (and outside of your organization, if necessary) to address the situation. What are some of the channels you could use in your particular workplace to address an issue rather than taking matters into your own hands?

6. Not all unethical decisions are made for intentional personal gain. Do you gain personally when you discriminate against someone? Probably not, yet discrimination is clearly unethical. What are some other situations that may not involve personal gain but are still unethical?

5. "Everyone does it" may be a way of rationalizing a behavior, but it doesn't make that behavior right. If all your co-workers were jumping off a bridge, would you do it too? Other employees might send inappropriate jokes or videos to each other. That doesn't mean it's okay for you to engage in that kind of behavior as well.

4. Making unethical decisions, just because you view that no one is being hurt by them, can create a very slippery slope. How do you truly know that no one is being hurt, and once you've deemed one unethical decision to be okay, will that be your first small step toward more significant ethical violations?

3. As the familiar saying goes, "The road to hell is paved with good intentions." Don't use good intentions as a way to rationalize something you know isn't right.

2. What are the differences between personal ethics and business ethics? Are there any? Should there be? Strive to make good ethical decisions at home and at work.

1. Sometimes it's tempting to push the boundaries. How far is too far? Be aware when you're getting ready to cross the line from ethical into questionable.

Hierarchy of Behavioral Ethics

Instructor: Ask the class what value the CPA title has for them. Ask if it carries any negative connotation or if there is a "cost" to the benefits of being a CPA.

The CPA designation carries a value to each CPA. While the value is most obvious through its positive impact on professional careers, the designation of CPA also brings opportunities for the professional to serve in volunteer roles and obtain a valued position in our society. However, with the respect paid to CPAs comes an expectation of good judgment, integrity, quality of character and other positive attributes that come with such favored status. Therefore, in order to maintain the value of our profession, CPAs seek to obtain and maintain the public's trust in our professionalism, judgment and skills. When the profession falls short, in the eyes of the public, corrective action needs to be taken.

In large part, that is why this course is required for all Virginia CPAs. In response to the accounting scandals of a decade or more ago, the profession highlighted the need for ethics training. Prior to the ethics training requirement, CPAs still had many rules and regulations that they were expected to follow. As with many professions, the world of CPAs has always been subject to many different rules, expectations and constraints.

With public expectations come laws that have been established by representatives of the general public. Our society quite often enacts legislation in order to either motivate proper behavior or punish improper behavior, but both perspectives seek to obtain the expected behavior. Thus, we are a society of laws.

Frank Zappa is quoted as saying "The United States is a nation of laws, badly written and randomly enforced."[1] Members of any profession — doctors, attorneys, stockbrokers — might agree with Mr. Zappa. Be that as it may, laws remain a constant in our society. It is difficult to consider compliance with the AICPA Code of Professional Conduct or to implement a principles-based approach to achieving better good for the society as a whole until a person has met his or her legal obligations. Perhaps it is better said that prior to attempting compliance with these other categories of ethical guidance, one must first avoid legal troubles. After all, failure to comply with the legal standards in Virginia can result in a CPA owing as much as $100,000 and losing his or her license.

Instructor: Ask for a show of hands — do CPAs comply with the law in order to avoid the penalties or because it is the "right" thing to do? What role does a sense of "duty" play in legal compliance? If the maximum fine that could be assessed was $1 instead of $100,000, would compliance levels change?

Since its beginning, with the major exception of the impact of the Sarbanes-Oxley Act (SOX) and the Public Company Accounting Oversight Board (PCAOB), the CPA profession has attempted to, for the most part, self-regulate. In the United States, licenses for CPAs are regulated and controlled by state laws. While state boards of accountancy are established by law to govern the licensed activity of the profession, many states, including Virginia, regulate the ethical conduct of the profession in part by the statutes or legal authority and in part by reference to other guidance for the conduct of CPAs, such as the AICPA Code of Professional Conduct.

Code of Virginia § 54.1-4413.3, (4) titled

"Standards of conduct and practice," requires all Virginia licensed CPAs to conform to several standards of conduct and practice, including: "the Code of Professional Conduct, and the related interpretive guidance, issued by the American Institute of Certified Public Accountants, or any successor standard-setting authorities."

Thus, upon the legal base of conduct, the AICPA Code is established as an additional layer of guidance. The AICPA Code is often viewed by CPAs as simply another set of rules to follow. However, even in its discussion of compliance, the Code notes its role in society and the interplay with public opinion and the society as a whole:[2]

> *Compliance with the Code of Professional Conduct, as with all standards in an open society, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.*

The interaction with society and the public perception referred to in the AICPA Code denote an additional level of ethical behavior or ethical decision making, which is based on moral reasoning. This suggests that once legal compliance is met and actions are considered within the context of the Code of Professional Conduct, CPAs often utilize other decision models to determine ethical courses of action. Because CPAs are valued members of society, the public does have an expectation that CPAs can make not only good decisions, but decisions that are morally acceptable.

Instructor: Ask if CPAs should ever "break" a rule in order to do what they perceive is "right" and what circumstances would justify such action.

In short, situations may arise that laws, codes of conduct or rules cannot adequately, efficiently or quickly address. Yet a CPA is expected to be a trusted advisor, so perhaps each professional should consider an individual approach or methodology for solving ethical issues. There certainly cannot be a one size fits all solution, because the very nature of ethical decision making is based on the reality that each person is ultimately the final judge of his or her own moral decisions. Unfortunately, CPAs must make ethical judgments under the pressure of the opinion of others.

While few CPAs enter the profession with any training in ethical or moral decision-making models, often their professional behavior can be viewed in terms of moral reasoning models that already exist. For example, the psychologist Lawrence Kohlberg outlined a theory of three levels of moral reasoning, roughly along the following lines:

1. **Pre-conventional morality**. A rules-based approach; right versus wrong. People define right and wrong based very much on their own perceived interests.

2. **Conventional morality**. People understand the impact of actions on others, seek to act in accordance with other people's expectations, understand that intent and perspectives can impact other people's actions, still regard obedience to rules as a duty and feel rules are needed for society.

3. **Post-conventional morality**. Rules are regarded as useful tools for society, but recognize that society's needs at times extend beyond the existing rules. People use more of a principles-based approach to determine appropriate actions.

A thoughtful review of Kohlberg's theory may result in CPAs concluding that it follows along the lines of their own personal path of professional development. Early in careers, they learn the rules, pass the CPA Exam and then learn a new set of rules specifically related to their new job. Only after the rules base is established can the CPA move toward more effectively and more fully meeting the needs of their clients or employers.

The entire development of ethical decision making through the various layers of ethical guidelines, from legal, then AICPA or professional guidance, then as needed the use of reasoning, advances the CPA toward achieving a greater social good, or providing a better benefit for society.

References

Managing to be ethical: Debunking five business ethics myths
—Linda Klebe Trevino and Michael E. Brown:
http://home.sandiego.edu/~pavett/docs/gsba532/mging_ethic_debunk.pdf

The Hierarchy of Compliance/Ethics Programs Needs: The Relationship Between Ethics and Compliance
—Roy Snells, Society for Corporate Compliance and Ethics:
http://www.europeanbusinessreview.com/?p=692

The Code of Professional Conduct of the American Institute of Certified Public Accountants:
http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/comp.aspx

"*Ethical Conduct is never out of vogue*"
—AICPA video on subordination of judgment, cgma.org, Dec. 19, 2012:
http://tinyurl.com/b6z5sx3

"*Business Ethics Insight: The Three Levels of Ethical Issues in Business*"
—Michael Josephson, July 5, 2012:
http://josephsoninstitute.org/business/blog/2012/07/business-ethics-insight-the-three-levels-of-ethical-issues-in-business/

Code of Virginia, Chapter 44:
http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+TOC54010000044000000000000

"*Kohlberg's Three Levels and Six Stages of Moral Reasoning*"
—T. M. McDevitt and J. E. Ormrod, Jul 20, 2010:
http://www.education.com/reference/article/kohlbergs-moral-reasoning/

Notes

1 Frank Zappa:
http://www.goodreads.com/quotes/63261-the-united-states-is-a-nation-of-laws-badly-written

2 American Institute of Certified Public Accountants, "*Composition, Applicability and Compliance*," Code of Professional Conduct:
http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/comp.aspx

The Legal Base for Virginia CPAs

Instructor: The proper lead-in here is that the laws represent the "base" of the Behavioral Ethics Hierarchy. A question might be posed, "What if there were no laws in our world?" as a way of eliciting thought about the importance of the "base."

In addition to the AICPA Code of Conduct, accounting standards, the IRS and state society ethics rules, CPAs in Virginia have an entire hierarchy of legal guidelines with which they must comply. On a day to day basis, the policies and regulations of the VBOA may have the most direct impact on many Virginia CPAs. For this reason and because they generally have the force of law and deal directly with licensing issues, the legal base of the ethical hierarchy is extremely important. However, the question arises, how are the laws, regulations and policies developed? What is their legal authority? A basic review of the overall legal/ regulatory environment for Virginia CPAs may be instructive.

Virginia's General Assembly is empowered, under Article IV of the Constitution of Virginia, to serve as the legislative branch of the state's government and is authorized to establish the laws of the Commonwealth. Additionally, in accordance with Article III it may also establish "administrative agencies with such authority and duties as the General Assembly may prescribe." The laws or statutes enacted by the General Assembly and signed by the governor are codified in the Code of Virginia. The Code of Virginia is organized into 67 titles dealing with particular topics, and these titles are organized into chapters.

Title 54.1 is titled "Professions and Occupations" and includes 44 chapters. Virginia regulates many different professions, including Auctioneers (Chapter 6), Polygraph Examiners (Chapter 18), Dentists (Chapter 27) and others, arriving at last, but far from least, with Public Accountants in Chapter 44.

The actual citation in the Code of Virginia for Public Accounting, in Chapter 44, includes §§ 54.1-4400 – 54.1-4425. The first section, as with most statutes, includes the "definitions," which are particularly useful in that they define important terms such as "attest services," "practice of public accounting," and so forth.

Instructor: The slide will likely not have the makeup of the VBOA outlined, but you may want to add this for information to the audience.

§ 54.1-4402 of the Code establishes and defines the Board of Accountancy, summarized as follows:

1. Established as an independent board in the executive branch of state government
2. The Board shall consist of seven (7) members appointed by the Governor as follows:
   a. One (1) shall be a public member, who may be an accountant who is not licensed
   b. One (1) shall be an educator in the field of accounting who holds a Virginia license
   c. Four (4) holding Virginia licenses who are from public practice
   d. One (1) with a Virginia license from either public practice or from industry or government who are providing services as a CPA

3. Members of the Board shall serve 4 year terms
4. The Board is specifically empowered to oversee the practice of public accounting, including attest and compilation services based upon licensing outlined in the Code of Virginia and to the ensure compliances with standards of conduct outlined in the Code of Virginia (54.1-4413.3).
5. The Board is authorized to ensure the continued competence of persons using the CPA title in Virginia (i.e., continuing professional education)
6. The Board is empowered to establish regulations, rules and procedures for the implementation of its responsibilities.

The final item noted above gives the VBOA the authority to establish regulations.

At this point, it becomes important for the CPA to understand the authority that flows through the entire legal/regulatory hierarchy in Virginia. Because the actions of the General Assembly, in the form of laws legislated or agencies established, is authorized (allowed or permitted as it were) by the Constitution of Virginia, all of those actions of the General Assembly must be consistent with the "higher authority," that is, the Constitution. Likewise, the statute enacted by the General Assembly establishes the VBOA and authorizes it to enact regulations. However, those regulations must be consistent with the statute enabling the regulations to be written. This underscores the importance of CPAs being familiar with the definitions contained in the Code of Virginia, since those definitions represent a "higher authority" than the regulations promulgated by the VBOA.

In accordance with the authority granted to it by the General Assembly in § 54.1-4402 of the Code of Virginia, the VBOA promulgated regulations to assist it in complying with its legislated duties. Regulations established by agencies in this manner are codified in the Virginia Administrative Code (VAC). The VBOA Regulations in effect as of Jan. 1, 2013, are found at 18VAC5-22.

The Attorney General's Office explains the legal impact of regulations as follows:[1]

Regulations of the type covered by this guide are administrative "legislation" and thus have the force and effect of law. The precise definition of "regulation" is found in § 2.2-4001 of the Code of Virginia, a part of the Administrative Process Act (APA). A regulation is:

> *Any statement of general application, having the force of law, affecting the rights or conduct of any person, adopted by an agency in accordance with the authority conferred on it by applicable basic laws.*

This distinguishes a regulation from an agency policy — which lacks the legal status of a regulation — and from a guidance document (§ 2.2-4001 of the Code of Virginia). A guidance document is the closest thing in Virginia statutory law to an "interpretative" regulation. It merely tells the public and agency staff how an agency interprets its statutes and regulations.

The policies established by the VBOA, which can be found on their website, include the following:

1. Trust Account
2. Sponsors Providing Continuing Professional Education (CPE)
3. Substantially Equivalent Jurisdictions
4. Continuing Professional Education (CPE) Guidelines
5. Publication of Board Disciplinary Action

6. CPA and International Qualification Examination
7. Peer Review Oversight Committee

The VBOA is authorized, under the Code of Virginia § 54.1-4402 (H), to "establish rules and procedures," which, as differentiated from regulations, are operational in nature. The policies do impact the manner in which the VBOA operates, but they do not in and of themselves have the full authority of law, since unlike the regulations, they were not subjected to a public hearing and formal review process.

Resources

Virginia Regulatory Town Hall:
http://townhall.virginia.gov/um/legalbasis.cfm

"*Introduction to Laws in Virginia,*" Office of the Attorney General:
http://www.virginiarules.com/virginia-rules/introduction-to-laws

Constitution of Virginia:
http://constitution.legis.virginia.gov

Code of Virginia, Chapter 44:
http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+TOC54010000044000000000000

Virginia Board of Accountancy website:
http://www.boa.virginia.gov

Notes

1 Office of the Attorney General, "Introduction to Laws in Virginia," http://www.virginiarules.com/virginia-rules/introduction-to-laws

AICPA Code of Professional Conduct Update

One of the hallmarks of a "profession" is that members of the profession are required to conform to a standard of conduct. The certified public accounting profession has documented standards of conduct at both the state and national level. Prior to providing service as a CPA whether in industry, academia or to the public, a CPA should consider the ethical standards of his or her board of accountancy, state CPA association or society and any other governmental agency, such as the Securities and Exchange Commission, which may have a regulatory impact on the CPA's services or the particular industry seeking the service.

Some states have merged their own standards of conduct quite closely with the national standards as outlined by the AICPA. In Virginia, the Code of Virginia has incorporated by reference the entire Code of Professional Conduct as well as other standards and guidance. This means that the changes in any of these codes, standards or guidance become legally binding on a Virginia CPA when they are made effective by the applicable standard-setting entity, such as the AICPA, FASB, etc.

The Code of Virginia § 54.1-4413.3 titled "Standards of conduct and practice" reads as follows:

> *Persons using the CPA title in Virginia and firms providing attest services or compilation services to persons or entities located in Virginia shall conform to the following standards of conduct and practice.*
>
> 1. *Exercise sensitive professional and moral judgment in all activities.*
> 2. *Act in a way that serves the public interest, honors the public trust and demonstrates commitment to professionalism.*
> 3. *Perform all professional responsibilities with the highest sense of integrity, maintain objectivity and freedom from conflicts of interest in discharging professional responsibilities, and avoid knowingly misrepresenting facts or inappropriately subordinating judgment to others.*
> 4. *Follow the Code of Professional Conduct, and the related interpretive guidance, issued by the American Institute of Certified Public Accountants, or any successor standard-setting authorities.*
> 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.

7. *Do not engage in any activity that is false, misleading or deceptive.*

Breaking the Law — Insider Trading

The facts: In Case No. 5 provided by the VBOA and included in this manual, a CPA was found by a Court to have violated a law — specifically, the Securities Exchange Act of 1934 and Rule 10b-5, for trading put options for a corporation's common stock.

The penalty: The court ordered $183,801.27 plus interest and that the VBOA suspend the CPA's license for at least one year, plus a $10,000 fine and reimbursement of investigative costs of $1,000.

Instructor: Emphasize that this was a violation of law first and resulted in VBOA action later.

Working With the Code

The actions and conduct of CPAs are at all times subject to the profession's Code of Conduct. The AICPA's Code of Professional Conduct encompasses two parts — (1) the Principles and (2) the Rules. The Principles essentially outline a framework for the more detailed Rules, which are intended to govern the delivery of professional services by members of the AICPA. The AICPA's Council designates specific bodies to promulgate technical standards under the Rules.

The Code of Professional Conduct is intended to provide guidance and rules to all members, whether they are providing services in public practice, industry, government or education.

Effective compliance with the Code of Professional Conduct is of necessity dependent on CPAs having a thorough understanding of the principles and rules. From an ethical perspective, more important than mere knowledge of the rules is a willingness on the part of the CPA to take voluntary efforts to comply with the Code, including corrective action, self-reporting and reporting of actions observed among colleagues.

Instructor: Use an emphasis on the need for CPAs to act in order to uphold the profession as a lead-in to a slide with the Ethics Hotline. Remind them that they can use either email or the toll-free number.

Ethics Hotline

The AICPA's Professional Ethics Division has as its mission the education of members and the promotion among CPAs of a proper understanding of ethical standards contained in the Code of Professional Conduct. Their staff is available to respond to AICPA member inquiries relating to the application of the Code in specific circumstances. A CPA can utilize these services via email at ethics@aicpa.org or via telephone at (888) 777-7077.

Interpretations and Rulings

Even though the Rules are more detailed than the Principles of the Code, other guidance is often needed to more effectively address specific circumstances. The guidance is in large part the result of the efforts of the Professional Ethics Executive Committee (PEEC), made up of 21 members of the profession. Because PEEC investigates potential disciplinary matters and presents findings to a Joint Trial Board, it is particularly well suited to interpret the Code of Professional Conduct and when necessary, propose amendments to the Code. The additional guidance provide by PEEC can be categorized in two sections, (1) Interpretations of Rules of Conduct and (2) Ethics Rulings.

Interpretations of Rules of Conduct have been adopted after exposure to and comments from interested parties, including state boards, state associations/societies, practice units and other interested parties, by PEEC to serve as guidelines for the applications of the Rules.

Ethics Rulings are the formal rulings made by PEEC after exposure to state associations/ societies, state boards and other interested parties. These rulings summarize the application of Rules of Conduct and Interpretations to a particular set of factual circumstances.

The AICPA considers publication of an Interpretation or Ethics Ruling in the *Journal of Accountancy* as officially constituting notice to its members.

A member is obligated to consult other applicable sources, including but not limited to: the ethical standards of his or her state CPA association/society, the state board of accountancy and applicable governmental agencies such as the Securities and Exchange Commission which may have oversight of the CPA's services or of the business operation of the client.

AICPA Ethics Codification Project

In an effort to make the Code of Conduct more user friendly, PEEC has drafted a restructuring of the ethics standards. The AICPA intends that the restructured codification will allow its member CPAs and others to apply the rules and reach correct conclusions more easily and intuitively. To achieve this, PEEC restructured the Code into several parts each organized by topic, edited the Code using consistent drafting and style conventions, incorporated a conceptual framework for members in public practice and in business, revised certain Code provisions to reflect the "conceptual framework" approach (also known as the "threats and safeguard" approach) and where applicable, referenced existing non-authoritative guidance to the relevant topic.

The Proposed Revised AICPA Code of Professional Conduct was exposed for comment on April 15, 2013, and the comment period was closed on Aug. 15, 2013. As of Dec. 1, 2013, the AICPA indicated on its website that it expects to issue the final codification in early 2014, with an anticipated effective date of Dec. 15, 2014.

Further information can be found at http://tinyurl.com/qa6tk89.

Instructor: You may want to suggest this video for the attendees. It walks the user through the new Code format and is very well done.

Independence — ET Section 100, Rule 101 of the AICPA Code of Professional Conduct

Rule 101 refers to a CPA's independence and simply states:

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

Revised Definition of Covered Member

Independence rules have been expanded, effective for engagements covering periods beginning on or after Dec. 15, 2014, to include "Partner Equivalents." These are CPAs who act in a partner capacity with respect to attest engagements but are not "actually" partners. A Partner Equivalent is defined as a person who:

- Has the authority to bind the firm relative to an attest engagement without partner approval
- Has ultimate responsibility for the attest engagement:
    - o Has the authority to issue or authorize others to issue an attest report without partner approval
    - o Has the authority to sign or affix the firm's name to an attest report

Position titles are not determinative of a Partner Equivalent. Firms may use different titles to refer to professional employees with this authority. The definition is solely used for purposes of the independence rule and should not be used to determine whether the Partner Equivalent is an owner of the firm.

Partner Equivalents are subject to the same independence rules as partners.

Instructor: This is the main point. Partner Equivalents equal partners for purposes of ascertaining Independence in attest engagements.

Other Revised Definitions

In March 2013, revised definitions were adopted for "Practice of Public Accounting" and "Professional Services," and the "Holding Out" definition was deleted.

"Professional Services" is now defined to apply to both members in public practice and business. The definition includes a list describing the types of services that would be considered "professional services," such as accounting, attest services, tax, bookkeeping, management consulting, financial management, corporate governance, personal financial planning, business valuation, etc. The listing is specifically designed to be non-inclusive, since the definition further includes "all services performed by a member for a client, an employer or on a volunteer basis requiring accountancy or related skills." This results in the need to apply professional judgment in interpreting the rules and can be therefore be interpreted broadly to include a wide array of services provided by the accounting profession.

Several portions of ET Section 92 were modified to change the phrase "engaged in the practice of public accounting" to read "engaged in public practice." This change in terminology more closely aligns the AICPA's Code with the International Ethics Standards Board for Accountants' (IESBA) Code of Ethics and is also more consistent with the wording utilized by most state boards of accountancy. The term "public practice" is broader and more inclusive since it can refer to services beyond purely accounting in the traditional sense.

The deletion of the definition for "holding out" was due to the fact that many AICPA members, including those in public practice and business, choose not to "hold out" as CPAs. AICPA membership includes both CPAs and non-CPAs, so the change was necessary to ensure that all AICPA members comply with the AICPA Code, regardless of whether they hold out as CPAs.

Planning and Supervision — ET Section 201, Rule 201.01 (C) of the AICPA Code of Professional Conduct

A CPA licensed in Virginia is required by law to "follow the Code of Professional Conduct, and the related interpretive guidance, issued by the American Institute of Certified Public Accountants, or any successor standard-setting authorities." (Code of Virginia § 54.1-4413.3) This requires that all professional services provided by a CPA whether to a client or employer be performed in a competent manner.

Specifically, AICPA Rule 201 reads as follows:

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.

Interpretation 201-1, titled "Competence," further reads:

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

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

The member may have the knowledge required to complete the services in accordance with professional standards prior to performance. In some cases, however, additional research or consultation with others may be necessary during the performance of the professional services. This does not ordinarily represent a lack of competence, but rather is a normal part of the performance of professional services.

However, if a member is unable to gain sufficient competence through these means, the member should suggest, in fairness to the client and the public, the engagement of someone competent to perform the needed professional service, either independently or as an associate.

Planning and Supervision

Instructor: While not a lot has changed in this topic area, the VBOA continues to encounter enforcement cases related to improper planning and supervision. This is the reason that the topic was specifically included in the 2014 VBOA outline for this course. This is a great topic to get the attendees involved. Almost everyone has an example of less-than-stellar planning and supervision from some point in their career. A professional service, meaning work performed for either a client or for an employer by a CPA, therefore requires adequate planning and supervision. Consider the following examples:

A professional service, meaning work performed for either a client or for an employer by a CPA, therefore requires adequate planning and supervision. Consider the following examples:

Example 1

CPA Emily is asked by a potential client to perform a business valuation service. She must do one of the following:

A. Have or obtain, prior to the service, adequate knowledge, training and experience to provide the service, or
B. Hire and properly plan and supervise another CPA who possesses the adequate knowledge, training and experience to provide the service, or
C. Refuse the engagement

Instructor: Engage the class on each of the three options. You might also ask those in the class who work in industry if they have any responsibility related to the hiring competent professionals to perform special services for their employer and if that poses any challenges.

Example 2

CPA Chip, employed as the Controller for a nonprofit entity, is asked by the Executive Director to prepare a multiyear financial forecast for a major real estate investment which was just proposed by a Board member. The presentation is needed for the Board's next meeting, two days later. Assuming CPA Chip has experience in such forecasting techniques, he must consider the following:

A. Does he really have time to properly plan, then execute the services?
B. Does he have any capable staff who can assist him in meeting this challenge? If so, can he adequately supervise their work in this tight timeframe?
C. Should he discuss the limitations of the deadlines and the potential impact on the quality of the forecast with the Executive Director?

Example 3

In a CPA firm, Walker & Jewell, LLC (W&J), Walker handles the firms audit services and Jewell specializes in tax services. W&J have been auditing a Department of Housing and Urban Development project for 11 years. In order to meet the deadline for the audit, the fieldwork is completed during the first two weeks of August each year. This year, because of their growing reputation in governmental audits, W&J were selected from several proposing firms to audit the area agency on aging, which would also require fieldwork during the first two weeks of August. Walker has begun to plan the audit, making the appropriate inquiries of the preceding auditor and performing an initial review of the predecessor firm's work papers. However, just before the audit is to begin, Walker is injured in a motorcycle accident. Jewell suggests that the staff accountant who had worked one year on the HUD apartment audit take the prior year's HUD audit program and use it to begin the agency on aging audit. Jewell promises to drop by in a few days and check on the staff accountant.

Is this adequate planning and supervision for the audit of the area agency on aging?

Probably not. Under Rule 201, taking an audit program from a completely different entity does not constitute adequate planning. An audit program must be tailored to the specific engagement, and the level of supervision should be based on the experience and abilities of the staff involved in the audit.

Resources

The Code of Virginia § 54.1-4413.3

AICPA Ethics Codification Project: http://tinyurl.com/p284lnp

Planning and Supervision — ET Section 201, Rule 201.01 (C) of the AICPA Code of Professional Conduct

Independence — ET Section 100, Rule 101 of the AICPA Code of Professional Conduct

Maintaining Your License and Your Competence

An important part of the legal obligations incumbent on a CPA is the maintenance of a license for the purpose of providing services to the public or an employer. The renewal of a CPA license is governed by the Code of Virginia (§ 54.1-4413.2) and is outlined on the website of the Virginia Board of Accountancy (www.boa.virginia.gov/CPALicense/Renewal) as follows:

> *All licensed Virginia CPAs must renew their individual license annually. In general, an Individual CPA License expires on the last day of the month in which the license was originally issued. Licensees may visit the VBOA's Licensee Search to determine when their license is due to expire. An Individual CPA License may be renewed within 40 days of expiration.*
>
> *The VBOA transmits renewal notices approximately 30 days prior to expiration of the license (followed by a 2nd notice approximately 60 days after expiration). In accordance with Board Regulation 18VAC5-22-170C, the VBOA transmits license renewal notices electronically unless a licensee is unable to communicate electronically (in which case a notice will be sent via USPS). However, § 54.1-4413.2, 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.*

See Code of Virginia § 54.1-4413.2 for details regarding renewal of an Individual CPA License.

A Virginia license provides its holder with a 12-month privilege to use the CPA title in Virginia or provide attest or compilation services to persons and entities located in Virginia.

The individual holding the license has an additional 12-month period after the expiration of a license to renew the license. During this additional 12-month period, the licensee status will show "Active — Renewal Fee Delinquent," although during this additional period, the individual is considered to be holding a Virginia license. If the license is not renewed by the end of the additional 12-month period, the license is considered to be "Expired" and the individual no longer holds a Virginia license, which would then require a license reinstatement.

The VBOA may prescribe renewal fees and requirements that increase based on the amount of time the individual allows to elapse before applying for renewal. The VBOA applies a $100 late fee if not paid by the expiration date.

Renewal requires affirmation of meeting CPE requirements. Do not submit CPE documentation with renewal unless specifically instructed by the VBOA as part of a CPE audit/review process. CPE documentation must be retained for a minimum of three calendar-years preceding the current calendar-year.

The VBOA generally updates its records within 24 hours after online processing. Check the VBOA Licensee Search to verify that a license has been renewed.

If renewal is not possible online, contact the VBOA. Download the Individual CPA License Renewal Form to renew a license manually and mail it to the VBOA for processing. The VBOA applies a $25 fee for manual renewals.

Unlicensed Activity — Enforcement Case No. 2

Facts — The VBOA received a complaint from a person's former employer that she had misrepresented herself as a CPA. The VBOA investigated and determined that the person had never been licensed as a CPA, but had benefitted financially from holding herself out to be a CPA.

Penalty — The VBOA ordered that the Respondent shall:

- Not practice as a CPA in the Commonwealth until the VBOA has granted the Respondent a CPA license;
- Remove all CPA signage that indicates she is a licensed CPA in the Commonwealth;
- Pay a monetary penalty of $12,000 within 90 days of the entry date of the Final Order;
- Provide reimbursement to the VBOA $1,000 for investigative costs.

Instructor: Emphasize that this case was brought about because a former employer made a complaint to the VBOA. This would be a good time to remind the class that any complaint made to the VBOA which results in a file or case being opened will become a permanent part of the CPA's record.

Continuing Education as Part of License Renewal

As noted from the VBOA website outlined above, an integral aspect of license renewal is certification of compliance with continuing education requirements. The VBOA is authorized in the Code of Virginia (§ 54.1-4403.12) to establish continuing professional education (CPE) requirements as a condition for issuance, renewal or reinstatement of a Virginia license.

Instructor: Take time to point out that the Code of Virginia delegates to the VBOA most of the details about CPE, which the VBOA ultimately outlines in the regulations, which are part of the Virginia Administrative Code (VAC) discussed below. CPE is one of the most popular topics at any Ethics course. The instructor should poll the audience to ask if any attendee has been audited for CPE recently and, without asking for details, whether the experience was more or less difficult than expected.

The specific CPE requirements are outlined in the Virginia Administrative Code (VAC) in section 18VAC5-22-90 entitled "Continuing professional education" and due to the importance of continuing education the VBOA has established a policy to govern its administration of CPE, which is included at the end of this section.

More than half of all Virginia CPAs do not work in public accounting. The Code of Virginia provides the legal authority requiring CPE for CPAs in industry. § 54.1-4400 reads as follows:

"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.

Any CPAs meeting the above definition are required to obtain the same number of CPE credits as CPAs in public practice, including the 2-hour annual Virginia-specific ethics course. It is important to note that the education obtained by industry CPAs, just like CPAs in public practice, must be relevant to their duties as an employee. For example, if they work in a non-profit environment, they should obtain education in that specialty, likewise for retail, manufacturing and other industries that are reasonably considered to have specialized accounting. CPAs who are responsible for performing tax preparation or related work for their employer or for the public should regularly obtain education in applicable tax topics.

The VBOA has provided the following guidance for CPAs in industry:

Volunteer Services — Nonprofit

Two important questions to ask are:

- **What types of services are to be provided?**
  An individual licensee who provides audit, review, attestation services or compilation services to a not-for-profit entity will be considered to be providing those services as a firm, organized as a sole proprietorship, and therefore will be required to maintain a firm license and meet the requirements of peer review. There are a host of other services CPAs can provide to not-for-profit entities that would not require maintaining a firm license and participating in a peer review program.
- **What is the role or capacity of the CPA performing the services?**
  One point the VBOA made clear was that Virginia law provides an exception to CPAs if they are performing the services in their role as an owner, officer, employee or member of a governing body of the entity or entities about whom the financial statements are provided. Typically, that means providing services in that role will not require you to have a firm license.

Instructor: Make sure to refer the class to the exact page (28) in the Student manual for the following guidance. If CPA's are present who are in public practice, remind them that this is also important to them because it affects their clients and may one day affect them personally if they leave public practice or even become semi-retired. Also, point out that the VBOA does not have an official "inactive status."

Virginia Board of Accountancy 2014 Virginia-specific Ethics Course

Practical Illustrations — "Substantial Use of Accounting, Financial, Tax or other skills that are relevant, as determined by the Board."

A series of practical illustrations follows to show how to determine whether a licensee is required to obtain continuing professional education under the new requirements and how the new requirements are less restrictive than the superseded requirements.

Illustration 1. The managing partner of a CPA firm holds a Virginia license and leaves the firm to become the chief executive officer (CEO) of an entity. She only provides services that would be expected of a CEO. None of those services requires the use of skills that would be relevant to determining whether she should be required to obtain continuing professional education. She is therefore not required to obtain continuing professional education. (The answer would have been the same under the superseded requirements.)

Illustration 2. Change the facts in illustration 1 so that it later becomes apparent that the chief financial officer (CFO) may leave and not prepare the annual financial statements. The licensee offers to prepare the annual financial statements if the CFO leaves and a replacement cannot be found in time. Preparing financial statements requires the use of skills that are relevant to determining whether the licensee should be required to obtain continuing professional education. However, the licensee has only offered to provide the service. Only services provided are considered under the new framework. She is therefore not required to obtain continuing professional education. (The answer would have been different under the superseded requirements. Since they included offering to provide any services that require the use of accounting skills, she would have been required to obtain continuing professional education. Because the new requirements are less restrictive, the licensee is no longer required to obtain continuing professional education.)

Illustration 3. Change the facts in illustration 2 so that the CFO leaves, a replacement cannot be found in time and the licensee prepares the annual financial statements. Preparing financial statements requires the use of skills that are relevant to determining whether the licensee should be required to obtain continuing professional education. However, the licensee does not use those skills to fulfill a substantial portion of her responsibilities to the employer. She is therefore not required to obtain continuing professional education. (The answer would have been different under the superseded requirements. Since they included providing any services that require the use of accounting skills, she would have been required to obtain continuing professional education even though this was a special, one-time situation. Because the new requirements are less restrictive, the licensee is no longer required to obtain continuing professional education.)

Illustration 4. The general manager of a car dealership holds a Virginia license. Each year, he prepares the dealership's federal and state income tax returns. Preparing income tax returns requires the use of skills that are relevant to determining whether the licensee should be required to obtain continuing professional education. However, the licensee does not use those skills to fulfill a substantial portion of his responsibilities to the employer. He is therefore not required to obtain continuing professional education. (The answer would have been different under the superseded requirements. Since they included preparing tax returns for an employer, he would have been required to obtain continuing professional education even though he did not use those skills to fulfill a substantial portion of his responsibilities to the employer. Because the new requirements are less restrictive, the licensee is no longer required to obtain continuing professional education.)

If in addition to preparing the dealership's tax returns, the licensee also prepares income tax returns for a few relatives and friends as a side venture, he would be considered to be providing services to the public and is required to obtain continuing professional education. (The answer would have been the same under the superseded requirements.)

Illustration 5. A licensee is a project manager for an entity that develops real estate. His responsibilities include analyzing sites for their development potential and making recommendations to the owners of the entity, preparing budgets for projects adopted, and analyzing and reporting significant variances between budgeted and actual results. The development of prospective information and the financial analyses are services that require the use of skills that are relevant to determining whether the licensee should be required to obtain continuing professional education. However, the licensee does not use those skills to fulfill a substantial portion of his responsibilities to the employer. He is therefore not required to obtain continuing professional education. (The answer would have been different under the superseded requirements. They included providing any services that require the use of accounting skills and reports on financial advisory services for an employer. Because the new requirements are less restrictive, the licensee is no longer required to obtain continuing professional education.)

Illustration 6. A licensee is the development director of a not-for-profit organization. A significant part of his responsibilities is consulting with potential donors and their advisors about the income tax and estate tax planning considerations for making contributions to the organization and obtaining and allocating federal and state tax credits. Those services require the use of skills that are relevant to determining whether the licensee should be required to obtain continuing professional education. In addition, the licensee uses those skills to fulfill a substantial portion of his responsibilities to the employer. As a practical matter, the fact that he is licensed was likely an important consideration to the organization in hiring him. He is therefore required to obtain continuing professional education. (The answer would have been the same under the superseded requirements. They included furnishing advice on tax matters for an employer.)

VBOA Policy No. 4: Continuing Professional Education (CPE) Guidelines

From §§ 54.1-4409.2 and 54.1-4413.2 of the Code of Virginia and Board Regulations 18VAC5-22-90 and 18VAC5-22-140: Specific CPE requirements of the Board are listed in the authority sections named above. This VBOA policy details the guidelines approved by the Board for administering the CPE requirements.

General Guidelines

Board Regulation 18VAC5-22-90 requires licensees who are not currently performing any services and who resume providing services to the public or to an employer to first obtain at least 120 hours of CPE prior to providing those services. The 120 hours must include a 2-hour Virginia specific ethics course (an annual requirement).

The Board recognizes that 50 minutes of CPE participation equals 1 hour of CPE credit. One semester hour of credit for courses at an accredited college or university constitutes 15 hours of CPE and one quarter-hour of credit constitutes 10 hours of CPE. CPE requirements may be adjusted depending upon when a Virginia CPA begins or ceases to provide services to the public or to an employer in accordance with Board Regulation 18VAC5-22-90. Specific questions may be addressed by contacting the VBOA.

Virginia-Specific Ethics Course

The VBOA requires that all licensees providing services to the public or to an employer complete on an annual basis a Virginia-specific ethics course that complies with Board Regulation 18VAC5-22-90, and the annual outline approved by the Board. The 2-hour Virginia-specific ethics course is a separate and distinct annual requirement from the one-time American Institute of Certified Public Accountants (AICPA) ethics course needed for initial licensure.

Sponsors who provide a Virginia-specific ethics course must ensure that the course content is in compliance with the VBOA annual outline. Virginia licensees must complete the required annual ethics course no later than Jan. 31 of each year to meet the previous calendar-year requirement.

Therefore, no sponsor should provide the annual ethics course later than Jan. 31 for the previous calendar year. At a minimum, sponsors must provide licensees a certificate of completion or some other form of documentation that includes the sponsor's name, participant's name, course/content name, date taken and CPE hours earned.

Instructor: At this point, you might comment on the fact that Jan. 31 is the last date on which a

CPA can obtain CPE for the prior calendar year.

It is the responsibility of the licensee to ensure that the Virginia-specific ethics course taken (online or classroom) complies with Board Regulations and the outline referenced above. If the licensee is not satisfied with the content of the course, the instructor, or does not believe the course taken satisfies the requirements of Board Regulations and/or the outline, the licensee is encouraged to contact the VBOA.

Qualifying CPE

It is the intent of the VBOA that all CPE (1) meet the requirements of Board Regulations 18VAC5-22-90 and 18VAC5-22-140; (2) provide course content pertinent to the profession; and (3) assist the licensee in becoming a better accounting professional. The VBOA accepts CPE obtained through a variety of forums, providing that the licensee is able to demonstrate that learning objectives were met. A variety of continuing professional education is acceptable, including:

- Attending a seminar or educational conference. Instructors must have up-to-date knowledge of the subject matter and use appropriate teaching materials. Attendance should be monitored in a manner that can be verified by the VBOA.
- Earning course credit at an accredited college or university.
- Completing a self-study course. Licensee must be able to demonstrate that learning objectives were met.
- Making a presentation. The licensee may present at a professional seminar, educational conference or classroom setting, provided that up-to-date knowledge of the subject matter is demonstrated and appropriate teaching materials are used.
- Producing written materials. The topic must be relevant to providing services to the public or an employer using the CPA title. The material is formally reviewed by an independent party and must be published in a book, magazine or similar publication used by individuals who provide services to the public using the CPA title or to an employer using the CPA title.
- Additional Board-approved CPE. The Board has approved the following CPE (without a certificate of completion indicating CPE hours earned) for passing the following exams (in the year passed), not to exceed a total of 60 hours over a three-year rolling period:
  - 30 CPE hours for passing each section of the CFA (Chartered Financial Analyst) Exam; and
  - 15 CPE hours for passing the CTP (Certified Treasury Professional) Exam.

The Board will determine on a case-by-case basis the acceptability of other forms of CPE.

The VBOA has restrictions on the CPE hours a licensee may regard as valid:

- Repeat presentations may not be counted as additional CPE.
- During each three-year period, a maximum of 30 hours for preparing and making presentations is allowable.
- One semester-hour of credit for courses at an accredited college or university constitutes 15 hours of CPE and one quarter-hour of credit constitutes 10 hours of CPE.

The Board has also approved that Continuing Education (CE), Continuing Education Units (CEU), Continuing Legal Education (CLE), Continuing Medical Education (CME), Quality Assurance Service (QAS) and semester and quarter-hour credits are acceptable as CPE credits.

The VBOA does not currently require licensees to obtain CPE from specific or approved sponsors. However, all licensees are required to obtain on an annual basis 2 CPE hours of a Virginia-specific ethics course. In addition, pursuant to Board Regulation 18VAC5-22-140, individuals who release or authorize the release of reports on attest or compilation services provided for persons or entities located in Virginia must obtain on an annual basis a minimum of 8 hours of CPE related to attest or compilation services.

CPE Reporting Period

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

CPE Compliance Reviews

On a monthly basis, the VBOA randomly selects licensed CPAs in Virginia for CPE compliance. The VBOA will notify licensees selected for a CPE compliance review. If selected, licensees will be required to submit the CPE Reporting Form and acceptable supporting CPE documentation to verify compliance. As a function of this CPE review process, licensees may be required to provide additional documentation as requested by the VBOA to support compliance.

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

Licensees should not submit CPE documentation during the annual renewal process unless specifically asked to by the VBOA. However, CPE documentation must be retained for the three calendar-years preceding the current calendar-year.

CPE Documentation Requirements

Required documentation can generally be satisfied by providing:

- Certificates of completion or some other form of documentation from the CPE sponsor(s) including the sponsor(s)' name, participant's name, course/content name, date taken and CPE hours earned when attending a seminar, educational conference or completing a self-study course.
- Official transcript of the college or university for earning course credit at an accredited college or university.
- Syllabus/agenda and signed statement indicating the length of the presentation when making a presentation.
- Copy of published article, book or written material (or proof of publication) when producing written material used by individuals who provide services to the public using the CPA title or to an employer using the CPA title.

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

The VBOA will determine on a case-by-case basis whether other forums are acceptable for CPE credit. The VBOA may also request additional documentation to support compliance. For a complete summary of CPE accepted by the VBOA, see Board Regulation 18VAC5-22-90F.

Retention Requirements for CPE Documentation

Licensees must retain CPE documentation for the three calendar years preceding the current calendar year.

CPE Violations

As the result of a CPE Compliance Review, the VBOA may find that a licensee has violated the CPE requirements during the reporting period. In such cases enforcement action will be taken and the licensee will generally be offered a consent agreement and be subject to disciplinary action.

A licensee may also determine on their own (outside of the CPE Compliance Review program) that they are deficient in CPE for a specific reporting period. The licensee should notify the VBOA immediately when it is determined that a CPE deficiency has occurred.

In accordance with Board Regulation 18VAC5-22-90H, depending on the facts and circumstances, the VBOA may waive all or part of the CPE requirement for one or more calendar years or grant additional time for complying with the CPE requirement, provided that the waiver or deferral is in the public interest. However, requests for a waiver or a deferral must generally be received in advance of the deadline for CPE completion. It is the policy of the VBOA that such waivers or deferrals be considered only in situations resulting from extreme medical hardship or active military deployment. Requests for a waiver or deferral made under this section will be considered on a case-by-case basis. Such approvals are rare.

Resources

Code of Virginia §§ 54.1-4400 – 54.1-4425

Virginia Board of Accountancy, Policy No. 4: Continuing Professional Education (CPE) Guidelines

Virginia Board of Accountancy, document titled “Virginia Board of Accountancy 2014 Virginia-specific Ethics Course — Practical Illustrations — “Substantial Use of Accounting, Financial, Tax or other skills that are relevant, as determined by the Board.”

Virginia Board of Accountancy website:
http://www.boa.virginia.gov/CPALicense/Renewal

Behavioral Ethics

In order to integrate an individual's principles into an established framework of rules, it is necessary to understand the development of those principles by the individual. Swiss psychologist Jean Piaget set forth in his "Theory on Cognitive Development" that intellectual development occurs in progressive stages and that one stage must be accomplished before the next occurs.

Once an individual has gained knowledge or insight at one stage, a new stage of development is created. Each new stage of development emerges only because the child can take for granted the past knowledge gained and look for still more sophisticated forms of knowledge and actions. Intellectual knowledge in general consists of many different areas of knowledge. It is possible for a child to grasp the one area of knowledge and not to have grasped all the areas within that developmental stage. Not all areas of knowledge in any particular stage of development must be completed before addressing that area of knowledge in the next stage of development. So, development can occur at different rates for different areas of knowledge.

Lawrence Kohlberg adapted Piaget's theory to isolate the development of moral reasoning while working on his doctorate at the University of Chicago in 1958. He continued to study moral reasoning as a basis for ethical behavior.

Accordingly, it is this moral reasoning and the related ethical behavior that impacts a CPA's adherence to professional ethical standards. In theory, the expectation is that someone who has progressed to a higher level of moral development will exhibit moral behavior that is more responsible, consistent and predictable.

So, let's examine Kohlberg's Theory of Moral Development further. Kohlberg separated the stages in his model into three levels, each with two stages within them for a total of six stages.

The levels and their respective stages are:

1. Pre-Conventional Morality:
   a. Learn the rules, obey the rules and avoid punishment
   b. Self-interest: What's in it for me?
2. Conventional Morality:
   a. Conformity and harmony with others
   b. Maintain social order, obey authority and perform one's duty
3. Post-Conventional Morality:
   a. Social contract orientation
   b. Personal principles applied based upon individual conscience

In Level 1 (Pre-Conventional Morality), the focus of the developing individual is on him or herself. In the first stage, the developing individual perceives the rules/parameters as absolute. Failure to follow those rules results in punishment. Punishment is to be avoided, so the rules are followed.

In the second stage, the individual begins to consider, from their individual point of view, their own needs and how the rules serve those needs. The rules are seen as negotiable or worth evaluating. They begin to evaluate trade-offs and choose courses of action where the self-benefit is worth the cost. This involves an assessment of the risk of possible punishment and the offsetting possible rewards. Reciprocity is possible, but only in the context of satisfying their individual needs.

In Level 2 (Conventional Morality), the focus is on conformity and social acceptance. In the first stage, the individual sees acceptable behavior as what is pleasing or helpful to others. This allows others to approve of those actions and the individual gains acceptance. Others judge the actions by their intent and, consequently, the intent becomes important. Conformance is desired because it results in approval of the individual.

In the second stage, the individual's thoughts have evolved to recognize the organization of society as a whole and that social order is important. Their actions are directed towards maintaining the social order and performing one's duty. They show respect for authority.

In Level 3 (Post-Conventional Morality), the focus is on independent thought. In the first stage, the individual begins to recognize and account for the differing values, opinions and beliefs of others. They recognize and acknowledge legal and moral rights may sometimes be different but that the rules can be changed. They acknowledge the standards governing society should be reached by agreement.

In the second stage, the individual incorporates into their moral reasoning what they consider to be universal principles. They choose the universal ethical principles that appeal to their personal logic and consistency to develop their own individual principles of conscience. They evaluate the laws and rules in relation to those internalized values. Their actions follow those internalized principles even if in conflict with laws and rules.

Kohlberg's stages of moral development can be superimposed over the environment in which CPAs operate professionally. At the base level, CPAs usually adhere to the non-negotiable rules of federal and state laws. They may make an occasional evaluation as to the cost and benefits of an individual act of disobedience such as speeding.

In recognition of the need for social order and the good of society and the CPA profession, they acknowledge there is a need for conformance, rules and regulations within the industry (Level 2). However, they acknowledge the need to consider evolving needs and evaluate those rules for needed modifications (Level 3, Stage 1). Occasionally, they may encounter a situation that requires the use of internalized individual principles of conscience — one's internal moral compass — to direct their actions.

We can further evaluate the CPA professional ethical guidelines relative to the Kohlberg model. The profession has two sets of ethical standards currently undergoing a convergence effort. Both sets of standards have similar objectives but different approaches.

Acknowledging the Level 2 needs for social/societal/professional guidelines as they relate to professional ethical behavior, the AICPA follows a rule-based approach. The organization of that framework is hierarchical, with broad-based rules implemented by more detailed interpretations and then further explained by rulings based upon those interpretations. The guidelines predominantly follow a "restricted actions" approach outlining boundaries and prohibited actions.

The IESBA follows a principles-based approach attempting to implement a conceptual framework where professional judgment is required. Recognizing that the conceptual framework cannot always be applied, the framework has specific guidance for common situations. Since this approach implies an individual involves and applies their internal moral reasoning, it can be argued it has a Level 3 orientation.

When the convergence project is complete, the degree to which an application of individual internalized personalized principles is required will become clearer.

In the context of social good as it relates to the CPA profession, it is useful to examine where some of colleagues' moral compasses have guided them and also assess where its use is required.

Selected 2013 AICPA disciplinary actions from the Mid-Atlantic area illustrate prime examples of CPAs committing unethical behavior. Federal and state laws are examples of Level 1, Stage 1 rules individuals have chosen to violate. Other examples include SEC and IRS regulations.

Level 2 standards of behavior include professional standards and regulations. Although CPAs, as professionals, acknowledge that licensing is vital to safeguard the interests of the public, there are still instances of unlicensed activity. Similarly, there are violations of other professional standards and regulations.

Also within the profession, there are colleagues who make a conscious decision as to whether to adhere to the professional requirements. They evaluate the costs of compliance in terms of both their time and money and they choose to run the risk of professional disciplinary actions when they are caught. Examples of these are seen in the failure of CPAs to obtain the required CPE.

In contrast, there are colleagues who make the profession proud of their association as a CPA. They exhibit personal values and internalized principles through their actions that contribute to others both individually and collectively. Those firms and individuals are found coast-to-coast. The following are just some examples of good works performed by CPAs.

Locally, for the sixth straight year the members of the Fairfax accounting firm Fritz & Company traveled more than 400 miles to Appalachia Elementary School in Southwest Virginia. They gave every student a new book. As of this year, they have donated more than 2,000 books on their annual trips to the school. Fritz & Company has made a tremendous positive impact on the lives of the students, the community and the perception of the CPA profession in the area. This impact and the regional effect on public opinion was evidenced this year by a TV news team from Bristol traveling approximately 60 miles to the school to cover this year's event.

Farther from home, La Alianza Hispana, a community based nonprofit organization dedicated to the advocacy for equal access to basic human services and providing linguistically and culturally appropriate services to the Latino community of Greater Boston, recognized Lillian Gonzalez, CPA. She was awarded the "2013 Women of Courage Award" as recognition for "representing excellence and … bringing courage, respect and other esteemed values to their professional fields." Gonzalez received national attention through an interview with NPR and quotes in *USA Today* and *The Boston Globe*.

These are only a couple of examples of social good by members of the CPA profession. As members continue to positively contribute to the lives of others, the public perception of the ethics and values of the profession is undoubtedly impacted.

In the profession, sometimes conflicts in executing the professional duties are encountered. Those choices in applying the ethical principles can range from relatively easy ones to situations requiring a much more difficult level of evaluation. There are times when the CPA is blatantly faced with regulatory directives contradicting the professional standards and they must look for additional direction on how to proceed.

Resources

Kendra Cherry, "Kohlberg's Theory of Moral Development":
http://psychology.about.com/od/developmentalpsychology/a/kohlberg.htm

Catherine Allen, CPA, and Robert Bunting, CPA: "A Global Standard for Professional Ethics: Cross-Border Business Concerns":
http://www.ifrs.com/overview/Accounting_Firms/Global_Standard.html

AICPA 2013 Disciplinary Actions:
http://www.aicpa.org/ForThePublic/DisciplinaryActions/2013/Pages/default.aspx

Confidential Client Information

Instructor: Read and briefly discuss how confidential client information is addressed in Rule 301 and 501.

Rule 301 of the AICPA Code of Professional Conduct addresses the issue of Confidential Client Information:

"Rule 301 [ET section 301.01] prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client."

Rule 501 of the AICPA Code of Professional Conduct addresses the issue of Confidential Information Obtained from Employment or Volunteer Activities:

"A member should maintain confidentiality of his or her employer's or firm's (employer) confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship (for example, discussions with the employer's vendors, customers, or lenders). This includes, but is not limited to, any confidential information pertaining to a current or previous employer, subsidiary, affiliate or parent thereof, as well as any entities for which the member is working in a volunteer capacity. For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the member may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships."

In addition, you should keep personal information about employees, such as their financial, medical and salary details, confidential.

Email Etiquette/Encryption

Instructor: Discuss the guidelines for professional email communication. Discuss the associated enforcement case.

Email etiquette is important because well written emails convey a professional image. In addition, following some simple guidelines will put you and your company at less risk.

- Never send, forward or reply to inappropriate emails. Inappropriate emails may contain bad language, pornography, racism, sexism or any other form of discrimination or jokes that include any of these things.
- Make sure email is the best communication method. Ask yourself if the content of your email would be better discussed through a more personal interaction, either a face-to-face discussion or by phone.
- Avoid the use of extremely informal writing. Slang, abbreviations, emoticons and sarcasm are typically not appropriate for professional business emails.
- Proofread your email in its entirety before sending it. Make sure that what you're saying will come across to the recipient in the right way.
- Don't send emails as a "knee-jerk reaction." If a topic or issue has become contentious, take some time to think it through before sending an email. This will help ensure that what you write is stated more professionally and less emotionally.
- Make sure you have the correct name/ email address in the "To" line. Double check to be sure you're sending the email to the correct person. This is particularly important when confidential or proprietary information is involved.
- Consider using a disclaimer. The following is an example of disclaimer wording: "This message is private and confidential. If you have received it in error, please notify the sender and remove it from your system."
- Consider encryption software. When transmitting confidential or proprietary data by email, the email should be encrypted. In addition, companies should have a privacy statement that includes their policies and procedures for keeping information private.

Enforcement Case

Summary of Violations	Rationale	VBOA Action	Date Closed
CASE #8 CONSENT ORDER § 54.1-4413.3 (2), (3), (4) AICPA Code of Professional Conduct ET Section 01.201B. IRS Circular 230 Subsection 10.25. Board Regulation 18VAC5-22-90. Violation of Standards of Conduct and Practice. Due Professional Care.	The Regulant failed to exercise due professional care in the performance of professional services in his unprofessional emailed responses to his client, the shredding of his clients original tax documents, and his failure to obtain the required amount of CPE to include the 2 hours of Virginia-specific Ethics CPE for the reporting year of 2012.	The VBOA ordered that the Regulant shall: Be reprimanded for failing to provide due professional care in the performance of professional services by failing to act in a way that serves the public interest, honors the public trust, and demonstrates commitment to professionalism in his unprofessional e-mailed responses to his client which will remain permanently on his record as of the entry date of this Order; Pay a monetary penalty of $500 for the deficiency of the annual required minimum of 20 CPE for the reporting year of 2012 within 60 days of the entry date of this Order; Pay a monetary penalty of $250 for failing to complete the required two (2) hours of Virginia-specific Ethics CPE for 2012 within 60 days of the entry date of this Order; Submit to the Board 20 deficient CPE certificates of completion within 60 days of the entry date of this Order. Four (4) of the deficient 20 CPE shall be in Practice Management; The Regulant shall understand that although the submitted 20 CPE certificates of completion will be acceptable to fulfill the 2012 CPE requirements, they will not be considered as part of the annual CPE requirements for the current calendar year; Submit to the Board proof of completion of the current year's Virginia-specific Ethics CPE course within 60 days of the entry date of this Order; Report to the Board his CPE compliance for the next three calendar years by submitting his CPE certificates of completion by Dec. 31 of the next 3 calendar years; Reimburse the Virginia Board of Accountancy for the reasonable cost of $1,000 for investigating this matter within ninety (90) days of the entry date of this Order; and Understand that failure to comply with the provisions of the signed and entered Consent Order within 60 days of the required compliance date as stated in this Order shall result in the automatic suspension of his CPA license.	Oct. 1, 2013

Conflict of Interest

Instructor: Read each conflict of interest definition. Discuss a few examples associated with each definition. If the Federal Acquisition Regulation (FAR) is particularly relevant to the audience, use the VBOA handouts for a more in-depth discussion on FAR-related conflicts of interest.

Rule 102 of the AICPA Code of Professional Conduct addresses the issue of Conflicts of Interest:

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

Examples of potential professional conduct conflicts of interest include:

- Performing litigation services for a plaintiff when their lawsuit is against one of your clients
- Suggesting a client invest in a business in which you have a financial interest
- Providing services for both a husband and wife who are going through a divorce

Have a system in place to identify potential conflicts of interest. Because conflicts of interest often involve "gray areas," assess the risks associated with the situation to help you determine the appropriate action to take.

Be sure that not only is there no conflict of interest in actuality but also that to an outsider it would not appear that your judgment could be biased because of personal relationships with family, friends, clients, customers, suppliers or competitors. If you are involved in a conflict of interest situation, or even potential conflict of interest situation, disclose the conflict or potential conflict to the parties who are affected and obtain their consent.

Companies involved in government contracting should also be aware of the areas of the Federal Acquisition Regulations that address conflict of interest.

FAR 2.101 Organizational Conflict of Interest definition — "Because of other activities or relationships … , a person is unable or potentially unable to render impartial assistance or advice, or the person's objectivity … is or might be impaired, or a person has an unfair competitive advantage."

Organizational conflicts of interest exist when there are circumstances that would prevent a contractor from being able to provide unbiased guidance to the government, do their work in an objective way and/or allow for an unfair advantage.

Examples of potential organizational conflicts of interest include:

- A contractor having access to information that is not available to other contractors.
- A contractor helping to create a Statement of Work and then submits a proposal to perform that Statement of Work.
- A contractor performing an assessment of an affiliated company.

Conflict of Interest

Case Study

You specialize in accounting for fish processors. Your client, Best Fish, requires an audited financial statement. You are currently engaged to audit Top Fish, a competitor of Best Fish. In the audit of Top Fish, you learn that a customer of both businesses is about to file for bankruptcy.

Can the CPA perform the audit for both clients, and can the information learned in the Top Fish engagement be used in the Best Fish engagement?

> *"A CPA is not prohibited from performing engagements for competing clients. In fact, specializing in specific industries for competing companies can increase professional competence and expertise. The problem that can develop is in disclosure of information learned in audits of competitors. Rule 301.01, "Confidential Client Information," states: "A member in public practice shall not disclose any confidential client information without the specific consent of the client." This rule prohibits the CPA from disclosing this information without the specific consent of the client, unless the information is a matter of public record and is acquired independently of the Top Fish engagement.*
>
> *The CPA firm should disclose the competing client relationships to each client prior to undertaking the engagements. This will help protect the firm from impairments of independence in appearance (as might be perceived by an aggrieved client if things go bad). Different partners at the firm should handle each engagement."*[1]

Notes

1 John Raspante. "An ethics quiz: the rules are there. These case studies look at some of them." *Journal of Accountancy*, Aug. 1, 2002. Web, Dec. 18, 2013.

Companies bidding on government contracts should turn their attention to FAR Subpart 9.5, Organizational and Consultant Conflict of Interest, to see the nature of potential conflicts of interest through the eyes of the contracting officer.

FAR 3.1101 Personal Conflict of Interest definition — "A situation in which a covered employee has a financial interest, personal activity or relationship that could impair the employee's ability to act impartially and in the best interest of the Government when performing under the contract."

Personal conflicts of interest exist when a person has personal, family, financial or other interests that could cause them bias in making business decisions.

Examples of potential personal conflicts of interest include:

- Compensation
- Stocks and real estate investments
- Future employment negotiations

Companies bidding on government contracts should turn their attention to FAR Subpart 3.11, Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions, for additional details.

The VBOA has also provided the following information on FAR-related conflicts of interest:

Conflicts of Interest

Conflicts of Interest (COI) can prevent a firm from winning a public contract and can result in the firm being removed from an existing public contract!

Conflicts of Interest Basics

A conflict of interest occurs when an individual or organization is involved in multiple interests, one of which could possibly bias the motivation for an act in the other. A conflict of interest can exist even if there has been no unethical or improper activity. It is NOT a "no harm, no foul" situation. Even the appearance of COI is reason to mitigate.

For many professionals and professions, it is virtually impossible NOT to encounter conflicts of interest from time to time.

COIs come in two forms:

- *Personal Conflicts of Interest (PCI)*
- *Organizational Conflicts of Interest (OCI)*

Personal Conflicts of Interest (PCIs)

PCIs can develop when a person has personal, family financial or other interests that could cause them bias in making business decisions. Examples of financial interest include compensation, consulting arrangements, stock and real estate investments, future employment negotiations, gifts and intellectual property.

FAR Part 3.11, Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions, is the primary regulation government PCI. This provision requires contractors to identify and prevent PCIs for "covered" employees and prohibit "covered" employees who have access to non-public info using such information for personal gain.

A Covered Employee is an individual who performs an acquisition function closely associated with inherently governmental functions and is:

- *An employee of the contractor; or*
- *A subcontractor that is a self-employed individual treated as a covered employee of the contractor because there is no employer to whom such an individual could submit the required disclosures.*

An acquisition function closely associated with an inherently governmental function is one performed under contract to the government for any of the following functions:

- *Planning acquisitions*
- *Determining requirement to be acquired, including developing statements of work*
- *Developing or approving any contractual documents*
- *Evaluating contract proposals*
- *Awarding government contracts*
- *Administering contracts*
- *Terminating contracts*
- *Determining whether costs are reasonable, allocable and allowable*

The provisions with respect to Personal Conflicts of Interest are implemented by FAR Clause 52.203-16. This clause requires contractors to have procedures in place to screen covered employees for PCIs by requiring Disclosure of Interest Statements updated when personal or financial circumstances change or at least annually.

Disclosure of Interest Statements must include:

- *Financial interests of the covered employee, of close family members, or of other members of the covered employee's household*
- *Other employment or financial relationships of the covered employee (including seeking or negotiating for prospective employment or business)*
- *Gifts, including travel*

In addition, Contractors are required to:

- *Train their employees on PCIs*
- *Maintain oversight and verify compliance with PCIs*
- *Take disciplinary action when PCIs are violated*
- *Report to the CO any PCI violation and corrective action taken*

In the event of a violation of the PCI rules, the contracting officer is required to seek agency legal counsel advise on course of action. Most likely outcomes are:

- *Removal of employee from contract*
- *Finding of inadequate internal controls/start of debarment process*
- *Fine imposed on Contractor (less likely)*

PCI is widely considered to be likely to expand into non-acquisition type activities in the near future. The following statement was included in an Advanced Notice of Proposed Rule for Service Contractor Employee PCIs published in the March 26, 2008 Federal Register:

"The Federal Government is increasingly turning to private contractors to perform a wide array of its work. As a result, contractor employees are increasingly working side-by-side with Federal employees, but are not subject to the same ethical safeguards that have been put in place for Federal employees to ensure the integrity of Government operations."

PCI Best Practices/Mitigation Strategies

Companies should make sure there are no penalties associated with disclosure. No one should be demoted or fined for disclosing a potential conflict. This promotes full disclosure while allowing for mitigation. Companies should also make sure the right people have all the information on potential conflicts so the right steps can be taken.

It is advisable to have predetermined, multiple mitigation strategies developed and on file for use if the situation should arise.

Organizational Conflicts of Interest

Potential for OCI typically exists when a business relationship could create incentives or self-interest. The original OCI concept was a remains to manage the conflicts, not to punish the conflicted. Even today in FAR and other agency regulations, OCI provisions are organized under "contractor qualifications," not "improper business practices." The FAR and other regulations recognize conflicts as occurring in the ordinary course of business.

In today's OCI environment, companies may invest heavily in pursuit of an opportunity only to have it rejected for OCI reasons (real or otherwise). Companies may even win a contract only to have it terminated for convenience for OCI reasons. OCI has become the new "third rail" for Contracting Officers and the newest best grounds for a protest.

General OCI Types are:

- *Unequal Access to Non-Public Information*
  - *Proprietary data*
  - *Source selection data*
  - *May give unfair competitive advantage*
- *Biased Ground Rules*
  - *Authoring of Statements of Work (SOW)*
  - *Could steer contracts or give unfair competitive advantage*
- *Impaired Objectivity*
  - *Evaluation of own products/ services or those of parent, subsidiary or affiliate*
  - *Advisory role on issues of significance to own work or that of parent, subsidiary or affiliate*

The specific prohibitions contained in FAR 9-505 are:

- *A provider of Systems Engineering or Technical Direction…*
  - *Shall not be awarded a contract to supply the system of a subcontract for any major component*
  - *Shall not be a subcontractor or consultant to a supplier of the system or any of its major components*
- *A contractor who prepares complete specs for a non-developmental item may not furnish the item as a prime or sub for at least the duration of the initial production contract. This does not apply when…*
  - *The specs are for item the contractor already supplies, or*
  - *The contractor acts as industry rep to assist in prep under Government supervision and control*
- *A contractor who writes the statement of work (SOW) for a competitive acquisition is excluded from supplying the system unless…*
  - *It is the sole source*
  - *It has participated in design work*

    - *More than one contractor worked on SOW*
- *A contractors may not perform contracts requiring it to evaluate its own products*
- *Contractors with access to proprietary information (including Marketing/BD consultants) may not compete when info would give unfair competitive advantage unless…*
    - *The data was furnished voluntarily without restrictions*
    - *The data was available from other sources without restriction*

More on the Types of OCI

Unequal Access to NonPublic Information This type of OCI is particularly hard to mitigate. It's like trying to "un-ring a bell." It is even harder to prove information has been purged and disclosure before the fact almost always results in exclusion from acquisition process. Other (related) business units may be able to participate in the affected procurement, but effective segregation of the proposal team is mandatory.

Case Study No. 1

In 2012, a major public company hired a retired (more than 3 years) Air Force officer to work in one of their field offices. The firm subjected this new hire to three days of (presumably) intensive ethics training. It is alleged the employee disclosed to other firm employees non-public procurement-related data that could have given it an unfair competitive advantage.

Another employee reported the disclosure to the firm's legal department and the company self-reported the violation and withdrew from participation in the procurement. The firm also terminated the employee, but the Air Force still suspended the field office involved from all Federal awards and formally proposed debarment of the offending field office (only).

The principle takeaways from this case study are (1) knowing non-public data is not misconduct and could be mitigated, but (2) retaining non-public data from a previous public position might be and (3) using or disclosing that data almost certainly is.

Case Study No. 2

A small Navy services contractor competed for and won a five-year training contract. After award, a "disappointed bidder" (FAR-speak for "loser") protested alleging that winner had employees "behind the firewall" in the program office. The core of the allegation was that the winner had unequal access to information. As a result, the contracting officer issued a stop work, the Navy conducted a minimal investigation and then converted the stop work order to a termination for convenience and proceeded to re-compete the work.

The principle takeaways from this case study are (1) having employees behind the firewall is not necessarily fatal to the procurement, but (2) keeping those employees in communication with anyone on or connected to the proposal team could be, and (3) not disclosing the situation and the mitigation efforts will almost certainly be fatal.

Biased Ground Rules

This type of OCI is much more susceptible to mitigation using so-called "Chinese *walls" to segregate the organization with the conflict from the rest of the firm. This type, however, can also be much more restrictive. If mitigation is impossible (or even difficult to demonstrate), the result may be exclusion from the procurement. There is no protection from Government's failure to identify the potential conflict. The contractor is solely responsible.*

Potential for "Bias COI" has led to recent divestitures in large firms. The Washington press has speculated that Northrop Grumman's divestiture of TASC was OCI-driven. Washington Technology (Feb 2012) described L-3 spinoff of defense engineering and technical services units (now Engility) as OCI-driven as well. There have been others…

- *ITT's spinoff of Excellis*
- *SAIC's sale of oil & gas unit to WIPRO*
- *QinetiQ's divestiture of security unit to ManTech*

Why divestiture is common because while Bias OCI can be mitigated, proof (or demonstration) that there is no OCI is VERY difficult. Appearance of OCI can lead to the same remedies as real OCI and the favored remedy from the government's perspective is procurement exclusion. This can be VERY expensive if a small services contract to perform test and evaluation (T&E) services excludes a company from participation in a major system procurement.

Impaired Objectivity
This is the hardest of all types of OCI to mitigate because financial self-interest at the organizational level is assumed in all cases. "Chinese walls" and proposal team segregation are not acceptable as mitigation techniques for impaired objectivity.

The favored mitigation technique here (from the Government's perspective) is also exclusion. For this reason, "divestiture" often crops up when this type of OCI is present.

Case Study No. 3

In February 2008, GSA was already embroiled in a multi-contractor protest on the Alliant program. During the protest, it was revealed that contractor past performance evaluations had been performed by a small consulting firm, not the Government. The firm had among its past and current clients a number of the competitors under evaluation. While this had no impact on the allegations of the protest, it did prevent GSA from using anything the contractor had done in the reevaluation of the Alliant proposals.

As a result, GSA was forced to completely redo the evaluations without using any of the outside work in settlement of the protest. When the second awards were made, they included virtually every qualified contractor and the final awards were more than two years late.

The principle takeaways here are that (1) contractor performance of activities "closely associated with inherently governmental functions" are ALWAYS risky, (2) GSA should have required disclosure and examined the firm selected to perform the evaluations for potential OCI and (3) the firm should have disclosed potential OCI whether or not required by contract provision.

This outcome could have been very different is GSA had used another contractor for evaluations. They could also have required that evaluations of the firm's *existing clients be performed by a third party with the results provided directly back to GAS without even going through the contractor's hands.*

Practical OCI Approaches

Contractors should build early identification of potential OCI into the business development process. They should also build identification of PCI into human resources policies and procedures.

Firms should consider designing effective mitigation techniques BEFORE they are needed and above all else, they should disclose, disclose, disclose.

A Brief History of Key Regulations

- *1986 — Packard Commission by President Ronald Reagan recommended that defense contractors promulgate and vigilantly enforce codes of ethics and internal controls to monitor compliance.*
  - *32 major contractors formed the "Defense Industry Initiative on Business Ethics and Conduct"*
- *1991 — US Sentencing Guidelines came up with 7 (minimum) guidelines for use in sentencing corporations and corporate employees found guilty of ethics-related violations.*

The original FAR provisions (FAR 3.1002(a)) was "Government contractors must conduct themselves with the "highest degree of integrity and honesty."

It wasn't enough.

Big Cases Leading Up to the Recent FAR Change

2004 — One of the largest owner/operators of inpatient rehabilitation facilities in the US agreed to pay $325 million for false claims.

2005 — An investor-owned health care delivery company operating 49 hospitals and 90 outpatient centers and a private teaching hospital were accused of fraudulently inflating patient care cost and were assessed a combined fine of $1.18 billion.

2006 — A major aerospace and defense corporation agreed to pay $615 million to resolve allegations of procurement fraud.

2007 — Two manufacturing corporations agreed to pay a combined $17 million fine for sale of faulty body armor to DOD.

2008 — A major drug company agreed to pay $362 million to settle a qui tam claim that it failed to provide the government its best price and paid kickbacks to prescribing physicians.

Recent Regulatory Changes

Key FAR Revisions Effective December 2008

- *FAR 3.10, Contractor Code of Business Ethics and Conduct*
- *FAR 3.1003, Requirements*
- *FAR 3.1004, Contract Clauses*

Together, these new provisions make the new ethics program clause mandatory for contracts greater than $5 million and more than 120 days duration and make contractors subject to suspension or debarment for knowing failure by a principal to disclose a violation of law or *regulation whether or not the contractor is performing contracts containing the clause. They also make contractors responsible for prompt notification if the Government has been overpaid (again, whether or not any contract contains the clause). However, mere disclosure of a violation is not protection from suspension or debarment.*

The New FAR Ethics Clauses

***FAR 52.203-13**, Contractor Code of Business Ethics and Conduct (December 2008)*

The clause requires contractors to have a written code and to make the code available to all employees. It requires contractors to maintain an adequate Internal Control System to prevent, detect and report ethical violations and to require disclosure to the Government of certain violations.

Small businesses are exempt from the clause.

***FAR 52.203-14**, Display of Hotline Poster(s) (December 2007)*

This clause requires display of a Government agency Hotline Poster unless the company has its own. It further requires the "flow-down" of the Hotline clause to subcontractors.

No one is exempt from this clause.

Not Required but Good Practice

It is highly recommended that contractors implement a code of ethics and compliance programs evenif not required by the FAR. Such a program is a good defensive position against improper practices.

Agencies can (and some have) set lower compliance thresholds and it is the contractor's responsibility to find out if its customer has set a lower level for compliance.

Contractors should look for clauses from an Agency-specific supplement (DFARS, DEAR, NFS, etc.) or for a "special provision" in contracts or solicitations.

What IS Required for a Small Business?

If contractor is a Small Business as defined by the NAICS code of a particular contract, or if the contract is for a commercial item within the meaning of FAR Part 12, the firm does not have to implement an ethics awareness training program or internal control systems.

Firms "on the cusp" in one or more NAICS codes should consider preparing for compliance prior to requirement. Remember that a firm can be large in one NAICS code and small in another.

The Effect of the Regulations

The effect of the changes to the FAR is to shift the burden to the contractor to institute anti-corruption practices. The Government no longer intends to make any effort to (or even wants to) catch the mistakes. It now expects companies to police themselves and self-report their violations.

Timely reporting is key to compliance. The emphasis has shifted and more is now placed on the actions of individuals.

Responsibility of Individuals

Common Individual Ethics Issues

- *Possession of "procurement sensitive" information*
    - o *Source selection plans*

  - o *Data of competitors*
- *Gifts and gratuities to "Government officials"*
  - o *Meals & entertainment*
  - o *Holiday gifts*
  - o *Speaking fees*
- *Campaign contributions*
  - o *By contractors*
  - o *By individuals employed by contractors*
- *Timekeeping irregularities*
  - o *By individuals*
  - o *By Supervisors or managers*

Procurement Sensitive Info

Procurement sensitive information is any non-public information concerning a Federal procurement that might give a contractor a competitive advantage. Examples include a source selection plan, an unpublished or advance copy of a solicitation, and proprietary data of another contractor obtained from Government sources, whether directly or indirectly. Such documents will often be marked "For Official Use Only," "Procurement Sensitive," "Proprietary Data," "Proprietary Information," or "Company Proprietary." Any kind of Government applied classification (Confidential, Secret, Top Secret) — creates other, much greater, problems.

Individuals are cautioned not to accept procurement sensitive data or information from ANY source. If procurement sensitive information is found in your company, report it immediately to the appropriate company official and turn the information or data over to the official promptly.

Case Study No. 1

In 2008, a major public corporation was suspended and recommended for debarment when a whistleblower alleged that employees of the company had obtained protected source-selection information from an Agency employee and then used it to their advantage in contract negotiations with the agency. The suspension lasted one week, five employees were fired and the company agreed to reimburse the Government for the cost of the investigation. The entire incident resulted from the wellmeaning, but misguided actions of a few individuals, but media estimates of the companies lost revenues during that week ranged from $5.7M to as much as $10M per day.

Case Study No. 2

In February, 2012, one office of a major Defense contractor suspended and proposed for debarment when the company disclosed to the Government that its employees possessed, but did not use, proprietary data of a competitor which might have given the company a competitive advantage in a competitive procurement. The suspension was lifted approximately one month later. They entered into a three year agreement with DOD requiring surveillance of their internal controls and extensive employee training, one employee was fired and the company voluntarily withdrew from the competition in question. The entire incident resulted from the misguided actions of a single individual, but it cost the company three years of intense scrutiny and loss of a major contract they were favored to win.

Gifts and Gratuities

The Standards of Ethical Conduct for Employees of the Executive Branch sets *the maximum permissible value of a "Gift" at $20 (see 5 CFR § 2635.203(b)). Many classes of individuals are prohibited from giving gifts or gratuities to employees of the Executive Branch including all Government contractors and their employees (see 5 CFR § 2635.203(d)).*

Federal employees can generally accept unsolicited gifts with a market value of up to $20 per giver, per occasion. There are exemptions for gifts between employees who also have "family relationship or personal friendship." "Family" is pretty straightforward, but as to "friendship," just don't go there.

Even though individual gifts of $20 or less are permitted, the Standards of Conduct prohibit gifts from a single source with an aggregate value in a year that exceeds $50. Federal employees are required to keep track of how much someone (either individual or company) gives them on separate occasions over the year, because the aggregate market value of gift they are permitted to accept cannot exceed $50 annually.

Meals are considered "gifts" if the value exceeds $20 (cost is used as the measure). While eating for less than $20 can be difficult in areas like DC, the rule has no exceptions and an "honor basket" at meetings or receptions is not considered sufficient. There is an exception to the meals rule for Widely Attended Gatherings (WAGs), but the definition of a WAG is ambiguous. Some ethics officers pin it at 25 or more attendees. Others set the number at 100. Still others consider how many different agencies and titles will be represented. If you plan to host a WAG, consider wording in the invitation that interested attendees should check with their ethics officers.

Campaign Contributions

General Limitation (11 CFR 115.2) — A Federal contractor may not make, either directly or indirectly, any contribution of money or other thing of value to any political party, committee, or candidate for Federal Office. However, employees of Federal contractors can make contributions from their personal funds.

Corporations, labor organizations, membership organizations, cooperatives and corporations without capital stock may establish, administer and solicit contributions to a separate segregated fund, referred to as a political action committee (see 11 CFR 115.3).

Limitations on partnerships (11 CFR 115.4) — A Federal contractor that is a partnership cannot use the assets of the Partnership to make contributions or expenditures in connection with a Federal election. However, individual partners can make contributions in their own names from their personal assets.

Limitations on individuals and sole proprietors (11 CFR 115.5) — Federal contractors who are individuals or sole proprietors are prohibited from making contributions or expenditures from their business, personal or other funds under their dominion or control in connection with a Federal election. Their spouses, however, may make donations in their own names.

Timekeeping

Employees must charge to the project or activity they work on regardless of the status of the job and they must comply *with the company's timekeeping policies and procedures. Supervisors must provide employees with a valid charge code for all work and ensure that employees under their supervision comply with all of the company's timekeeping policies and procedures.*

Timekeeping and associated labor law violations are the most common of all ethics issues. In the past year, more than 2,200 firms or individuals were added to the excluded parties list (debarred from federal contracting) for violations of timekeeping rules on federal contracts or other labor laws. Most, but not all, were associated with "wage and hour" laws, but some some were associated with failures of timekeeping systems.

The primary agency charged with surveillance of contractor timekeeping systems is the Defense Contract Audit Agency. (DCAA) This agency was created to perform contract audits on all Department of Defense (DoD) procurement and contract administration activities and to provide uniformity between DoD components. They also perform these functions for many civilian agencies.

DCAA conducts audits in accordance with the Defense Contract Audit Manual (DCAM) and Generally Accepted Government Auditing Standards (GAGAS). Among the audits they perform are:

- *Audit of Timekeeping and Labor Systems*
- *Audit of Internal Controls over those systems*
- *Floor Checks (timekeeping compliance)*
- *Compensation Systems Reviews*
- *Billing Systems Reviews (including tracing labor transactions from TS to voucher)*

The most serious timekeeping ethical lapses are those involving diversion of charges or unauthorized changes to contracts. Such actions could result in False Claims Act violation with penalties including fines of up to $10k per occurrence and even criminal penalty for willful violation by an individual. In addition, such a violation could (and probably would) result in finding of a significant deficiency in the contractor's timekeeping and/or accounting systems.

Consequences of an Ethical Lapse

The following is just a partial list of the Federal statutes that may be used to pursue remedies for an ethical violation.

- *False Claims Act — 31 U.S.C. § 3729*
- *False Statements Act — 18 U.S.C. § 1001*
- *Contract Disputes Act — 41 U.S.C. §§ 601–613*
- *Forfeiture Statute — 28 U.S.C. § 2514*
- *Anti-Kickback Act — 41 U.S.C. § 54*
- *Truth in Negotiations Act — 10 U.S.C. § 2306*
- *Bribery and Gratuities Statutes — 18 U.S.C. §§ 201–208*
- *Mail and Wire Fraud Statutes — 18 U.S.C. §§ 1341 and 1343*
- *Procurement Integrity Act — 41 U.S.C. § 423*
- *Bid Rigging and Collusive Bidding — 15 U.S.C. § 1*
- *Suspension and Debarment — FAR 9.406-2 and 9.407-2*

Parties at Risk and Potential Consequences

Corporate officers may be at risk if they…

- *Certify percentage of completion*
- *Certify cost and pricing data*
- *Certify claims*
- *Oversee compliance programs*

Corporate officers and employees may be at risk if they…

- *Sign contracts*
- *Sign payment applications*
- *Sign change orders*

Consequences of an ethical violation may include…

- *Suspension from eligibility for awards*
- *Debarment from all Federal contracting (including prime, sub and vendor)*

In the event of a violation of law, a contractor's failure to have a program in place will be evidence used to determine punishment — the same standard currently in place for judges to use in sentencing companies found guilty of violating federal law. The Federal Sentencing Guidelines come into play as well as the culpability score. The less evidence that a company has a formal ethics program, the more the courts are instructed to be tough on sentencing.

If a company self-reports, whistle-blowers must be protected (see FAR 52.203-15) and under the Fraud Enforcement and Recovery Act of 2009 (FERA) (see Relief from Retaliatory Actions, 31 U.S.C. 3730(h)), whistleblowers suffering retaliation are entitled to…

- *reinstatement with the same seniority status;*
- *double back-pay;*
- *any "special damages"; and*
- *attorneys' fees.*

In addition to fines, suspension, or debarment, the Government could require a "Monitor" to oversee your company's ethics program. Monitors, when required, are paid for by the company but approved by the agency. Monitors operate independently from both the contractor and the government and reports back to the government periodically on the company's compliance status for a period of one to three years.

2014's Other Relevant Issues

Comfort Letters

Comfort letters are defined in AU-C Section 920.07 as:

"A letter issued by an auditor in accordance with this section to requesting parties in connection with an entity's financial statements included in a securities offering."

Accordingly, most "comfort letters" do not meet this technical definition and are, in fact, letters requesting verification of a client's information.

These verification letters are typically sent by a third-party or provided by a client at the request of a third party. The third party requests a CPA to make assertions about a client's information. Usually, this is in the context of supplying or verifying information for the third party's evaluation as to whether to extend financing or services to the client. The wording of third-party forms requesting information may even go so far as to imply a guarantee that certain information is correct.

The requestor third party's objective is an attempt at risk-reduction or risk-shifting. If the extent of the request represents assurance, then the CPA's response could violate professional and ethical standards. Assertions provide a potential opportunity to involve the CPA in litigation. Also, AT Section 9101 specifically prohibits CPAs from providing ANY assurance as to solvency.

Verification (Comfort) letter requests frequently come from the mortgage and lending industry. The information routinely requested includes:

- Verification of income from self-employment
- Confirmation of a client's self-employment
- Verification of the client's business ownership percentage
- Profitability or sustainability of a self-employed client's business
- Assessment of the impact of client's withdrawals from the business

The Farm Service Agency (FSA) of the U.S. Department of Agriculture (USDA) in its implementation of the 2008 Farm Bill (formally known as The Food, Conservation, and Energy Act of 2008) requires documentation from recipients of payments through the program. One method of proving compliance with the adjusted gross income limitation is providing a "certification" letter from a CPA or attorney. This is an alternative to providing the last three years actual tax returns to prove compliance.

Contractor professional associations and cooperatives may request information for providing such services as general liability and worker's compensation insurance. Also, regulatory agencies may request information from contractors to assess compliance. Franchisors such as FedEx may make inquiries into a franchisee's information such as payroll tax practices. Adoption agencies and health insurance providers occasionally request information before providing benefits or services. Credit Suisse Group AG issued a tax compliance certification to be signed by the U.S. tax return preparer certifying Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) information. These are just some of the sources of verification letter requests.

Efforts addressing the issues surrounding these verification letters are occurring at the national, local and individual levels. The AICPA regularly communicates with the mortgage industry in an attempt to educate them as to both the alternatives available for substantiating the information and the limitations placed upon CPAs.

Upon notification of the Farm Service Agency's "certification" letter wording that violated professional standards, the AICPA contacted the FSA to educate them about the professional standards and the limitations imposed upon CPAs. Accordingly, the AICPA and FSA agreed upon a revised wording for the statement which is found in the USDA Notice PL-243.

At an individual level, the CPA should be thoroughly familiar with the documents or regulations upon which the requestor is basing their requests for information. Usually, there are alternate methods of substantiation with some being preferable to the letter from a CPA. However, it is frequently easier to just "put the monkey on the back" of the CPA to provide the information. For mortgage motivated requests, the CPA can find information on the documentation and verification requirements for both Fannie Mae and the Freddie Mac Single Family Seller/ Servicer Guide (See Section 37 et.al.) online.

For FSA requests, the "certification" letter is an alternative to providing the previous three years' tax returns. Accordingly, it is preferable from the CPA's point of view for the client to supply those to the FSA. A legitimate reason may exist to not provide three years of tax returns such as possible confusion where the person qualifies individually but files a joint return that reports AGI in excess of the limitation. Then, the CPA should recommend the client engage an attorney to verify the person qualifies on an individual level. The attorney would then sign the sample letter. If the CPA is put into a position of responding, then the CPA should become thoroughly familiar with the USDA statute and the FSA regulations, use the sample engagement letter, use the appropriate disclosure form and use the AICPA approved letter for average AGI compliance verification.

If you have a requestor who insists you are the only source of acceptable verification, you may contact the AICPA Accounting and Auditing Technical Hotline at (877) 242-7212 or by submitting your request on the hotline form for assistance. In response to a number of these requests, the AICPA contacted the requestors to educate them and to work toward a resolution of the situation. The AICPA also provides the following sample letter that may be used in their Technical Practice Aids TIS § 9110.19, Special Reports.

Date
ABC
Company Address
City, State Zip

Dear Mr. ________________:

I am writing to you at the request of Mr. & Mrs. ______________________.

The purpose of this letter is to confirm to you that I prepared the 20XX federal income tax return of Mr. & Mrs. ________________ and delivered this return to them for filing with the IRS. At their request, I have attached a copy of the tax return and related schedules provided to them for filing.

This return was prepared from information furnished to me by Mr. & Mrs. _______________ . This information was neither audited nor verified by me, and I make no representation nor do I provide any assurance regarding the accuracy of this information or the sufficiency of this tax return for your credit decision-making purposes.

I prepared Mr. & Mrs. _____________________tax return in accordance with the applicable IRS rules and regulations solely for filing with the IRS. As a result, the tax return does not represent any assessment on my part regarding creditworthiness and does not include any statement of their financial position or income and expense for the year 20XX, in accordance with accounting principles generally accepted in the United States of America, and should not be construed to do so.

As you know, a credit decision should be based on a lender's exercise of due diligence in obtaining and considering multiple factors and information. Any use by you of Mr. & Mrs. ______________________ 20XX federal income tax return and this letter is solely a matter of your responsibility and judgment. This letter is not intended to establish a client relationship with you nor is it intended to establish any obligation on my part to provide any future information to you with regard to Mr. & Mrs. _______________________.

Sincerely,

______________________ (Firm Name)

cc: Mr. & Mrs. _____________________ (Client)

[Issue Date: July 2012.]

In addition, if a CPA is aware the purpose of a client's request for copies of tax returns is to provide them to third parties, the CPA should consider adding the following language in the transmittal letter that accompanies the copies of tax returns:

"We prepared the tax returns solely for filing with the Internal Revenue Service (IRS) and state and local tax authorities. They are not intended to benefit or influence any third party, either to obtain credit or for any other purpose.

As a result, you agree to indemnify and hold our firm and any of its partners, principals, shareholders, officers, directors, members, employees, agents or assigns harmless from any and all claims arising from the use of the tax returns for any purpose other than filing with the IRS and state and local tax authorities, regardless of the nature of the claim, including the negligence of any party."

When asked by a client to prepare a verification letter for a third party, the CPA should advise the client on the cost-saving use of alternative methods of verification. If the client insists upon the CPA participating, the CPA should advise the client on our professional limitations and the services available and their respective costs.

If the CPA chooses to provide a verification letter in response to the request then they should educate themselves on the applicable regulations associated with the request. The professional liability insurance coverage should be reviewed for possible coverage limitations. The CPA should obtain an engagement letter. An example of an engagement letter is found in the AICPA provided sample engagement for the FSA "certification" letter.

The CPA must obtain signed authorization for disclosure of the client information prior to the engagement. For engagements involving tax information, the CPA must ensure the authorization meets the detailed requirements of IRS Section 7216. Also, the CPA is advised to use the AICPA approved sample language in their response.

Sources:

AICPA AT § 9101

AICPA Blog, March 15, 2013. "The Dangers of Providing Client Comfort Letters" Posted by Susan S. Coffey CPA, CGMA: http://blog.aicpa.org/2013/03/the-dangers-of-providing-client-comfort-letters.html

AICPA Blog, Aug. 26, 2013. "That 'Comfort Letter' Request May Really Be a Third-Party Verification" Posted by Susan S. Coffey CPA, CGMA: http://blog.aicpa.org/2013/08/that-comfort-letter-request-may-really-be-a-third-party-verification.html

AICPA, "Concerns Regarding Comfort Letters/Third Party Verification": http://www.aicpa.org/interestareas/frc/pages/concernsregardingcomfortletters.aspx

United States Department of Agriculture Farm Service Agency: Fact Sheet, January 2012

United States Department of Agriculture Farm Service Agency: PL-243, Aug. 1, 2013

AICPA: FSA Certification Letter Guidance

Internal Revenue Code § 7216

AICPA Technical Practice Aids: TIS Section 9110.19 Lender Comfort Letters July 2012

The Tax Adviser: CPAs and Comfort Letters: The New Chocolate: DC Currents, Edward S. Karl CPA Published July 1, 2013

AICPA Insurance Programs: Third Party Verification Letters

Financial Reporting Framework for Small- and Medium-Sized Entities

The AICPA Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SME) is designed to provide useful, relevant information in a simplified, consistent, cost-effective manner where U.S. Generally Accepted Accounting Principles (GAAP) financial statements are not required.

The special purpose financial reporting framework is designed for private small- and medium-sized for-profit entities (SME) that may not need GAAP-based financial statements. If GAAP isn't required, a special purpose framework may be the financial reporting option currently used such as:

- Tax Basis
- Cash Basis
- Modified Cash Basis
- Regulatory Basis
- Contractual Basis
- Other non-GAAP bases of accounting that utilize a definite set of logical, reasonable criteria that is applied to all material items appearing in the financial statements

Special Purpose Framework is the term that replaces Other Comprehensive Basis of Accounting (OCBOA). The Framework was developed and released to provide a cost-beneficial non-GAAP solution for streamlined financial statements based upon traditional and proven accounting methods. It is intended to provide meaningful financial reports without needless complexity.

Some of the advantages of the FRF for SMEs include:

- More closely aligned with income tax returns
- Accounting policy options allow flexibility
- Goodwill amortized over same period as federal tax purposes
- Only relevant principles included
- Accounting is simplified
- Disclosures are targeted to small business issues
- Disclosures are streamlined to avoid excess detail, complexity and extraneous information
- Management can tailor nature and extent of disclosures as needed

The basic principles behind the FRF for SMEs include:

- Primarily uses historical cost basis
- Provides options in certain accounting policies:
  - o Income taxes (taxes payable or deferred income taxes method)
  - o Subsidiaries (consolidate or equity method)
  - o Joint ventures (equity method or proportionate consolidation)
  - o Long-term contracts & service contracts (percentage of completion or completed contract method)
  - o Intangible assets acquired in business combination (recognize separately or include in goodwill)
  - o Internally-generated intangible assets (expenses of capitalize development costs)
  - o Certain interest costs (expense or capitalize)
  - o Defined benefit plans (contribution payable or accrued benefit obligation)

Selected issues and treatments for illustration within the FRF for SMEs include:

- Intangibles:
  - Amortized over same period as used for federal income taxes
  - No impairment testing
  - All are considered to have finite useful lives and are amortized over them
- Income Taxes:
  - Allows choice of taxes payable or deferred income taxes method
  - States that no provisions made in financial statements of businesses if income taxed directly to owners
- Leases:
  - Criteria for capitalizing generally matches tax purposes
  - Reduces book to tax adjustments
  - Classifies leases from lessee's point of view as either operating or capital
  - Classifies leases from lessor's point of view as either operating or sales-type or direct financing

In an effort to facilitate the adoption of the FRF for SMEs, the AICPA has a number of resources available. They include the following practice aids:

- Publication: Financial Reporting for Small- and Medium-Sized Entities
- PowerPoint Presentation: FRF for SMEs Accounting Framework
- Presentation and Disclosure Checklist
- FRF for SMEs Toolkit for CPAs and CPA Firms
- FRF for SMEs Toolkit for Financial Statement Users
- FRF for SMEs Toolkit for Small Businesses

If the CPA wishes to contact the AICPA or find more information concerning the FRF for SMEs, they have provided two different convenient options as follows:

- Website: www.aipca.org/FRF-SMEs
- Email: FRFforSMEs@aicpa.org

Confidential Client Information

See page 38.

AICPA Code of Conduct Changes

See page 20.

Tax Transparency

"Tax transparency" refers to the disclosures necessary to reveal the taxes paid, the effective tax rates and the business units paying those taxes to the various tax jurisdictions & the respective units' interrelationships to the other business units within the organization.

The topic has become timelier due to the convergence of a number of factors including:

- Government needs for increased revenue
- Rise of media focus
- Internationalization of businesses
- Increased use of the Internet
- Availability of information
- New required disclosures

As a result of the global recession, tax revenues were decreased when businesses struggling under the economic downturn either failed or suffered reduced profitability resulting in lower tax liabilities. When the governments' level of spending was recognized and acknowledged as unsustainable, various austerity measures were implemented. Those measures alone were insufficient to provide enough relief with a limited reduction in cash outflows. Consequently, governments also needed to concentrate on the cash inflows side of the equation. This need for increased tax revenues provided the incentive for tax reform discussions. Within the context of that discussion, politicians reacted to the public focus on tax rates paid by businesses and the "rich."

This public focus was fueled by what many felt was irresponsible journalism that frequently sensationalized the topic instead of educating the public in an objective manner. The public was not educated in the role and benefits of tax incentives in attracting employers to their area, nor did they care when they felt the businesses were paying less than a "fair" amount. The corporations were exposed to reputational risks when they were accused of not paying their "fair share" of taxes. This was exacerbated by political rhetoric creating an adversarial environment focusing on perceived inequalities.

Business internationalization had allowed corporations to both sometimes willingly and other times innocently put themselves in the crosshairs of the discussion. Corporations had separate business units focused on intellectual capacity, marketing capacity and support services located in areas which were neither the parent company's resident area nor the areas of their principal customer bases. Some corporations had willingly and intentionally located business units in territories primarily to take advantage of favorable tax environments.

Additionally, increased internet usage by businesses as an instrument in providing services and making sales created a much different environment than the one which existed when the tax treaties were negotiated. Taxing authorities were alarmed by both the actual and perceived revenue losses due to the shifts created by that trend in internet usage.

The concurrence of a number of new disclosure initiatives made some business tax information more easily available. The Dodd-Frank Act specified SEC registrants in the extraction industry must make certain disclosures including detailed tax information. FIN 48 and other FASB required disclosures made more tax information available than previously. And, certain foreign countries (particularly in Europe) are requiring public disclosures and are publishing those disclosures in English on the internet.

In addition to the availability of the reports on the internet, social media also plays a role. Social media creates a mechanism for rapid dissemination of sometimes emotionally charged information that can alter public perception in a very short period of time. Activist groups and investigative journalists have found this extremely effective as they pursue "name and shame" campaigns.

In reaction to all these events, governments have responded by giving a higher priority to the issue of not only the tax rate structures and tax treaties, but also where and to whom actual amounts are paid. Some of these initiatives include:

- G8 Finance Ministers make international tax reform the central issue of 2013
- G20 committed to the Multilateral Convention on Mutual Assistance in Tax Matters
- EU Parliament approved country-by-country reporting for European banks
- Organization for Economic Cooperation & Development (OECD) Global Forum

on Transparency & Exchange of Information has 120 members
- Tax authorities from BRICS (Brazil, Russia, India, China and South Africa) agreed to share information & tax practices

In response to the changing environment, corporations are reexamining and revising their corporate structuring both in terms of operating structure and business units' locations. They are developing strategies to address the increased importance of balancing the need to minimize taxes in order to increase shareholder wealth while yet managing the reputational risks with the public. They are also realizing their exposure to increased tax risk due to the revenue authorities increased scrutiny of filings.

Taxing authorities are expected to be both more vigilant and aggressive in protecting and increasing their tax revenues. With increased visibility and perceived public emphasis, it is anticipated governments will reevaluate tax incentives and their related effect upon the public's perception of tax "fairness." In light of the public perception and the possible objections to tax incentives, governments may reassess their methods of raising revenue and attracting businesses and the resulting impact on financing public services. To facilitate the increased emphasis on revenue collection, authorities will look for new ways to implement and use the enhanced corporate reporting in the evaluation of their taxation.

Tax transparency is anticipated to have a number of effects on corporations. Active reputation protection and management of the public's perception by avoiding "bad press" will enter the tax discussion. Also the opportunity to promote corporate social responsibility may enter the discussion as well. As a result of the potential impact on the after-tax profitability and the resulting effect on shareholder returns, some corporations will strive to improve shareholder understanding of the issue. Some corporations are expected to realign their business units' locations to insure legitimate business purposes and not just to reap tax benefits. Business planning is expected to incorporate tax risks. And, increased transparency is expected to enhance corporate tax compliance.

Tax Transparency: Overview of Current and Proposed U.S. and International Initiatives

As increasing pressures on government budgets lead to austerity measures, a growing number of protesters, corporate watchdog groups, and policymakers are shining the light on worldwide corporate tax avoidance. Current and proposed disclosures at the entity and country levels will pull back the veil of tax secrecy and inevitably prompt more regulatory and tax authority oversight. These disclosures could also lead to damning front-page stories and, ultimately, tax code reform. Executives, along with the accountants and consults who advise them, should consider how tax transparency initiatives play a role in corporate strategy.

International Initiatives: In many foreign jurisdictions, each subsidiary within a group must file "accounts" (i.e., financial statements) with a regulatory body and these are made available to the public for no or a nominal fee. These filings will include details on intragroup activities (debt, management fees and other transfer payments made within the consolidated group) and tax liabilities by jurisdiction.[1] While the websites are often in foreign languages, the actual filings are often in English so language is not a barrier to understanding these filings. These accounts disclosures are which led to the recent publicity about Google, Starbucks and Apple's low tax liabilities in England (and the accompanying hearings and tax protests). Both the G20 and the Organization for Economic Cooperation and Development (OECD) are confronting tax avoidance and evasion through information sharing efforts, which also include revising tax treaties. Surprisingly, in January 2013, tax authorities from the BRICS countries Brazil, Russia, India, China and South Africa) pledged to share information and tax collection practices with each other. Finally, the Extraction Industries Transparency Initiative (EITI) requires that signatory countries and the entities which extract natural resources from these countries publicly publish the taxes and royalties paid in each jurisdiction.[2] The EU recently extended country-level tax reporting (similar to EITI) for financial institutions.

U.S. Initiatives: The EITI regime will soon be effective in the United States. The Dodd-Frank Act provides that SEC registrants in an extraction industry must annually report payments made by the company, its subsidiaries, or entities under its control to the U.S. and foreign governments by project and by country. The payments subject to disclosure include taxes, royalties, bonuses, dividends and infrastructure improvements. For each payment, companies must provide the type and amount paid on a cash basis, the total for each category listed above, the government and country that received the payment, and the projects to which the payments relate. This initiative coupled with recent changes from FIN48, FACTA and tax treaties reduces the transparency of tax positions in the US and abroad.

Reform Proposals: Proposals coming down the pipeline include "Publish what you pay." This idea is promoted by a number of public interest groups and entails comprehensive, country-by-country reporting of all government payments made by multinational organizations, whether publicly or privately held. Executives should anticipate that the country-by-country reporting required of EU financial institutions and U.S. extraction enterprises will be imposed by more jurisdictions — including U.S. states — on more industries.

[1] For example, the UK filings are found at http://www.companieshouse.gov.uk/

[2] Country- and entity-level reports are posted at eiti.org.

Resources

A New Era in International Tax, KPMG International Cooperative, 2013.

Tax Transparency Framework, PricewaterhouseCoopers, 2008.

Tax Transparency, Raquel Meyer Alexander, 2013.

New AICPA Preparation vs. Compilation Exposure Draft

On October 23, 2013 the AICPA issued a new exposure draft on "Proposed Statements on Standards for Accounting and Review Services" (SSARS). The exposure draft covers preparation of financial statements, compilation engagements and association with financial statements. It addresses the need for common conventions to facilitate ease of reading, comprehension and applicability.

The proposal would create three new sections in the SSARS:

- AR Section 50, Association with Financial Statements
- AR Section 70, Preparation of Financial Statements
- AR Section 80, Compilation Engagements.

The proposed standards would supersede the following:

- AR Section 80, Compilation of Financial Statements
- AR Section 110, Compilation of Specified Elements, Accounts, or Items of a Financial Statement
- AR Section 300, Compilation Reports on Financial Statements Included in Certain Prescribed Forms
- AR Section 600, Reporting on Personal Financial Statements Included in Written Personal Financial Plans
- AR Section 60 Paragraphs .05 – .06

While the proposed standards represent a significant revision in the requirements, they stop short of being fully harmonized with the International Standard on Related Services (ISRS) 4410 Engagements to Compile Financial Statements. The proposed standards adopted some of the international requirements but omitted others because the underlying premises are different in the United States.

The following table compares and contrasts attributes of the proposed SSARS:

	Compilation	Preparation
When does the standard apply?	When an accountant is engaged to perform a compilation	When an accountant is engaged to prepare financial statements
Is an engagement letter required?	Yes	Yes
Is the accountant required to determine if he or she is independent of the client?	Yes	No
If the accountant is not independent, is that fact required to be disclosed?	Yes	N/A
Does the engagement require a report?	Yes	No*
May the financial statements go to users outside of management?	Yes	Yes
May the financial statements omit notes?	Yes	Yes

* *When an accountant is engaged to prepare financial statements, the accountant is required to include an adequate statement on each page of the financial statements indicating that no CPA provides any assurance on the financial statements. If the accountant is unable to include an adequate statement on each page of the financial statements, the accountant is required to issue a disclaimer on the financial statements.*

Proposed AR Section 70: Preparation of Financial Statements

This standard applies when an accountant in public practice is engaged by management to prepare financial statements. The statement does not apply to the following:

- Preparation of financial statements when engaged to perform audit, review or compilation with respect to financial statements
- Preparation of tax returns or other data prepared solely for submission to taxing authorities
- Personal financial statements prepared for inclusion in written financial plans prepared by the CPA
- Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings

The preparation engagement is clarified as a nonattest service and does not require independence. In addition, the accountant is not required to verify accuracy or completeness of the information provided or otherwise gather evidence to express an opinion or a conclusion or otherwise report on the financial statements.

Proposed AR Section 80: Compilation Engagements

This standard applies when an accountant is engaged to perform a compilation engagement. The proposed standard may also be applied as necessary in the circumstances to other historical or prospective financial information.

A compilation engagement is not an assurance engagement. Accordingly, a compilation engagement does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements.

The accountant's objective in a compilation engagement is to apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with this standard without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

Proposed AR Section 50: Association With Financial Statements

This standard addresses the accountant's responsibility when the accountant is associated with financial statements and the accountant has not issued an audit, review or compilation report on those financial statements. The standard's objective is to prevent misinterpretations regarding the degree of responsibility the accountant assumes.

There are two circumstances under which an accountant's name is used in a report, document, or written communication containing financial statements on which the accountant has not issued an audit, review, or compilation report. The accountant's information may be used when the accountant was approached asking permission or when the accountant was not approached asking permission.

When the accountant is approached for permission, then:

> *Prior to permitting the use of the accountant's name in a report, document, or written communication containing financial statements on which the accountant has not issued an audit, review, or compilation report, the accountant should read the financial statements for obvious material misstatements in light of the accountant's understanding of the applicable financial reporting framework and the significant accounting policies adopted by management.*
>
> *If, in the course of reading the financial statements in accordance with the above, the accountant becomes aware of obvious material misstatements in the financial statements, the accountant should request that management revise the financial statements, as appropriate.*
>
> *If management does not revise the financial statements, as appropriate, the accountant should not permit the use of the accountant's name.*
>
> *If the accountant permits the use of the accountant's name in a report, document or written communication containing financial statements, the accountant should:*
>
> - *Determine that the financial statements are marked to indicate that no CPA provides any assurance on the financial statements, or*
> - *Issue a disclaimer on the financial statements.*

When the accountant's name was used without the accountant's permission, the accountant is advised to:

- *Advise the entity that the use of the accountant's name has not been permitted, and*
- *Consult the accountant's legal counsel.*

Reference:

"Proposed Statements on Standards for Accounting and Review Services." Preparation of Financial Statements, Compilation Engagements, Association with Financial Statements, Oct. 23, 2013.

Volunteer Services — Not-For-Profit

Two important questions to ask are:

- *What types of services are to be provided?*
  An individual licensee who provides audit, review, attestation services or compilation services to a not-for-profit entity will be considered to be providing those services as a firm, organized as a sole proprietorship, and therefore will be required to maintain a firm license and meet the requirements of peer review. There are a host of other services CPAs can provide to not-for-profit entities that would not require maintaining a firm license and participating in a peer review program.

- *What is the role or capacity of the CPA performing the services?*
  One point the VBOA made clear was that Virginia law provides an exception to CPAs if they are performing the services in their role as an owner, officer, employee or member of a governing body of the entity or entities about whom the financial statements are provided. Typically, that means providing services in that role will not require you to have a firm license.

2014's Other Relevant Issues

Summary of Violations	Rationale	VBOA Action	Date Closed
CASE #1 CONSENT ORDER § 54.1-4413.3 (2), (3), (4) 18VAC5-22-90 Violation of Standards of Conduct and Practice. Due Professional Care and CPE Deficiency.	The VBOA received a complaint indicating failure to communicate with the client in a timely manner regarding the status of the client's tax documents that were e-filed, failure to maintain competency, failure to complete services agreed upon and failure to return phone calls upon numerous requests. Upon review of the Regulant's electronic filing records, the Regulant discovered that the status of his clients tax return submission had been checked, but by some error, the return had not been filed so the Regulant immediately e-filed the return again which was accepted by the software the same day. The Regulant failed to exercise due professional care in the performance of professional services by failing to timely file the client's tax return and failed to follow through with the confirmation of acceptance regarding the e-file of his client's taxes.	The VBOA ordered that the Regulant shall: Submit certificates of completion for 8 hours of CPE in Tax Practice Management/ Circular 230; Report CPE compliance for the next three calendar years; Be reprimanded for not completing the Virginia-specific Ethics CPE course in 2009, 2010 and 2011; Submit the deficient 17 CPE; Pay a monetary penalty of $100; The Regulant shall reimburse the VBOA for the reasonable cost of $500 within 90 days of the entry date of the Order for the investigation of this matter; and The Regulant understands that failure to comply with the provision of the Order within 90 days shall result in the automatic suspension of his CPA license.	Jan. 8, 2013
CASE #2 FINAL ORDER §§ 54.1-111, 54.1-4409.1 and 54.1-4414 Unlicensed Activity.	The VBOA received a complaint from a previous employer indicating the Respondent misrepresented herself as a CPA by the continued use of the CPA designation in her email address, in the signature line of her business email address, on Facebook, LinkedIn and on her resume without a valid CPA license. The VBOA determined that the Respondent has never been licensed as a CPA and benefitted financially from the unlicensed and unauthorized use of the CPA designation.	The VBOA ordered that the Respondent shall: Not practice as a CPA in the Commonwealth until the VBOA has granted the Respondent a CPA license; Remove all CPA signage that indicates she is a licensed CPA in the Commonwealth; Pay a monetary penalty of $12,000 within 90 days of the entry date of the Final Order; and Provide reimbursement to the VBOA for the reasonable cost of $1,000 within 90 days of the entry date of the Order for the investigation of this matter.	March 1, 2013

Summary of Violations	Rationale	VBOA Action	Date Closed
CASE #3 FINAL ORDER §§54.1-4413.4 (C) (1) and 54.1-4409.1 Exam Candidate Deemed Unsuited/Unfit to Continue sitting for the CPA Exam in Virginia.	In accordance with the testimony of witnesses from Prometric, NASBA and the VBOA staff, and pursuant to the twelve year timeline of documented concerns, complaints and behavioral issues, to include the Respondent's responses and past actions, the VBOA determined that the Respondent's behavior of uncooperativeness, unprofessionalism and demeaning outbursts to be unsuited and that the Respondent was unfit to continue sitting for the CPA Exam in Virginia.	The VBOA Ordered that the Respondent shall be banned from sitting for the CPA Exam in Virginia for no less than five years from the entry date of the Order. The Respondent may petition the VBOA, in person, after a period of five years to be permitted to sit for the CPA exam in VA. In determining eligibility to sit for the CPA Exam in Virginia, the Respondent must demonstrate that he is fit and suited to be a CPA in VA. If future authorization is granted to the Respondent to sit for the CPA Exam in Virginia, he must reapply as a new CPA Exam applicant and must meet all existing requirements at the time of application.	Dec. 4, 2012
CASE #4 CONSENT ORDER §§ 54.1-111, 54.1-4409.1 and 54.1-4414 Unlicensed Activity.	The VBOA received a complaint indicating that in numerous church bulletins and verbally in church meetings and/or private meetings the Respondent was referred to as a CPA. Church bulletins were provided indicating the Respondent stated, "We are happy to report that our financial process is in conformity with Generally Accepted Accounting Principles" signed by the Respondent as a CPA. The Respondent was found in violation in that he allowed himself to be represented as a CPA on church bulletins without a valid CPA license.	The VBOA ordered that the Respondent shall: Not practice as a CPA or use the CPA title in the Commonwealth; Remove all signage that refers to him as a CPA; Pay a monetary penalty of $8,000 within 90 days of the entry date of the Order; and Reimburse the VBOA for the reasonable cost of $1,000 within 90 days of the entry date of the Order for the investigation of this matter.	March 1, 2013

2014's Other Relevant Issues

Summary of Violations	Rationale	VBOA Action	Date Closed
CASE #5 FINAL ORDER § 54.1-4413.4 (B) (1), (5) and (7) SEC Violation — Suspension of Practice Before the SEC.	The Court rendered a judgment against the Regulant ordering that the Regulant be permanently restrained and enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 for the trading of put options for a corporation's common stock. The Regulant was required to pay disgorgement, prejudgment interest, and a civil penalty for a total amount of $183,801.27, together with interest from the date of the Final Judgment until paid in full. Having fully considered the record before the IFF conference, the VBOA concluded the SEC Judgment as supported by substantial evidence.	The VBOA ordered the suspension of the CPA's license for a period of no less than 1 year from the entry date of the Order and that he shall: Remove all signage with the CPA designation on it; Pay a monetary penalty of $10,000 for the Judgment rendered by the Courts for the trading of the corporations put options as referenced in the Final Judgment; and The Regulant shall reimburse the VBOA for the reasonable cost of $1,000 within 90 days of the entry date of the Order for the investigation of this matter.	Dec. 4, 2012
CASE #6 CONSENT ORDER §§ 54.1-111, 54.1-4409.1 and 54.1-4414 Unlicensed Activity.	The VBOA received notification from an anonymous citizen by way of a phone call regarding the unlicensed use of the CPA designation on the website of the Respondent's current employment in the executive team directory representing himself as a CPA. It was determined that the Respondent had never been licensed in Virginia; however, he had an "Inactive" CPA license in Maryland.	The VBOA ordered that the Respondent shall: Not practice as a CPA or use the CPA title in Virginia until he has been duly licensed; Remove all CPA signage that refers to him as a CPA; Pay a monetary penalty of $8,000 within 90 days of the entry date of the Order; and The Respondent shall reimburse the VBOA for the reasonable cost of $500 within 90 days of the entry date of the Order for the investigation of this matter.	March 1, 2013

Summary of Violations	Rationale	VBOA Action	Date Closed
CASE #7 CONSENT ORDER § 54.1-4413.3 (4) Violation of Standards of Conduct and Practice. Due Professional Care.	The Regulant failed to exercise due professional care in the performance of professional services by failing to keep copies of relevant client tax documents concerning the request to the IRS for extensions, and therefore demonstrated several insufficient office management practices.	The VBOA ordered that the Regulant shall: Be reprimanded for failing to keep copies or relevant documents concerning the request to the IRS for extensions; Provide satisfactory completion of not less than 8 hours of CPE in Tax Practice management to be completed and submitted prior to December 31, 2013; and The Regulant shall reimburse the VBOA for the reasonable cost of $1,000 within 90 days of the entry date of the Order for the investigation of this matter.	March 1, 2013
CASE #8 See page 40			
CASE #9 CONSENT ORDER §54.1-4413.3 (1) and (2) Violation of Standards of Conduct and Practice. Due Professional Care.	The Regulant failed to exercise sensitive professional and moral judgment in all activities and act in a way that serves the public interest, honors the public trust, and demonstrates commitment to professionalism by his unprofessional e-mailed responses to his client.	The VBOA ordered that the Regulant shall: Be reprimanded for his unprofessional responses in his emailed communications with his client by failing to exercise sensitive professional and moral judgment in all activities and act in a way that serves the public interest, honors the public trust, and demonstrates commitment to professionalism which will remain permanently on his record as of the entry date of this Order. Reimburse the Virginia Board of Accountancy for the reasonable cost of $500 for investigating this matter within ninety (90) days of the entry date of this Order. The Regulant understands that failure to comply with the provisions of the signed and entered Consent Order within 90 days of the required compliance date as stated in this Order shall result in the automatic suspension of his CPA license.	Nov. 6, 2013

Summary of Violations	Rationale	VBOA Action	Date Closed
CASE #10 CONSENT ORDER §§ 54.1-111, 54.1-4409.1 and 54.1-4414 Unlicensed Activity.	The VBOA received notification from an anonymous source regarding the unlicensed use of the CPA designation on her business cards and in her business email address during the time her CPA license was expired. The Respondent worked at a local Richmond manufacturing and marketing firm.	The VBOA ordered that the Respondent shall: Not practice as a CPA in the Commonwealth until the Virginia Board of Accountancy has granted reinstatement of her expired CPA license. Immediately remove all signage, to include but not limited to: business cards, all letterhead, email signatures or addresses, resumes, newspaper, internet ads, all social media to include LinkedIn, Facebook, and any and all software with the CPA designation on it until she has been granted reinstatement of her expired CPA license. Pay a monetary penalty of $1,000 for the unlicensed use of the CPA designation, as referenced on her business cards and in her email signature, within 90 days of the entry date of the Order. Reimburse the Virginia Board of Accountancy for the reasonable cost of $1,000 for the investigation of this matter within 90 days of the entry date of the Order. Provide the Board with a 1,000 word essay on the requirements of licensure as an individual CPA referencing the importance of those requirements in protecting the public within 90 days of the entry date of the Order.	Oct. 1, 2013

Instructor: Briefly discuss the whistleblower program based on the FAQ below. Discuss the whistleblower case studies.

SEC Whistleblower Rules

The U.S. Securities and Exchange Commission (SEC) maintains a website at www.sec.gov/whistleblower where the public can provide assistance and information regarding possible securities law violations. Below are the questions and answers for potential whistleblowers from the website's Frequently Asked Questions (FAQ) page.

1. ***What is the SEC Whistleblower Program?***
    a. *The Whistleblower Program was created by Congress to provide monetary incentives for individuals to come forward and report possible violations of the federal securities laws to the SEC. Under the program eligible whistleblowers (defined below) are entitled to an award of between 10 percent and 30 percent of the monetary sanctions collected in actions brought by the SEC and related actions brought by other regulatory and law enforcement authorities.*
    b. *The program also prohibits retaliation by employers against employees who provide us with information about possible securities violations.*

2. ***Who is an eligible whistleblower?***
    a. *An "eligible whistleblower" is a person who voluntarily provides us with original information about a possible violation of the federal securities laws that has occurred, is ongoing, or is about to occur. The information provided must lead to a successful SEC action resulting in an order of monetary sanctions exceeding $1 million. One or more people are allowed to act as a whistleblower, but companies or organizations cannot qualify as whistleblowers. You are not required to be an employee of the company to submit information about that company. See Rule 21F-2.*

3. ***What does it mean to "voluntarily" provide information?***
    a. *Your information is provided "voluntarily" if you provide it to us or another regulatory or law enforcement authority before (i) we request it from you or your lawyer or (ii) Congress, another regulatory or enforcement agency or self-regulatory organization (such as FINRA) asks you to provide the information in connection with an investigation or certain examinations or inspections. See Rule 21F-4(a).*

4. ***What is "original information?"***
    a. *"Original information" is information derived from your independent knowledge (facts known to you that are not derived from publicly available sources) or independent analysis (evaluation of information that may be publicly available but which reveals information that is not generally known) that is not already known by us. So if we received your information previously from another person, that information will not be original information unless you were the original source of the information that the other person submitted. See Rule 21F-4(b)(1).*

5. ***How might my information "lead to" a successful SEC action?***
   a. *Your information satisfies the "led to" criterion if your information causes us to open a new investigation, re-open a previously closed investigation or pursue a new line of inquiry in connection with an ongoing investigation, and we bring a successful enforcement action based at least in part on the information you provided. Additionally, you may still be eligible if your information relates to an ongoing examination or investigation, if the information you provide significantly contributes to the success of our resulting enforcement action. You may also be eligible if you report your information internally first to your company, and the company later reports your information to us, or reports the results of an internal investigation that was prompted by your information, as long as you also report directly to us within 120 days. See Rule 21F-4(c).*

6. ***I work at a company with an internal compliance process. Can I report internally and still be eligible for a whistleblower award?***
   a. *Although internal reporting is not required to be considered for an award, you may be eligible for an award for information you reported internally if you also report the information to us within 120 days of reporting it internally. Under these circumstances, we will consider your place in line for determining whether your information is "original information" to be the date you reported it internally. In addition, if the company to which you reported conducts an investigation and reports the results to us, you will benefit from all the information the Company's investigation turns up when we are considering whether you should receive an award and if so where the award should fall in the 10 percent to 30 percent range. See Rules 21F-4(b)(7) and 21F-4(c).*

7. ***I provided information to the SEC before the enactment of Dodd-Frank on July 21, 2010. Am I eligible for an award?***
   a. *No. The statute makes awards available only in connection with information submitted to the SEC after July 21, 2010. See Rule 21F-4(b)(1).*

8. ***How do I submit information under the SEC whistleblower program?***
   a. *In order to qualify for an award under the whistleblower program, you must submit your information either through our online Tips, Complaints and Referrals questionnaire or by completing our hardcopy Form-TCR and mailing or faxing it to the SEC Office of the Whistleblower, 100 F Street NE, Mail Stop 5553, Washington, DC 20549, Fax (703) 813-9322. See Rule 21F-9.*

9. ***Can I submit my information anonymously?***
   a. *Yes, you may submit anonymously. To do so, you must have an attorney represent you in connection with your submission. You must also provide the attorney with a completed Form TCR signed under penalty of perjury at the time you make your anonymous submission. See Rule 21F-7.*

10. ***Will the SEC keep my identity confidential?***
    a. *Whether or not you seek anonymity, the SEC is committed to protecting your identity to the fullest extent possible. For example, we will not disclose your identity in response to requests under the Freedom of Information Act. However, there are limits on our ability to shield your identity and in certain circumstances we must disclose it to outside entities. For example, in an administrative or court proceeding, we may be required to produce documents or other information which would reveal your identity. In addition, as part of our ongoing investigatory responsibilities, we may use information you have provided during the course of our investigation. In appropriate circumstances, we may also provide information, subject to confidentiality requirements, to other governmental or regulatory entities. See Rule 21F-7.*

11. ***How will I learn about the opportunity to apply for an award?***
    a. *We will post on this web site notices of actions exceeding $1 million in sanctions so that anyone who believes they may be eligible will have an opportunity to apply for a whistleblower award. In addition, if we have been working with you and believe you may be eligible, we will contact you or your attorney directly to alert you to the opportunity to apply for an award. See Rule 21F-10.*

12. ***How do I apply for an award?***
    a. *Once the case you believe your information led to is posted, you must complete and return Form WB-APP within 90 calendar days to the Office of the Whistleblower via mail to 100 F Street, NE, Mail Stop 5553, Washington DC 20549, or by fax (703) 813-9322. See Rule 21F-10.*

13. ***What factors does the SEC consider in determining the amount of the award?***
    a. *The Rules require that we consider many factors in determining the amount of an award based on the unique facts and circumstances of each case.*
    b. *We may increase the award percentage based on the existence of these factors:*
        c. *The significance of the information you provided us to the success of any proceeding brought against wrongdoers.*
        d. *The extent of the assistance you provide us in our investigation and any successful proceeding.*
        e. *Our law enforcement interest in deterring violations of the sec urities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of these laws.*
        f. *Whether, and the extent to which, you participated in your company's internal compliance systems, such as, for example, reporting the possible securities violations through internal whistleblower, legal or compliance procedures before, or at the same time, you reported them to us.*
    g. *We may reduce the amount of an award based on these factors:*
        h. *If you were a participant in, or*

culpable for the securities law violation(s) you reported.

i. *If you unreasonably delayed reporting the violation(s) to us.*

j. *If you interfered with your com pany's internal compliance and reporting systems, such as, for ex ample, making false statements to your compliance department that hindered its efforts to investigate possible wrongdoing. See Rule 21F-6.*

14. ***Can I appeal the SEC's award decision?***
    a. *It depends. If the Commission follows the factors described above, authorizes an award, and the amount awarded is between 10 percent and 30 percent of the monetary sanctions collected in the Commission or related action, then the Commission's determination of the amount of the award is not appealable. If the Commission denies your application for an award, you may file an appeal in an appropriate United States Court of Appeals within 30 days of the decision being issued. See Rule 21F-13.*

15. ***What rights do I have if my employer retaliates against me for submitting information to the SEC?***
    a. *Employers may not discharge, demote, suspend, harass or in any way discriminate against you because of any lawful act done by you in providing information to us under the whistleblower program or assisting us in any investigation or proceeding based on the information submitted. If you believe that your employer has wrongfully retaliated against you, you may bring a private action in federal court against your employer. If you prevail, you may be entitled to reinstatement, double back pay, litigation costs, expert witness fees, and attorney's fees. The Commission can also take legal action in an enforcement proceeding against any employer who retaliates against a whistleblower for reporting information to us. See Rule 21F-2.*
    b. *Also, under the Sarbanes-Oxley Act, you may be entitled to file a complaint with the Department of Labor if you are retaliated against for reporting possible securities law violations, including making internal reports to your company. For more details, please see the OSHA Fact Sheet on filing whistleblower complaints under the Sarbanes-Oxley Act.*

Case Studies

Sherron Watkins, the former vice president of corporate development at Enron, became a famous whistleblower when she exposed the irregular accounting activities of the company. She was one of three whistleblowers selected as People of the Year in 2002 by Time magazine. But Dan Ackman, writer for Forbes magazine and The Wall Street Journal, argued that she was not a true whistleblower because she only wrote an internal email to Enron's CEO and didn't alert anyone outside of the company. Because of this, some feel Watkins didn't do enough; others think her courage in reporting her concerns to the CEO is admirable.

What do you think? Is Watkins someone to be admired or did she not do enough?

This is just another example of the gray area that exists when it comes to ethics. There is no doubt that it's very difficult for us to put ourselves in someone else's shoes and to know for sure what we would do if placed in the same situation. Hindsight is always 20/20, but we must be as prepared as we can to know how to do the right thing when the time comes.

In a case closer to home, Timothy Ferner, a retired Air Force lieutenant colonel, filed a suit under the whistleblower provisions against Virginia-based Science Applications International Corp (SAIC). The suit alleged that SAIC provided false information to GSA contracting officials in order to receive a contract award. SAIC settled the case in July 2013 for $5.75 million. Ferner will receive $977,500. SAIC said it "disputes the allegations brought in a complaint by [the Justice Department] but agreed to settle to avoid cost of protracted litigation."

What do you think about SAIC's statement and the fact that Ferner will receive a large sum of money even though the Justice Department never made a determination of liability in the case?

Sarbanes-Oxley Revisited

In response to what the public perceived were multiple accounting scandals, particularly Enron, WorldCom, etc., Congress passed the Sarbanes-Oxley Act of 2002 (SOX). At the signing of the bill, President George W. Bush declared the new law to be "the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt." SOX mandated several reforms designed to enhance corporate responsibility, enhance and improve the reliability of financial disclosures and address corporate fraud, particularly from an accounting perspective. As far-reaching as the mandated reforms was the fact that the SOX established the Public Company Accounting Oversight Board (PCAOB) as a means to oversee the auditing profession, especially the accounting related to publicly traded companies.

Strong penalties are included in SOX:

- Potential loss of exchange listing by the company
- A CEO or CFO is subject to a fine up to $1 million and imprisonment for up to 10 years
- If "willful", the fine can be $5 million and the prison term can be 20 years

Instructor: Seek examples from the audience as to why SOX was needed and whether the number of stories of "accounting scandals" have increased or decreased and if they think SOX has achieved its purpose.

Title II of SOX addresses auditor independence by outlining services that can and cannot be performed for a public company attest client. Auditors now have a list of non-audit services they can't perform during an audit. CPAs leaving an auditing firm have a one-year waiting period imposed prior to their being able to be employed at a former client.

In effect, SOX requires the use of audit committees and greatly expands their role. Audit committees, not management, must hire the audit firm and oversee the relationship. Also, any non-audit services provided by the firm must be approved by the audit committee. This was intended to provide more outside perspectives into the auditor/management relationship.

SOX strongly encouraged audit committees to have at least one member who is a "financial expert." It was thought that such a person could provide more effective insight for the committee in carrying out its role. The strengthening of its role allows the audit committee to be in a better position to understand and review financial statements and can lead to enhanced internal controls. This theoretically allows the committee to better protect shareholder interests. In order to enforce the "suggestion," companies that do not have an audit committee member with financial expertise must disclose the fact in the annual proxy statement and explain the rationale for not having such an "expert." This of course has led many public companies to seek persons with applicable financial backgrounds in order to avoid such disclosure.

Instructor: Ask the class if the emphasis of a "financial expert" is an effective approach. Seek examples of whether their work with audit committees, especially those that are not publicly traded companies, has been effective.

Financial disclosures have been expanded, such as transactions and relationships that are "off-balance sheet" but which might reasonably be expected to affect the company's perceived financial condition. Companies must reconcile pro forma information with U.S. GAAP and not omit information that otherwise makes financial disclosures misleading. Personal loans from a corporation to its executives are now largely prohibited. Periodic financial reports are required to include specific certifications and a report on the internal control structure and procedures for financial reporting.

For each publicly issued financial report (quarterly or annual) the CEO and CFO have to make specific certifications:[1]

- They have reviewed the report.
- Based on their knowledge, the financial information included in the report is fairly presented.
- Based on their knowledge, the report does not contain any untrue statement of material fact or omit a material fact that would make the financial statements misleading.
- They acknowledge their responsibility for establishing and maintaining internal controls over financial reporting and other disclosures.
- They have evaluated the effectiveness of these controls, presented their conclusion as to effectiveness and disclosed any material changes in the company's controls.

Instructor: Discuss whether or not the public, prior to SOX, had simply assumed that many of the steps in the certifications had already been done, particularly "reviewing the report."

SOX also impacts non-CPA professionals such as security analysts. These professionals who make public appearances or provide public information must make disclosures of potential conflicts of interest. The disclosures include information about the company, whether he or she holds any securities in the company or has received compensation from the company and whether the public company is a client.

SOX also addresses altering, destroying, concealing or falsifying records or documents related to an investigation or bankruptcy case. Penalties include possible fines and imprisonment. New audit workpapers must be retained for five years.

SOX also included restrictions which prohibited audit firms from providing certain services to public companies they audit:[2]

- Bookkeeping
- Financial information systems design and implementation
- Appraisal or valuation services or fairness opinions
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources

- Broker, dealer, investment adviser or investment banking services
- Legal and expert services unrelated to the audit

PCAOB

The PCAOB was intended to improve audit effectiveness for the audits of publicly traded companies. PCAOB has a full set of standards and rules for audit reports. Every accounting firm that audits public companies must register with the Oversight Board. The Board regularly inspects, investigates and enforces compliance by the registered firms.

Through the end of 2012, the PCAOB had registered 2,363 accounting firms, a number which included 911 non-U.S. firms located in 87 countries. Nine firms each had more than 100 public company audit clients and were inspected by the PCAOB. Inspectors from the PCAOB examined portions of 290 audits performed by the nine firms.[3]

The PCAOB has issued guidance in several forms:

Auditing Standard No. 16 was adopted in 2012 and is effective for audits of public companies for fiscal periods beginning on or after Dec. 15, 2012. Following the SOX emphasis on the audit committee, the standard requires the auditor to communicate certain significant matters regarding the audit and the financial statements to the audit committee, which is intended to assist the audit committee in fulfilling its oversight responsibilities regarding the financial reporting process. Enhanced two-way communication between the auditor (firm) and the audit committee on such matters is intended to benefit the auditor in performing an effective audit.[4]

The issues of auditor independence and auditor rotation were addressed by the PCAOB in a concept release, Auditor Independence and Audit Firm Rotation, issued by the Board Aug. 16, 2011. The Board hosted public meetings to discuss this matter, which remains a major topic of interest. Currently, the lead partner in the audit firm must rotate off for five years after being the lead partner for five years. Other audit partners assigned to the engagement must rotate off after seven years and remain off for at least two years.

On March 26, 2013, the Board issued for public comment a potential framework for reorganizing the existing interim and PCAOB-issued auditing standards into a topic-based structure.

A Decade Under SOX

After more than a decade in force, numerous reports and analyses have been prepared which study the impact of SOX and evaluate its effectiveness. In a report issued in July 2012, the international firm of Ernst & Young, LLP, noted the following results of a decade under SOX:

- Audit quality has been improved by stronger alignment of independent auditors, independent audit committees, independent audit oversight authorities and public company shareholders. In a 2008 audit committee survey reported by the Center for Audit quality, 90 percent of audit committee members surveyed said that "they work more closely with the independent auditor" post-SOX.
- Audit quality has improved because of PCAOB inspections and standard setting. As of Dec. 31, 2011, over 2,000 audit firms from more than 80 countries were registered with the PCAOB. In 2011, the organization conducted inspections of 213 registered audit firms, and initiated an interim inspection program for broker-dealers.
- More audit committees have financial

experts. In 2003, only a small number of audit committee members were financial experts. Today, almost one-half of all audit committee members are identified through proxy statement disclosure as meeting the definition of a financial expert.

- Companies that comply with all of the internal control provisions in SOX are less likely to issue financial restatements. A November 2009 study published by Audit Analytics found the rate of financial restatements was 46 percent higher for companies that did not comply with all of the SOX internal control provisions.
- Corporate governance is stronger. Prior to SOX, the process for the selection and assessment of the independent auditor typically was controlled by management. Audit committees now play an essential role in corporate governance framework by overseeing the quality and integrity of company financial statements.

Instructor: Ask the class if they concur with the conclusions drawn by this report from a Big Four firm and whether smaller audit firms with fewer public company clients would have a different opinion.

Resources

"The Laws That Govern the Securities Industry," Securities and Exchange Commission, www.sec.gov/about/laws

"Building Value in Your SOX Reporting Program," Protiviti, Inc.: www.protiviti.com/en-US/Documents/Surveys/2013-SOX-Compliance-Survey-Protiviti.pdf

"A Guide to Sarbanes-Oxley Legislation," Addison-Hewitt Associates: www.soxlaw.com

"Corporate Accountability: A Summary of the Sarbanes-Oxley Act," Donald Simon: www.legalzoom.com/business-law/corporate-law/corporate-accountability-summary

"Sarbanes-Oxley Essential Information," SOX-Online: www.sox-online.com/basics.html

"About the PCAOB," Public Company Accounting Oversight Board,: www.pcaobus.org/About

Notes

1 Ernst & Young, LLP, 2012, "The Sarbanes-Oxley Act at 10,": http://www.ey.com/US/en/Issues/Governance-and-reporting p.6

2 Ibid. p. 8.

3 Public Company Accounting Oversight Board, "Annual Report, 2012." http://pcaobus.org/About/Ops/Documents/Annual%20Reports/2012.pdf p.4

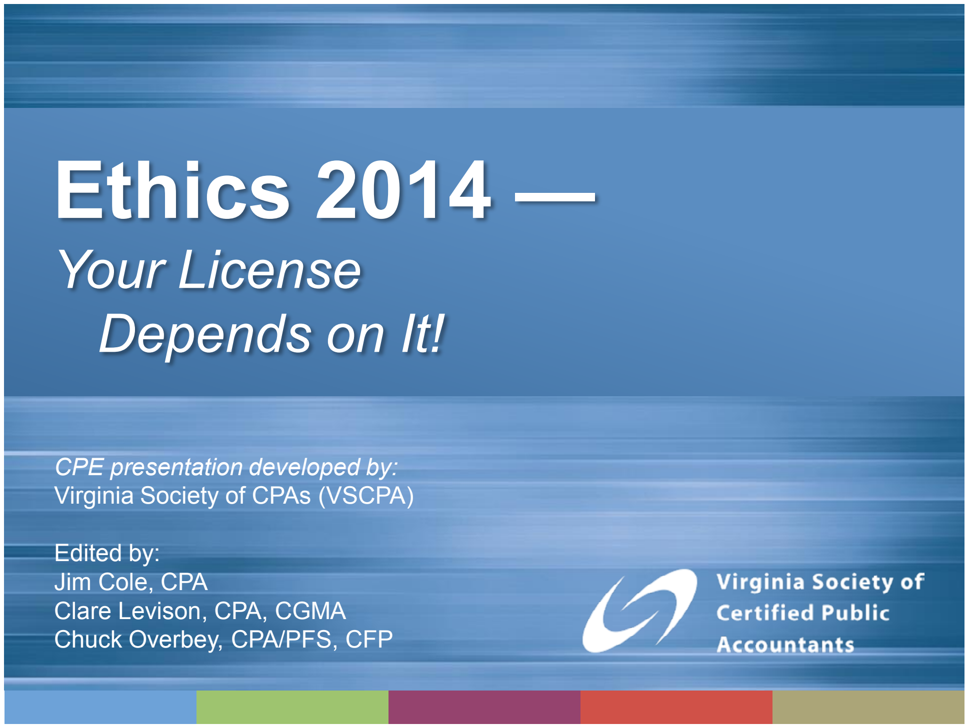
4 Ernst & Young, LLP, 2012. "At ten year anniversary of Sarbanes-Oxley corporate governance is stronger, audit quality is improved": www.ey.com/US/en/Newsroom/News-releases/At-ten-year-anniversary-of-Sarbanes-Oxley-corporate-governance-is-stronger--audit-quality-is-improved

Conclusion

When dealing with ethical dilemmas, you can ask yourself this simple question in order to help you decide what to do: Would I feel uncomfortable if other people knew that I was involved in this situation? Feeling the need to hide something is often an indicator that unethical behavior is taking place. But remember, even if you had no fear of being caught or exposed, being a truly ethical CPA means doing the right thing even when no one is watching.

Please ensure that you have checked the status of your CPA license at the VBOA website. If you have any additional questions, contact one of the organizations listed on Page 3.

Please complete the class evaluations that will be sent to you via email. We appreciate any and all feedback you can provide. Your feedback helps us make improvements to this course.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CPE presentation developed by:
Virginia Society of CPAs (VSCPA)
Edited by:
Jim Cole, CPA
Clare Levison, CPA, CGMA
Chuck Overbey, CPA/PFS, CFP
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Accountants


What Are the 10 Myths of Ethics?

What Are the 10 Myths of Ethics?

10. It's ethical if I do it for you.
9. It's ethical if I fight fire with fire.
8. It's ethical if I'm objective.
7. It's ethical if I've got it coming.
6. It's ethical if I don't gain personally.
5. It's ethical if everyone does it.
4. It's ethical if no one's hurt.
3. It's ethical if it's for a good cause.
2. It's ethical if it's part of the job.
1. It's ethical if it's legal and permissible.

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Welcome to Ethics 2014

VIDEO

4

The CPA Credential

- Has value
- Implies:
  - Professional judgment
  - Integrity
  - Objectivity
- Result:
  - Public expectations of behavior

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AICPA Code of Conduct

Compared to legal guidelines, the Code:

- May be more easily changed and therefore more adaptive to changing situations
- Like laws, is intended in part to address public perception and expectation
- Can be more principles-based in nature
- Can address issues not as easily covered by laws

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Moral Stages of Reasoning

Laws and codes of conduct may not be flexible enough to meet the needs of specific situations

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Behavioral Ethics Hierarchy

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Legal Base — Code of Virginia

- Code of Virginia statute for Public Accounting — Sections 54.1-4400 through 54.1-4425
  - Defines "practice of public accounting" and other terms
  - Outlines broad licensing and practice requirements
  - Incorporates AICPA Code of Conduct
  - Establishes Virginia Board of Accountancy, authorizes them to issue regulations and policies

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Legal Base — Code of Virginia

VIDEO

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Legal Base — Code of Virginia

HB 275 (2012) closed a loophole in the Virginia Freedom of Information Act (FOIA).

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Legal Base — Code of Virginia

VIDEO

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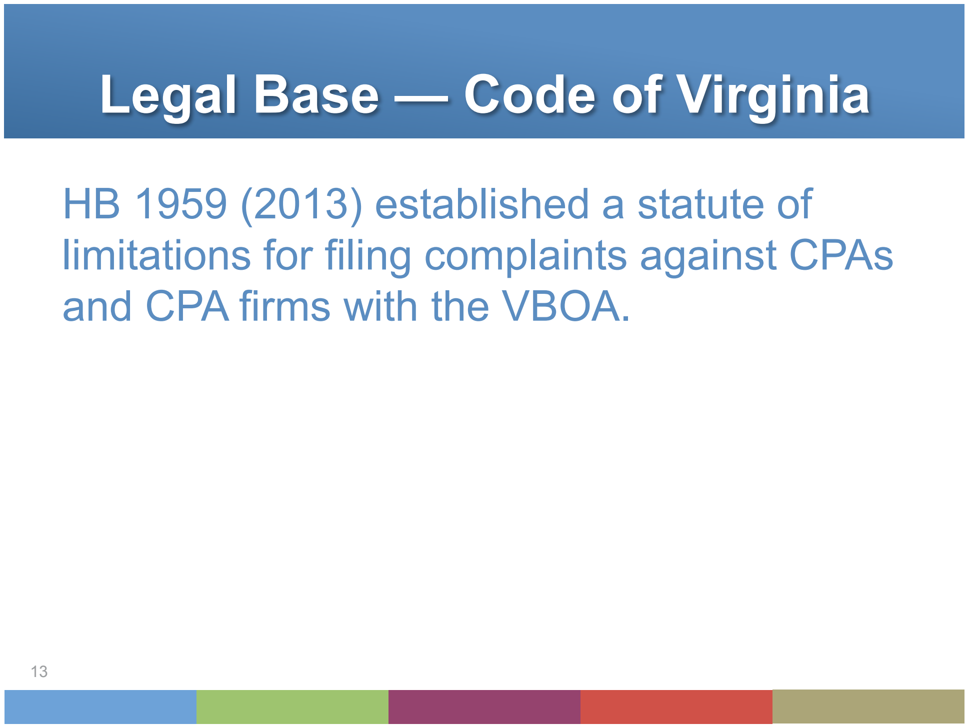
Legal Base — Code of Virginia
HB 1959 (2013) established a statute of limitations for filing complaints against CPAs and CPA firms with the VBOA.
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Legal Base — Code of Virginia
VIDEO
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Legal Base — Code of Virginia

VIDEO

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VBOA Regulations

Virginia Administrative Code at 18VAC5-22:

- Lists all fees
- Defines “holding out” to be met by holding a Virginia license due to the website posting
- Further defines education, examination, experience requirements and other terms from Statute
- Breakdown of CPE requirements

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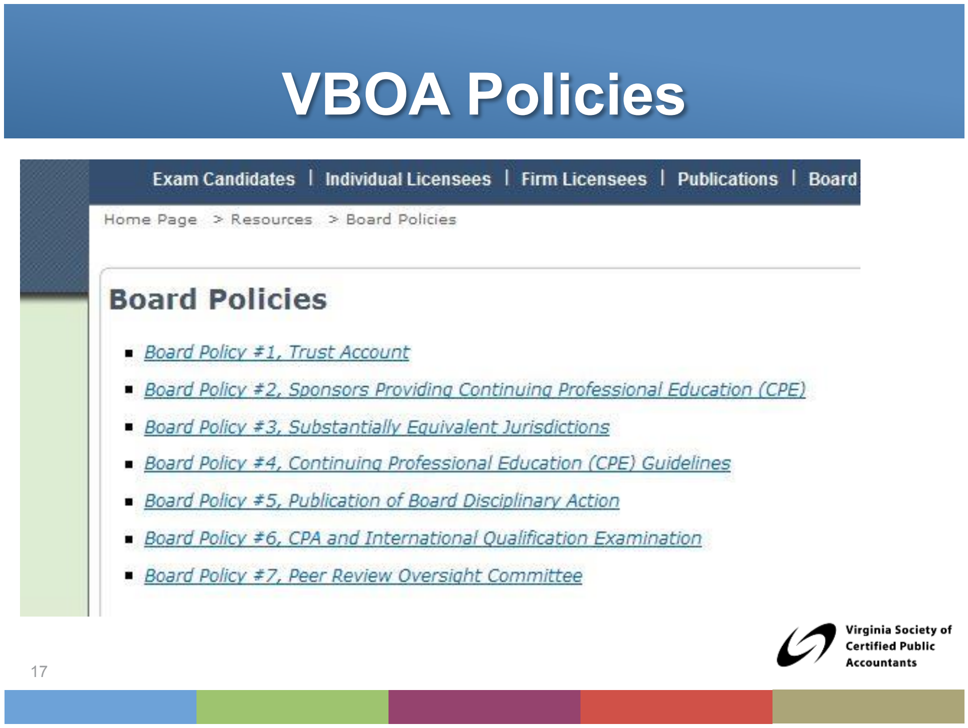
VBOA Policies
Exam Candidates | Individual Licensees | Firm Licensees | Publications | Board
Home Page > Resources > Board Policies
Board Policies
Board Policy #1, Trust Account
Board Policy #2, Sponsors Providing Continuing Professional Education (CPE)
Board Policy #3, Substantially Equivalent Jurisdictions
Board Policy #4, Continuing Professional Education (CPE) Guidelines
Board Policy #5, Publication of Board Disciplinary Action
Board Policy #6, CPA and International Qualification Examination
Board Policy #7, Peer Review Oversight Committee
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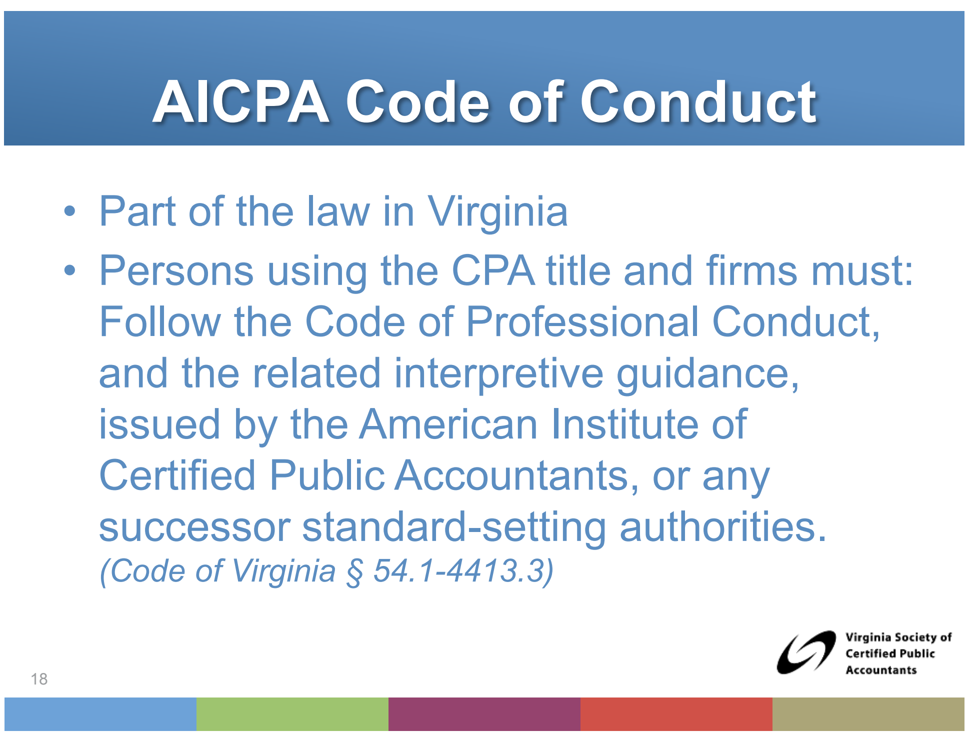
AICPA Code of Conduct
• Part of the law in Virginia
• Persons using the CPA title and firms must: Follow the Code of Professional Conduct, and the related interpretive guidance, issued by the American Institute of Certified Public Accountants, or any successor standard-setting authorities.
(Code of Virginia § 54.1-4413.3)
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Ethical Standards

Prior to providing an attest service, a CPA must consider ethical standards applicable to the service and to the entity/industry involved, including, but not limited to:

- AICPA
- State board or society
- PCAOB
- Other governmental agencies as applicable (SEC, GAO, etc.)

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Breaking the Law

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AICPA Ethics Hotline

For any CPA inquiries relating to the application of the Professional Code of Conduct:

- Email: Ethics@aicpa.org
- Telephone: (888) 777-7077

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Independence — Rule 101

Definition of Partner Equivalent

- Has authority to bind the firm relative to an attest engagement without partner approval
- Has ultimate responsibility for the attest engagement:
  - Authority to issue attest report or authorize issuance without partner approval
  - Authority to sign or affix the firm's name to an attest report
- Facts, not position titles, determine the applicability
- Only applies for purposes of Independence rule, not intended to determine whether the Partner Equivalent is an owner of the firm

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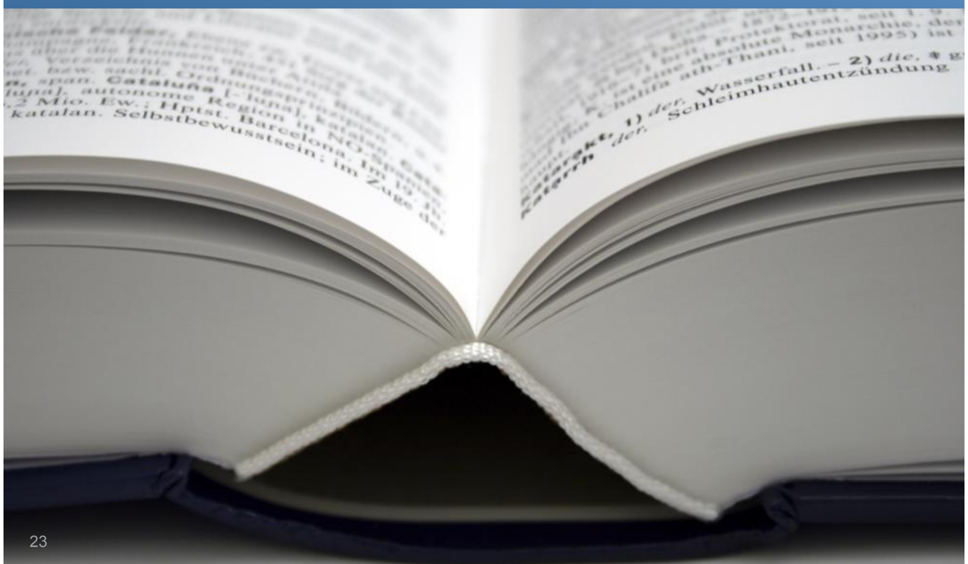
Rule 101 — Other New Definitions



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Rule 201.01 (C)

Deals with planning and supervision

- What is "adequate" planning?
- How much supervision is enough?

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CPA Licensing in Virginia

The VBOA sets CPE requirements to maintain a Virginia CPA license.

CPA Licensing in Virginia

VIDEO

CPA Licensing in Virginia

- Annual renewal required online at boa.virginia.gov
- Renewal notices are emailed 30 days prior to renewal deadline
- Late fee is $100
- If late, website shows "Active-Renewal Fee Delinquent" for 12 months
- After 12 months, license considered "Expired"

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Unlicensed Activity

- Citizen misrepresented to employer that she was a CPA; had never been a licensed CPA
- VBOA penalty: cease and desist until licensed, plus $12,000 fine and reimbursement of investigative costs of $1,000

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CPE as Part of Renewal

- Renewing CPA must certify meeting CPE requirements, even if the required CPE is “none”
- Many in industry need CPE, but some do not, VBOA has issued guidance — see manual
- Part-time or “on the side” tax preparation or accounting work may require CPE even for those not otherwise needing CPE

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CPE Sponsor Policy

- No pre-qualification for sponsors
- VBOA generally accepts courses from:
  - NASBA-certified/compliant sponsors
  - Accredited college or university
  - Employer of a CPA
  - Federal, state or local government
  - State CPA society
  - AICPA
  - Others (subject to possible additional review)

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Kohlberg’s Moral Stages
Level 1: Pre-conventional Morality
• Stage 1:
• Laws and rules considered absolute
• Avoid punishment
• Stage 2:
• Rules seen as negotiable or worth evaluating for cost/benefit
• Evaluation of potential punishment versus potential rewards
• Self-Interest is primary motivation
• Reciprocity is acceptable if it benefits me
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Kohlberg’s Moral Stages
Level 2: Conventional Morality
• Stage 1:
• Acceptable behavior is pleasing or helpful to others
• Approval of others is motivating
• Conformance is desired
• Intent becomes important
• Stage 2:
• Maintenance of social order important
• Show respect for authority
• Perform one’s duty
• Begin to consider society as a whole
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Kohlberg’s Moral Stages

Level 3: Post-Conventional Morality

- Stage 1:
  - Begin to account for differing values, opinions and beliefs
  - Should be agreement on standards governing society
  - Acknowledge legal and moral rights are sometimes different
  - Standards should be for the good of he majority
  - Rules can be changed

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Kohlberg’s Moral Stages

Level 3: Post-Conventional Morality

- Stage 2:
  - Principles more universal in nature and are abstract
  - Chooses universal ethical principles appealing to personal logic and consistency
  - Develops individual principles of conscience
  - Evaluates principles and laws in relation to those internalized values
  - Actions follow internalized principles and reasoning such as justice even if in conflict with laws and rules

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Kohlberg's Moral Stages

- Level 1: Federal and State Laws
  - We might speed, but not commit murder
- Level 2: Professional Standards, Regulations and Code of Professional Conduct
  - We acknowledge that there is a need for conformance, rules and regulations while constantly evaluating those rules for needed modifications
- Level 3: Occasionally, we encounter a situation requiring us to follow our internal moral compass

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Kohlberg and Frameworks

- AICPA Code of Professional Conduct:
  - Rules-based
  - Hierarchy of rules, interpretations, rulings
  - More restrictive oriented with a "prohibited actions" (rules) orientation
- IESBA Code of Ethics for Professional Accountants:
  - Principles-based
  - Conceptual framework approach
  - Professional judgment required
  - Not devoid of rules as specific guidance exists for common situations where a conceptual framework cannot be applied
- Where does each structure "fit" in the pyramid?

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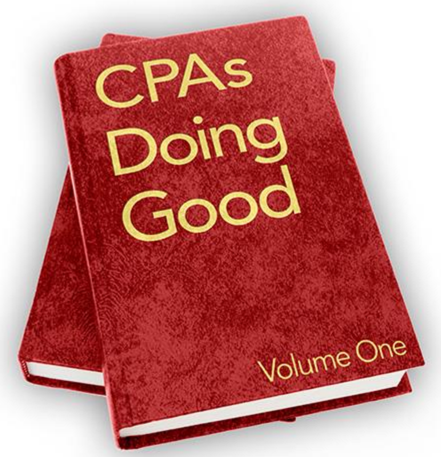
The Social Good



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The Social Good

Conflicts experienced as a CPA range from easily resolved / recognized to more challenging

- Easy: (Linzy, T.C. Memo 2013-219) Tax preparer working from home office deducted travel expenses to get away from home to “just get some rest” so that she “could function” by getting a good night’s rest.
- Harder: Verification Letters — in case of “Comfort Letters,” information requested often conflicts with professional standards

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Confidential Client Information

Rule 301 of the AICPA Code of Professional Conduct:

"Prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client."

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Confidential Client Information

Rule 501 of the AICPA Code of Professional Conduct:

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

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Conflict of Interest

Rule 102 of the AICPA Code of Professional Conduct:

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

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Conflict of Interest

FAR 2.101 Organizational Conflict of Interest:

"Because of other activities or relationships … , a person is unable or potentially unable to render impartial assistance or advice, or the person's objectivity … is or might be impaired, or a person has an unfair competitive advantage."

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Conflict of Interest

FAR 3.1101 Personal Conflict of Interest:
"A situation in which a covered employee has a financial interest, personal activity, or relationship that could impair the employee's ability to act impartially and in the best interest of the Government when performing under the contract."

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Comfort Letters

- Typically requests for verification
- A third party requests a CPA to make assertions about a client's information

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AICPA FRF for SME

- AICPA Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SME)
- Designed to provide useful, relevant information in a simplified, consistent, cost-effective manner where GAAP financial statements are not required.

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AICPA FRF for SME

- AICPA has released the Financial Reporting Framework for SMEs
  - Non-GAAP
  - Streamlined
  - Based on traditional and proven accounting methods
  - Provides meaningful financial reports without needless complexity

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FRF for SME: Advantages
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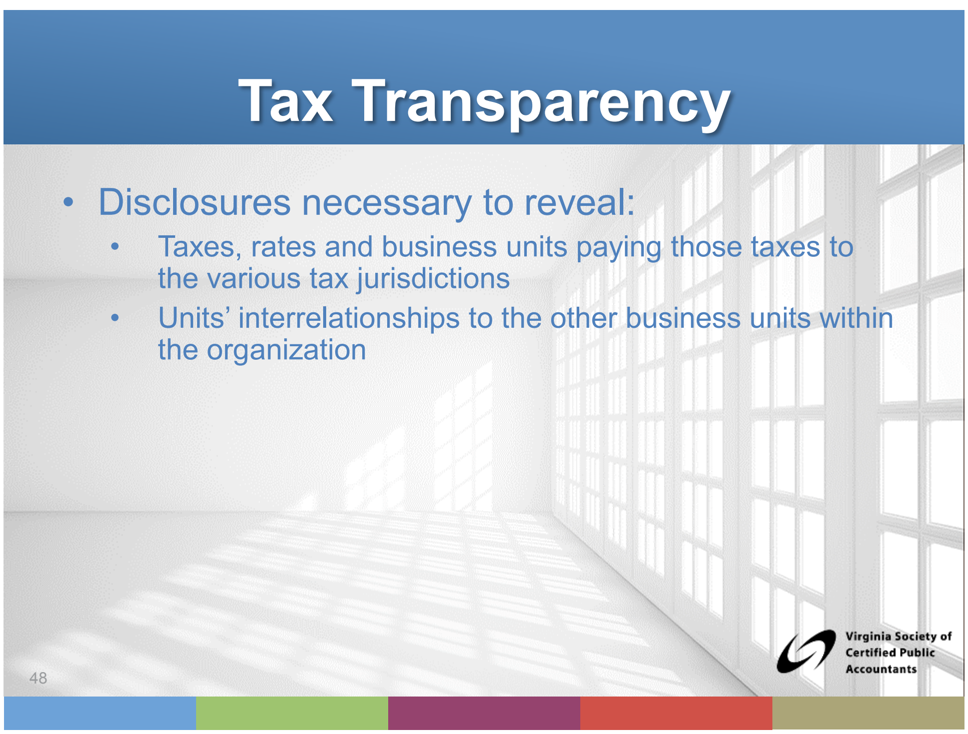
Tax Transparency
• Disclosures necessary to reveal:
• Taxes, rates and business units paying those taxes to the various tax jurisdictions
• Units' interrelationships to the other business units within the organization
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Tax Transparency

- Government needs for increased revenue
- Rise of media focus
- Internationalization of businesses
- Increased use of the internet
- Availability of information
- New required disclosures

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Preparation vs. Compilation

- Exposure Draft: *Proposed Statements on Standards for Accounting and Review Services*
- Issued Oct. 23, 2013
- Addresses need for common conventions for ease of reading, comprehension and applicability
- Not fully harmonized with international standards

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Preparation vs. Compilation

	Compilation	Preparation
When does the standard apply?	When an accountant is engaged to perform a compilation	When an accountant is engaged to prepare financial statements
Is an engagement letter required?	Yes	Yes
Is the accountant required to determine if he or she is independent of the client?	Yes	No
If the accountant is not independent, is that fact required to be disclosed?	Yes	N/A
Does the engagement require a report?	Yes	No*
May the financial statements go to users outside of management?	Yes	Yes
May the financial statements omit notes?	Yes	Yes

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VBOA Enforcement Cases

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SEC Whistleblower Program

- Created by Congress to provide monetary incentives for individuals to come forward and report possible violations of the federal securities laws to the SEC
- Eligible whistleblowers are entitled to an monetary reward
- Prohibits retaliation by employers against employees who provide information about possible securities violations

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Sarbanes-Oxley Revisited

- Signed into law in 2002 following accounting scandals
- Attempt to improve reliability of financial information
- Includes several reforms
- Prohibition of certain services from firms to companies they audit
- Established PCAOB

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A Decade Under SOX

- Perceived audit quality has improved in part due to bigger role of audit committees
- PCAOB has likely improved audit quality through inspections
- More audit committees have financial experts
- Companies less likely to restate financial statements

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Conclusion

When dealing with ethical dilemmas, ask yourself: Would I feel uncomfortable if other people knew that I was involved in this situation?

But remember: being a truly ethical CPA means doing the right thing even when no one is watching.

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Closing Reminders

- Ensure your license is up to date at boa.virginia.gov
- Reference pages 3–4 of the participant manual to contact the appropriate organization if you have further questions.
- Your CPE verification will be emailed to you.
- Please complete the evaluation that will be emailed to you shortly. Your feedback helps us make this a better course!

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Appendix II: Tax Transparency Handout

Business Horizons (2013) **56**, 543—549

Available online at www.sciencedirect.com

SciVerse ScienceDirect

KELLEY SCHOOL OF BUSINESS
INDIANA UNIVERSITY

www.elsevier.com/locate/bushor

ACCOUNTING MATTERS

Tax transparency

Raquel Meyer Alexander

Williams School of Commerce, Economics, & Politics, Washington and Lee University, Lexington, VA 24450, U.S.A.

KEYWORDS
Tax transparency;
Corporate tax avoidance;
Global tax reporting;
Tax code reform;
Business planning strategies

Abstract As increasing pressures on government budgets lead to austerity measures, a growing number of protesters, corporate watchdog groups, and policymakers are shining the light on worldwide corporate tax avoidance. Current and proposed disclosures at the entity and country levels will pull back the veil of tax secrecy and inevitably prompt more regulatory and tax authority oversight. These disclosures could also lead to damning front-page stories and, ultimately, tax code reform. This first installment of Accounting Matters takes a close look at what tax transparency may mean for U.S. multinationals in the coming years. The article concludes with recommendations for officers and owners to manage tax and reputational risks through U.S. and international planning strategies.

1. Tax transparency isn't coming—It's already here

According to fashionistas, new trends start in Europe, move to the U.S. coasts, and then become mainstream in the Midwest. If these claims are true, tax directors and business owners who ignore the recent tax protests and boycotts in the UK and the G8 efforts to increase corporate tax disclosures do so at their firm's peril. Populist rage about corporations not paying their fair share of taxes is fueled by a complicated tax planning strategy which offshores profits to a tax haven with no business purpose aside from tax avoidance. Dilbert's take on Google's infamous Double-Irish, Dutch Sandwich (Figure 1) shows how complicated tax strategies can appear to the public.

During the past two decades, the corporate tax function has become more integrally aligned with firms' activities. Taxes are now a factor in business plans, compensation packages, and market valuation. For example, many executives are compensated based upon *after-tax* returns of firm activities and effective tax rate is a metric for benchmarking CFO performance. Recent academic research shows that firms that engage in aggressive tax planning are rewarded with increased stock prices (Desai & Dharmapala, 2009; Koester, 2011) and a lower cost of debt (Lisowsky, Mescall, Novack, & Pittman, 2010).

The movement of the tax function from a cost-center to a profit-center, along with an increasing global business market and a robust marketplace of tax consultants, has led to more international tax planning. Until recently, rumblings about successful lobbyists who have carved out too many tax loopholes for corporations were met with relative indifference by the public because tax rates were moving

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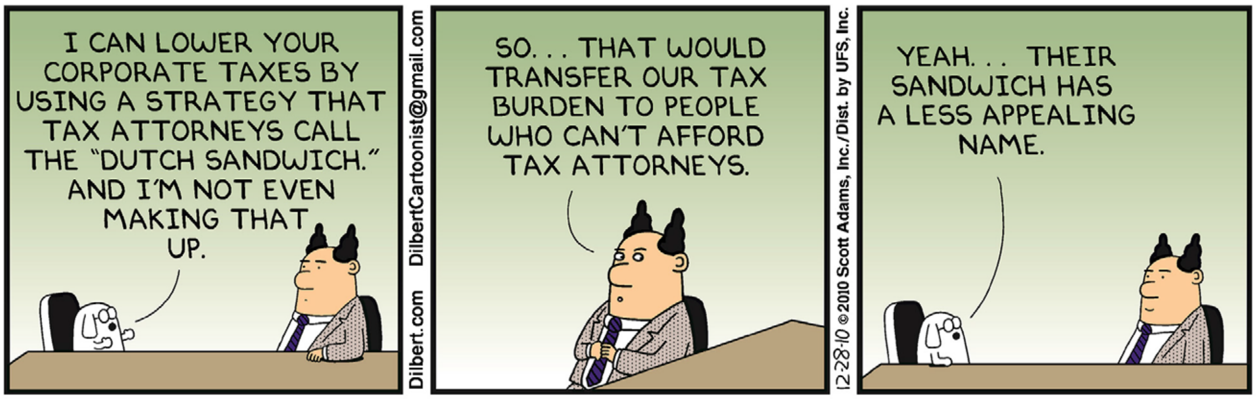
Appendix II: Tax Transparency Handout

Figure 1.



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downward and federal/state economies were relatively healthy. But the great recession changed the rules of the game, especially for U.S. multinational corporations that find themselves now in the tax spotlight. Consider Apple Inc., which faces a shareholder lawsuit for not wisely using its cash hoard of \$137 billion, two-thirds of which is held offshore to avoid U.S. taxation. Recent reports suggest that \$20 trillion is hidden in tax havens and over \$60 billion of annual tax revenues are foregone by multinational corporations' (MNC) use of international tax strategies.

In response to austerity measures which led to significant cuts in social services across Europe, more citizens, businesses, and policymakers are reexamining tax revenues, and a new policy of name-and-shame seems to be sweeping the continent. When Amazon paid only £1.8 million (\$2.7 million) in taxes for £3.35 billion (\$5.05 billion) in sales last year, the normally staid UK citizenry was in an uproar. U.S. journalists are focusing national attention on tax planning with lists such as the Top 25 Corporate Tax Dodgers (Kristof, 2011) and the Top 10 Tax Evaders' Wall of Shame (Poe, 2011). David Kocieniewski's 2012 Pulitzer Prize for his corporate tax evasion series, *But Nobody Pays That*, gives journalists an incentive and—just as important—a template for writing about firms' corporate tax disclosures.

The consequences of public scrutiny can be intense, long-lasting, and a boardroom-level concern. In the short term, firms may find themselves subject to brand-eroding boycotts and protests; indeed, a recent study found that 34% of the UK is boycotting tax avoiders (Tax Research UK, 2013). The impact will first be felt by retailers, service providers, and manufacturers of discretionary goods. Companies seeking state and local incentives for expansion and relocation may find the target community's leaders unable to financially support companies perceived to be tax avoiders. Lobbying efforts on non-tax matters might also be impacted when a company's tax issues makes them radioactive to politicians. For many firms, non-tax lobbying is essential to business success. For example, large manufacturers may undermine their own efforts to get regulatory relief from labor, safety, and emissions standards if they are embroiled in a public tax controversy.

In the long term, companies and entire industries may find themselves subject to increased oversight and enhanced disclosure regimes from financial and tax authorities. Expensive tax planning may have to be undone, consuming additional firm resources and racking up consultant fees. For example, Verizon—a so-called Top 25 Tax Dodger and #7 on the Wall of Shame—recently reorganized its entity structure to use Singapore, rather than a haven in the Caribbean, as an intermediary for sales. While the overall strategy is the same (i.e., use of an offshore intermediary to park worldwide profits), the optics have improved considerably. Unlike the Cayman Islands, the general public does not view Singapore purely as a tax haven. Verizon's large commercial presence in Singapore, in terms of both suppliers and markets, also provides a business purpose for use of this low-tax jurisdiction. The lengthy and expensive restructuring involved several U.S. and Singapore law and accounting firms, tied up considerable internal resources, and required the support of the C-suite.

Whereas Verizon voluntarily restructured, public scrutiny may lead to changes in the tax law which will *require* all affected firms to restructure and/or pay more taxes. In many developed nations, registered companies must provide company financial statements—frequently called 'accounts'—at the entity level. In the U.S., the SEC allows companies to file consolidated financial statements that obscure intra-company transactions (e.g., loans, royalties, management fees used to reduce tax liabilities). The EU is moving toward additional reporting at the country level to allow the public to observe the total taxes remitted in each jurisdiction. Several U.S. bills combat offshore secrecy with information reporting, and require enhanced disclosures of employees, sales, financing, tax obligations, and tax payments on a country-by-country basis for all SEC registrants.[1]

2. Disclosures currently available, or "How did they know that?"

The disclosure regime in the U.S. and abroad is changing rapidly, and interested parties are increasingly using corporate disclosures to highlight firms. Employees of universities, the Internal Revenue Service (IRS), and other government agencies have long had access to confidential tax return data for research projects on corporate income taxation. However, all results are reported in the aggregate because individual-firm tax information derived from federal income tax filings is confidential under U.S. Treasury regulations. Although the calls for public disclosure of corporate income tax returns are falling on deaf ears, interested parties can explore new disclosures required by the SEC, the FASB, and foreign governments. Non-U.S. filings are available on country websites, such as the Netherlands' Trade Register (www.kvk.nl).

Unlike academic research, which seldom identifies individual companies, investigative reporters make their case through heart-wrenching stories of people affected by a company. For example, Associated British Foods—a UK multinational which owns brands including Silver Spoon, Twinings, and Kingsmill—was caught in a global tax scandal when reporters showed how transfer pricing was used to avoid paying tax in Zambia, an African state blighted with childhood hunger and malnutrition (Boffey, 2013).

The disclosures currently available vary by reporting regime, but when pieced together, can present compelling evidence of aggressive tax planning strategies. Due to significant reform in 2011, the IRS whistleblower business is becoming a cottage industry for some, with rewards of up to 30% of taxes recovered. During the 2012 fiscal year, the IRS issued 128 whistleblower rewards totaling $125 million and received over 8,600 submissions which are working their way through the system. The financial stakes are higher and investigating international corporate tax strategies is no longer relegated to journalists on the business beat or do-gooders without expertise.

[1] These include the American Jobs and Closing Loops Act (H.R. 4213), the Stop Tax Haven Abuse Act (S. 506, H.R. 1265), and the Bipartisan Tax Fairness and Simplification Act (S. 3018).

2.1. Disclosure abroad

Required disclosures of company financial and tax information vary by jurisdiction. However, most EU and G20 countries require companies to file audited financial statements, prepared at the company level, with government authorities; these are colloquially known abroad as 'accounts.' Tax returns are confidential, but select tax information is presented in the accounts. Accounts are available online, and in many countries, an original audit report written in English can be downloaded free or for a nominal fee. The types of entities that are required to disclose accounts also vary by jurisdiction. For example, the Netherlands is considered a tax haven because trusts do not have to file accounts but corporations do. Using the audited accounts from a Dutch subsidiary, Bloomberg reporter Jesse Drucker (2012) discovered Google's income was routed through a Bermuda shell company to avoid $2 billion in worldwide taxes. Entity-level audited accounts filed in the Netherlands are publicly available and downloadable for €2.9 ($3.80) each.

In the EU and many other developed nations, ownership information must be filed with the authorities. Many tax haven countries do not collect ownership information and others do not make such information available. With recent estimates of over $20 trillion hidden in tax havens, new inter-jurisdictional initiatives are being developed to require tax haven countries to enhance ownership reporting.

2.2. U.S. disclosure

Company ownership disclosure varies by state, but Delaware and Nevada often make the tax haven list because of the level of secrecy afforded to business owners. SEC registrants face more extensive disclosure requirements. The newest tax disclosure, FIN 48, was enacted in 2007. FIN 48 enhances the financial statement tax footnotes by requiring quarterly and annual disclosures of unrecognized tax benefits (i.e., tax positions which require an accounting reserve) and changes in tax reserves due to settlements and lapses arising from expiring statutes of limitations. FIN 48 disclosures supplement the other Form 10-K information that provides tax position transparency.[2]

[2] These include FAS 109 (deferred tax liabilities), FAS 5 (loss contingencies for non-income tax related items), FAS 45 (indemnity disclosures), SOP 94-6 (disclosure when it is reasonably possible that an accounting estimate will change in the near term), Schedule II (roll-forward NOL valuation allowance accounts), and permanently reinvested foreign earnings.

But unlike the entity-level accounts disclosures in foreign jurisdictions, SEC reporting of company financial information is presented at the consolidated level so intercompany transactions are not disclosed.

The FIN 48 information is also presented on Schedule UTP (Uncertain Tax Position Statement) filed with the corporate tax return. Designed to assist the IRS during examinations, Schedule UTP requires corporations to list individual income tax positions that comprise the tax reserve presented in the financial statements. For each position, the taxpayer must identify the relevant code section(s), the EIN of any pass-through entity affected, and a description of the tax position.

2.3. Internal Revenue Service

The Internal Revenue Service's position on tax transparency offers one bright spot for taxpayers who aim to be compliant and cooperate with the IRS on potential disputes. Advanced pricing agreements (APA) and pre-filing agreements (PFA) offer two alternatives to the traditional post-filing dispute process. The IRS's long-standing APA program is a binding contract between the IRS and the taxpayer to treat specified international transfer price transactions in an agreed-upon manner. The IRS PFA program was initiated in 2002, allowing a taxpayer to reduce costly and time-consuming disputes in an audit by requesting consideration of a tax issue before the return is filed. In 2012, the Service received 33 PFA requests, accepted 12, and reached 10 closing agreements. Increasing tax transparency with the IRS, through formal programs such as APA and PFA and through informal interactions, can reduce monetary and reputational risks arising from tax controversies. Further, these agreements eliminate uncertainty and, by corollary, eliminate FIN 48 and Schedule UTP disclosures on these transactions.

Another recent development is the U.S. Treasury's Foreign Account Tax Compliance Act (FATCA), a unilateral effort to impose reporting and withholding requirements to reduce banking secrecy. FATCA requires U.S. taxpayers to report foreign financial assets over certain amounts to the IRS and foreign financial firms to disclose U.S. clients.

2.4. Harmonization and cooperation

The international community is confronting tax evasion through information sharing. Tax treaties are being revised to include tax information exchange agreements; the Organization for Economic Cooperation and Development (OECD) Global Forum on Transparency and Exchange of Information for Tax Purposes has 120 member countries. The number of active information requests between nations is at an all-time high and countries normally recalcitrant to participate (e.g., Japan, Brazil) are getting on board. Many more countries have entered into bilateral agreements with key trading partners. Even developing nations, such as those in Africa and Central America with less sophisticated taxing authorities and fewer resources directed toward tax collections, are establishing tax information sharing initiatives. In early January 2013, tax authorities from the BRICS (Brazil, Russia, India, China, and South Africa) pledged to share information and tax collection practices with each other.

The G8, a group of finance ministers and central bank governors from eight major economies, has made international taxation reform the central issue for 2013. The 2013 G8 chair is pro-business, conservative British Prime Minister David Cameron, who has surprised many by vowing to combat aggressive tax avoidance by international companies and likening it to illegal tax evasion. In 2011, the G20 committed to the multilateral Convention on Mutual Administrative Assistance in Tax Matters. In 2012, a less splashy—but just as important—change was approved to make tax evasion a predicate offense for money laundering. In other words, the nimble money laundering statutes with relatively low burdens of proof and favorable mutual assistance treaties can now be applied to tax evasion.

Individual initiatives to harmonize international tax regimes and increase transparency are also appearing. UK Parliament Member Stephen McPartland sent letters to the top 100 FTSE companies requesting that they sign on to tax transparency initiatives via a tax challenge that promotes country-by-country reporting. The responses he received may be categorized into two groups: (1) companies with tax planning strategies that do not think country-by-country reporting will improve transparency, and (2) companies with little international presence that fully support the initiative.

3. Prospects for long-term tax transparency

The single-largest change on the horizon is implementation of country-by-country reporting. On February 28, 2013, the EU Parliament approved country-by-country reporting for European banks starting in January 2014. These confidential reports will include data on employees, profits, and taxes paid in each jurisdiction, along with subsidiary ownership information.

The Dodd-Frank Act specified that SEC registrants in an extraction industry must annually report payments made by the company, its subsidiaries, or entities under its control to the U.S. and foreign governments by project and by country. The payments subject to disclosure include taxes, royalties, bonuses, dividends, and infrastructure improvements. For each payment, companies must provide the type and amount paid on a cash basis, the total for each category listed above, the government and country that received the payment, and the projects to which the payments relate.

Other transparency initiatives include Publish What You Pay. This idea is promoted by a number of public interest groups and entails required, comprehensive country-by-country reporting of all government payments made by multinational organizations, whether public or privately held. Executives should anticipate that the country-by-country reporting required of EU financial institutions and U.S. extraction enterprises will be imposed by more jurisdictions—including U.S. states—on more industries.

4. Recommendations

4.1. Don't let the tax tail wag the dog

This is a good time to consider restructuring based upon business models, not tax efficiencies. Tax consultants often devise clever names to give the appearance of a business purpose, but the IRS and the Tax Court will likely know that 'tax-efficient supply chain management' is really just tax sheltering with a fancy name. Examine the subsidiaries listed on Form 10-K, Exhibit 21 (Subsidiaries of the Registrant) with a keen eye toward those located in known tax havens. To reduce exposure, many large multinationals are engaging in synthetic mergers to eliminate inactive subs and those in tax havens. As the consumers of tax shelters hawked by accounting firms, investment banks, and lawyers in the 1990s and 2000s discovered, taxing authorities can distinguish between real investments and transactions without economic substance. Further, recent settlements involving Ernst & Young, KPMG, and PWC require the firms to disclose tax shelter information to the IRS so corporations engaged in the most risky transactions have lower odds of winning the audit lottery.

4.2. Don't treat the symptom, cure the disease

Executives should consider becoming involved in tax policy at the national and international levels. While lobbyists are helpful in getting access, owners and managers who tell the story of their company's tax issues are often more persuasive to policy makers and elected officials. The tax issues likely to be up for debate are identified in *Addressing Base Erosion and Profit Shifting* (Organization for Economic Cooperation & Development, 2013) as key pressure points in international corporate tax reform: related party debt, captive insurance, intergroup financial transactions, transfer pricing between related entities, thin capitalization rules, tax treaty abuse, and preferential regimes. Executives would be well served to work on leveling the playing field in international tax rather than investing more resources in short-term fixes, such as tax planning strategies.

There is no shortage of opportunities to get involved in tax policy. This year, three OECD taskforces are working on international tax issues. Britain chairs one on transfer pricing, Germany chairs the tax-base erosion group, and France and the U.S. co-chair a taskforce on jurisdiction issues with emphasis on e-commerce.

Executives should also consider engaging in the debate about transparency. Recent initiatives in the U.S. and abroad call for country-by-country reporting of sales, profits, and taxes paid in every jurisdiction where an entity operates; automatic exchange of tax data through international tax cooperation among governments including nonresident individuals, corporations, and trusts; and public disclosure of beneficial ownership of all business entities, trusts, foundations, and charities.

4.3. Get ahead of the press. . .and stay there

Employees charged with media and investor relations should be informed of transactions and tax matters that may raise eyebrows among regulators, the media, and the public. Help these employees be prepared for inevitable questions, such as:

- How much in taxes do you pay in X jurisdiction?
- How do you keep your tax rates lower than the statutory corporate tax rate?
- Why did you pay your CEO—or lobbyist, or private jet pilot, and so on—more than you paid in taxes?

Executives should be ready with an explanation that addresses the business reasons behind the low tax rates, and take a lesson from the responses of General Electric (GE) and Electronic Arts (EA) when each was the focus of a tax avoidance story by the *New York Times*. GE kept the news cycle going with varying explanations, while EA gave a response that (1) highlighted tax law designed to support new technology industries, lowering the company's tax rate; and (2) summarized the other taxes EA pays, along with the number of individuals its employs in the United States. Because of the great potential for misunderstanding complex financial data, companies should strive to present tax information in a useful way to the public.

Executives should also publicly recognize the problem—no outright denials—while reassuring the public and constituents that the company will consider changes in tax planning. Throwing blame on tax laws and tax administrators is not effective, nor is stating that the IRS agreed to the transaction in advance. The public is only angered by one response: "Don't hate the player; hate the game." Recall that Richard Nixon released the results of his clean tax audit in hopes of assuring the public that he was not a crook. This, however, just provided more fodder for the press and led to increased scrutiny of his other extracurricular activities. A second audit revealed a significant deficiency and, of course, the press did not let go of the Watergate story.

4.4. Tax transparency as a strategy

Executives might consider how to use transparency to the firm's advantage. In general, new initiatives are phased in slowly, allowing smaller firms time to adapt to the changing reporting regime. Consider whether or not your firm will be an early adopter. Research shows that the market does not necessarily reward voluntary disclosures, even when they are verifiable (Ronen & Yaari, 2002).

Tax transparency is certainly being met with resistance, as evidenced by the aforementioned responses to MP McPartland's tax challenge. It should be noted that tax transparency itself won't necessarily lead to increased tax revenues. It is more likely that tax transparency will change the competition between countries, states, and localities for economic development, but the competition will not go away. With access to competitors' disclosures, executives may be able to strategically position their company for business incentives. For example, firms with more employees than their competitors in a particular jurisdiction may find elected officials amenable to property and sales tax abatements.

Tax transparency accompanied by international tax reform may also provide opportunity for a tax director to clean up all the company's tax strategies that do not serve a legitimate purpose. Because all firms will be subject to the same rules, the market will likely not penalize any firm during the adoption period. For example, research shows that firms with large FIN 48 disclosures upon adoption in 2007 did not, in general, suffer from a negative market reaction.

5. Conclusion

Tax transparency has been a hot-button issue throughout the world, and multinationals are now being targeted for aggressive tax sheltering activities. While Americans take pride in the success of U.S. companies doing business abroad and rely upon these profits to fund the retirements of American workers, foreigners clearly hold a different opinion: United States-based MNCs are often viewed as predators that steal sales from local businesses, use local services, skirt tax obligations, and hide profits in tax havens to enrich wealthy U.S. shareholders. Consider the case of Vodafone—a British telecommunications giant—in India. After battling Indian tax authorities' charge that the firm owed taxes stemming from an acquisition, the Indian Supreme Court finally ruled in favor of Vodafone in 2012. Rather than acquiesce, however, the Indian government simply voted to change tax law—retroactively back to 1964—so that Vodafone remains liable for the tax assessment ("Vodafone," 2013). Given that India is providing guidance to Chinese, Brazilian, and Russian taxing authorities, United States-based MNCs should not be surprised to find that current tax planning strategies are increasingly ineffective. In sum, U.S. executives should resign themselves to new disclosure regimes, both domestically and abroad, and look for opportunities to use these inevitable changes to their firms' strategic advantage.

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VBOA Policy Updates

The VBOA has made changes to its license statuses, changing terminology on one status to "Active — Renewal Fee Delinquent" and adding the "Active — CPE Exempt" status.

"Active — Renewal Fee Delinquent," previously called "Expired — Late Renewal," concerns the renewal status for late licensees. Individuals holding a CPA license have an additional 12 months after their license expiration date to renew the license. During that period, their licensee status would be "Active — Renewal Fee Delinquent," but they would still be considered to hold a Virginia license, although late renewal fees still apply to any licensee who falls under this status. Licenses not renewed by the end of the grace period would be considered "Expired" and the licensee would need to reapply for licensure.

"Active — CPE Exempt" went into effect July 1, 2014, and affects CPAs who wish to maintain their license but are not providing services to an employer or the public and do not expect to provide such services for a period of time. Licensees who qualify for this status will be allowed to renew their licenses annually and pay the renewal fee, but will not have to fulfill CPE requirements.

Licensees using this status who begin providing services to an employer or to the public would need to reactivate their "Active" status and fulfill CPE requirements before initiating services.

The VBOA also updated its policy (PDF) concerning sponsors providing CPE with regard to the annual Virginia-specific Ethics course. Beginning with the 2015 course, the VBOA approved the VSCPA as the sole provider of the Ethics course content and materials, to be completed in accordance with the VBOA's annual course outline.

The VBOA also specified that all instructors of the Ethics course must hold an active Virginia CPA license in good standing and that sponsors that desire to teach the Ethics course must fulfill the following requirements:

- Obtain the course content and materials from the VSCPA
- Be pre-approved annually by VBOA staff, in writing, as a provider of the Ethics course
- Be listed on the VBOA website as a pre-approved provider of the Ethics course
- Submit all participant comments to the VBOA within 60 days of receipt

Visit www.vscpa.com/EthicsFAQ for information on the VBOA's decision and the VSCPA's role in the Ethics course moving forward.

In all, the VBOA has three new and updated policies effective Jan. 1, 2015:

- Policy No. 2: CPE Sponsors (PDF)
- Policy No. 4: CPE Guidelines (PDF)
- (New) Policy No. 8: Ethics Committee (PDF)

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