



Professional Ethics for CPA's

4 CPE Hours

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CONTINUING EDUCATION for Certified Public Accountants

PROFESSIONAL ETHICS FOR CPAs

Course Abstract

This course provides an in-depth overview of the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct. The Code of Professional Conduct is a set of principles, rules and interpretations that guides CPAs in the performance of their professional responsibilities. The course includes a discussion of those principles applicable to all members, but also addresses those requirements for members in business, members in public practice, and members in neither business nor public practice. A full copy of the most recent AICPA Code of Professional Conduct is available on the AICPA website.

Learning Objectives

Upon completion of this course, you will be able to:

- Identify the different parts of the AICPA Code of Professional Conduct
- List the steps within the conceptual framework approach
- Differentiate between various threats for both members in public practice and members in business
- Recognize examples of threats for both members in public practice and members in business
- Identify safeguards to be applied to various identified threats
- Differentiate between the various principles, rules, and interpretations within the Code
- Identify those activities that would and would not impair a member's independence
- Differentiate between interpretations applicable to members in public practice, members in business, and other members

Field of Study	Professional Ethics
Level of Knowledge	Overview
Prerequisite:	Knowledge of AICPA Code of Professional Conduct
Advanced Preparation	None
Recommended CPE hours	4
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Under the NASBA-AICPA self-study standards, self-study sponsors are required to present review questions intermittently throughout each self-study course. Additionally, feedback must be given to the course participant in the form of answers to the review questions and the reason why answers are correct or incorrect.

To obtain the maximum benefit from this course, we recommend that you complete each of the following questions, and then compare your answers with the solutions that follow at the end of course. *These questions and related suggested solutions are not part of the final examination and will not be graded by the sponsor.*

Introduction

As noted in the course overview, the AICPA Code of Professional Conduct (herein referred to simply as the Code) is a set of principles, rules and interpretations that guides CPAs in the performance of their professional responsibilities. For over 100 years, CPAs across the country have voluntarily adhered to the Code in recognition of the accounting profession's dedication to integrity, objectivity, and independence.¹

The AICPA notes that a national effort is underway to encourage more state boards of accountancy to adopt standards prescribed within the Code. The AICPA further notes that twenty states and jurisdictions already have adopted the Code as a requirement for CPAs to practice in their states. In all, over 412,000 AICPA members adhere to the code as part of their AICPA membership. The CPA profession has long been bound by a distinctive ethical code that is based on the fundamental principles of integrity, objectivity, independence, due care and serving the public interest. Each of these topics above will be discussed extensively throughout this course.

Organization of the Code

The Code is organized primarily into three different parts as follows:

- Part 1: Applies to members in public practice
- Part 2: Applies to members in business
- Part 3: Applies to members who are not in public practice or business

These three parts form the primary framework for the AICPA Code of Professional Conduct. In addition to these parts listed above, there is also a Preface section within the Code. This Preface includes principles and rules that are applicable to all members, whether they be in public practice and business. So for example, a member in public practice would need to adhere to the rules and principles included in both the Preface and Part 1 of the code. Similarly, a member in business would need to adhere to the rules and principles included in both the Preface and Part 2 of the code. It's important to note that in certain circumstances, a member may have multiple roles (i.e. both in business and in public practice) in which case they would need to adhere to both Parts 1 and 2, along with the Preface.

Specific to organization of the Code, each part noted above contains certain topics, subtopics, and one or more sections. As a result, parenthetical references will be made as appropriate to the Code throughout this course where content is referenced verbatim. As an example, Section 1.100.001.01 relates to the integrity and objectivity rule for members in public practice where "1" relates to the Part, "100" relates to Integrity and Objectivity, and "001" relates to the Integrity

¹ AICPA Publication "The AICPA Code of Professional Conduct: Protecting the Public Interest".

and Objectivity Rule, and "01" is the actual text of interpretation that a member would need to follow. This organization and method of reference will be apparent when the user reviews the table of contents included within the first few pages of the Code.

Evolution of the Code

The Code was originally adopted on January 12, 1988, and has been periodically revised and updated through June 1, 2014. Similar to the codification of U.S. Generally Accepted Accounting Principles (GAAP) by the Financial Accounting Standards Board (FASB) effective July 1, 2000, the Code also underwent a similar codification project. Prior to the codification, the Code was not structured for quick and easy navigation. For example, the Code at the time was not topically organized and as a result, was difficult to navigate.

The primary objectives of the Ethics Codification Project, as noted by the AICPA in its project overview presentation available on www.aicpa.org, was the following:

- Create a user friendly, intuitively arranged Code
- Revise without making significant changes to existing requirements and restrictions
- Incorporate conceptual framework approach
- Incorporate references to division's nonauthoritative guidance
- Include separate parts for members in public practice, business and all other members
- Create an online codification with enhanced functionality

While intent of the codification project primarily was to reorganize and clarify certain aspects of the Code, certain substantive changes were made during the project. This included the incorporation of two new conceptual frameworks (discussed further below) as well as other substantive changes to include, but not limited to, discussions of ethical conflicts, definitions of attest client, and expanded application of certain independence situations.

The revised Code is effective December 15, 2014, excluding the Conceptual Framework sections which are effected a year later on December 15, 2015. While members were allowed to early implement the revised Code prior to the effective date, a member was not allowed to implement the Conceptual Framework prior to implementing the entire revised Code (0.200.020.01).

Conceptual Frameworks

The AICPA notes in its AICPA Conceptual Framework Approach discussion on its website that the most

significant change to the content in the revised AICPA Code is the incorporation of two conceptual frameworks, one for members in public practice and one for members in business. The conceptual framework approach included in these two frameworks, the AICPA notes, is a way of identifying, evaluating and addressing threats to compliance with the rules resulting from a specific relationship or circumstance that is not otherwise addressed in the code.

Scope and Application of the Code

The rules of conduct included within the Code applies to all professional services with certain exceptions. However, before discussing these exceptions, it's important to fully understand what is meant by the term "professional services". Refer to Exhibit 1-1 below for an overview of the definition of professional services as referenced in the Code.

Exhibit 1-1: Professional Services Definition (0.400.40)

Includes all services requiring accountancy or related skills that are performed by a member for a client, an employer, or on a volunteer basis. These services include, but are not limited to accounting, audit and other attest services, tax, bookkeeping, management consulting, financial management, corporate governance, personal financial planning, business valuation, litigation support, educational, and those services for which standards are promulgated by bodies designated by Council.

Now that you understand the scope of the Code is applicable to all professional services, the Code does specifically prescribe a listing of certain instances where the rules of conduct do not apply, or in other words, a situation when a member would not be in violation of the rules of conduct if they did not perform in accordance with the Code. These include the following situations (0.200.020.03):

- When a member is practicing outside the United States as long as the member's conduct is in accordance with the rules of the organized accounting profession in the country in which he or she is practicing
- When a member is a member of a group engagement team, and a foreign component auditor departs from any of the rules of conduct, so long as the foreign component auditor's conduct, at a minimum, is in accordance with the ethics and independence requirements in the International Ethics Standards Bards for Accountants (IESBA's) Code of Ethics for Professional Accountants.
- A member firm's independence will not be impaired if another firm or entity outside the United States that is within the member firm's network departed from any of the rules of conduct, so long as the other firm's conduct, at a minimum, is in accordance with

the independence requirements in the IESBA's Code of Ethics for Professional Accountants.

While the above scope exceptions may seem complex, you're right in thinking so. The main takeaway is to simply note that in certain situations, especially when professional services involve participation in international engagements or the use of component auditors in foreign jurisdictions, members should well attune to the respective requirements and when the Code is applicable to a particular engagement and when it is not.

Principles of Professional Conduct

Included within the Code is a set of overarching principles which govern all members, not just those in business or those in public practice. A summary of the AICPA's view of these principles is outlined in Exhibit 1-2 below.

Exhibit 1-2: Principles of Professional Conduct (0.300.010.02)

These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

So what are the principles of professional conduct referenced above? Simply put, these include the following seven principles, each of which are discussed in further detail in the following sections:

- Responsibilities principle
- Public interest principle
- Integrity principle
- Objectivity and independence principle
- Due care principle
- Scope and nature of services principle

Responsibilities Principle

The overall belief related to this principle is that a member should exercise sensitive professional and moral judgment in all of their activities (0.300.030.01). The Code further notes the following with respect to this principle (0.300.020.02):

“As professionals, members perform an essential role in society. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public’s confidence, and carry out the profession’s special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.”

Public Interest Principle

While the Code does not specify any order of importance or note that one principle is more important than the other, the public interest principle would undoubtedly rank high if it were assessed against other principles (not to discount the other principles by no means). The overall belief with respect to this principle is that member should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism (0.300.030.01). Exhibit 1-3 below provides additional information and clarifications with respect to this principle.

Exhibit 1-3: Public Interest Principle (0.300.030.02 thru .04)

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

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

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

Integrity Principle

The term integrity is thrown out frequently in everyday business. But what is exactly meant by the term integrity? The Code notes that integrity is an element of character fundamental recognition and is the quality from which the public trust derives, in other words, the benchmark which a member must ultimately test all decisions (0.300.040.02). Furthermore, integrity commonly includes the traits of honesty and candidness within the constraints of client confidentiality. To that end, public trust should not be subordinated to personal gain, deceit, or subordination of principle (0.300.040.03).

How is integrity tested? This is one of the key fundamental questions that are routinely asked. The simple answer is that a member should ask some of the following questions to assist in this determination:

- Am I doing what a person of integrity would do?
- Have I retained my integrity?

Often times, the answer to these questions will likely be apparent in a given situation. In other times, however, the answers may not be. The key takeaway is that a member should perform all professional responsibilities with the highest sense of integrity.

Objective and Independence Principle

This principle is one of the hallmarks of the accounting profession. Let’s look at each term independently though. What is objectivity? Objectivity is a state of mind that lends value to a member’s services and imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest (0.300.050.02). Independence, on the other hand, consists of two elements defined as follows (0.400.21):

- Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.
- Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including the safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.

These two elements noted above are commonly referred to as independence in fact and appearance. So how does independence relate to objectivity? Well, it’s important to note that independence precludes relationships that may appear to impair a member’s objective in rendering

attestation services (0.300.050.02). Said another way, a member likely cannot be objective (i.e. impartial) if that member is not independent of the client.

As you have likely inferred at this point, independence is generally only applicable to those members in public practice. In other words, those members performing services such as audits and other attestation engagements. For members in business, this cannot be accomplished given the members role in the client/organization. So while members in business cannot maintain independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services (0.300.050.05). Exhibit 1-4 below summarizes some of the overall key points with respect to this principle for both members in business and members in public practice.

Exhibit 1-4: Objectivity and Independence (0.300.050.03)

Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

Due Care Principle

The due care principle states in part that a member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability (0.300.060.01). But what specifically is meant by the term due care? Due care requires that a member perform with both competence and diligence. An expansive discussion of these two components of due care is included in Exhibit 1-5 below.

Exhibit 1-5: Competence & Diligence (0.300.0060.03 thru .05)

Competence

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

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

Diligence

Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

Scope and Nature of Services Principle

The final principle of professional conduct addressed within the Code relates to the scope and nature of services. This principle requires that a member in public practice should observe the other principles within the Code in determining the scope and nature of services to be provided within an engagement (0.300.070.01). As you can note, this principle essentially ties it all together and requires each member's service performed be consistent with the previously addressed principles. In the end, the assessment of these principles assist members in making the determination of whether or not to provide a specific service in their individual circumstances (0.300.070.03).

Furthermore, the AICPA notes that there are no hard-and-fast rules for members to use to reach a judgment on whether or not a service can be provided, but instead, a member must be satisfied that they are meeting the spirit of the principles (0.300.070.03). In order to accomplish this, the Code prescribes three steps that should be performed (0.300.070.04):

- Practice in firms that have in place internal quality control procedures to ensure that services are competently delivered and adequately supervised

- Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client
- Assess, in their individual judgments, whether an activity is consistent with their role as professionals

review questions...

1. Which of the following parts within the Code prescribes the professional conduct requirements required by both members in business and members in public practice?
 - a. Preface.
 - b. Part 1.
 - c. Part 2.
 - d. Part 3.
2. Which of the following identifies a professional service performed by a member where the requirements prescribed by the Code would not be applicable?
 - a. A member in public practice is performing a management consulting engagement for a nonpublic entity.
 - b. A member in business is performing litigation support services for his or her employing organization.
 - c. A member practicing outside the United States as long as the member's conduct is in accordance with that country's rules of the organized accounting profession.
 - d. A member in public practice is performing personal financial planning in the United States for an individual who holds international assets.
3. Which of the following principles outlined within the Code states in part that a member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability?
 - a. Due care principle.
 - b. Integrity principle.
 - c. Scope and nature of services principle.
 - d. Responsibilities principle.

Please refer to solution/answer pages at back of booklet

Members in Public Practice

As we've noted throughout the course so far, the Code is organized into parts, with parts applicable to members in public practice, members in business, and all others. In this section of the course we focus primarily on members in public practice. This part, which includes rules and interpretations with respect to independence considerations, constitutes a significant majority of the Code.

Fundamentally, what is meant by the term public practice? Quite simply, the Code defines public practice as the performance of professional services for a client by a member or member's firm (0.400.42). However, these leads to another fundamental question of what is a client? A client, as defined by the Code, is any person or entity, other than the member's employer, that engages a member or member's firm to perform professional services and, if different, the person or entity with respect to which professional services are performed. It's also important to note that government auditors within a governmental audit organization who audit federal, state, or local governments or component units, that are structurally located within the governmental audit organization, are considered to be in public practice.

Conceptual Framework

As noted in an earlier part of this course, we introduced the concept of the conceptual framework that was included within the Code as a result of the codification project. Before reviewing and applying the conceptual framework, it's important to have an understanding of some of the terms included within the conceptual framework. Refer to Exhibit 1-6 below for an overview three key terms (threats, safeguards, and acceptable level) included within the conceptual framework.

Exhibit 1-6: Conceptual Framework Definitions (1.000.010.04 thru .06)

Threats

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

Safeguards

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

Acceptable Level

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

With an understanding of these key terms, it's now possible to explore the conceptual framework further for those members in public practice. The overall need for the conceptual framework is that members may encounter various relationships or circumstances that create threats to the member's compliance with the rules (1.000.010.01). As a result, the rules and interpretations included within the Code were developed to address these situations. As you can imagine though, there are only so many rules and interpretations that it is near impossible to prescribe specific guidance to address all situations a member may encounter in public practice. As a result, a certain level of professional judgment and assessment of the particular facts and circumstances

of the situations is an obvious requirement. In other words, a member should put themselves in the shoes of an external informed third party to assess whether a particular threat to a member’s compliance is or is not at an acceptable level.

With respect to the actual application of the conceptual framework process, members should identify threats (both individually and in the aggregate) to compliance with the rules and evaluate the significance of those threats (1.000.010.07). More specifically, there are three primary steps to applying this conceptual framework process as noted in the illustration below. Each of the three steps are discussed in additional detail in the following sections.



Step 1 - Identify Threats

We previously defined threats as anything, such as relationships or circumstances that could compromise a member’s compliance with the rules within the Code. Note, emphasis should be added on the word “could” in the preceding sentence. It’s important to note that a threat could, instead of would, compromise a member’s compliance with the rules within the Code.

The AICPA notes that threats generally fall into one or more of the seven broad categories that follows:

- Adverse interest threats
- Advocacy threats
- Familiarity threats
- Management participation threat
- Self-interest threat
- Self-review threat
- Undue influence threat

Each of the above threats, including examples of each, are included in the following sections. It’s important to note that while the Code does provide a fairly descriptive list of examples of each of the above threats (with the exception of management participation threats), the examples are not all-inclusive and should not be construed as such.

Adverse Interest Threat

The Code defines this type of threat as a situation where a member will not act with objectivity because the member’s interests are opposed to the client’s interests

(1.000.010.10). Examples of adverse interest threats, as defined by the Code, include the following:

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

Advocacy Threat

The Code defines this type of threat as a situation where a member will promote a client’s interests or positions to the point that his or her objectivity or independence is compromised (1.000.010.11). Examples of this type of threat, as defined by the Code, include the following:

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

Familiarity Threat

The Code defines this type of threat as a situation where a member will become too sympathetic to a client’s interest or too accepting of a client’s work or product given a long or close relationship with the client (1.000.010.12). Examples of this type of threat, as defined by the Code, include the following:

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

Management Participation Threat

The Code defines this type of threat as a situation where a member will take on the role of client management or otherwise assume management responsibilities during an engagement to provide nonattest services (1.000.010.13). Compared to the other types of threats previously listed, the Code does not provide examples of this situation. Instead, given the relative simplicity of identifying this type of threat, no examples are necessary to further describe this type of threat.

Self-Interest Threat

The Code defines this type of threat as a situation where a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client (1.000.010.14). Examples of this type of threat, as defined by the Code, include the following:

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

Self-Review Threat

The Code defines this type of threat as a situation where a member will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the member or an individual in the member's firm and that the member will rely on that service in forming a judgment as part of another service (1.000.010.15). Examples of this type of threat, as defined by the Code, include the following:

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

Undue Influence Threat

The final threat, of the seven broad categories noted previously, is defined by the Code as a situation where a member will subordinate his or her judgment to an individual associated with a client or any relevant third party due to that individual's reputation or expertise,

aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member (1.000.010.15). Examples of this type of threat, as defined by the Code, include the following:

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

Step 2 – Evaluate the Significance of the Threat(s)

The next step in the process relates to a member's evaluation of the significance of an identified threat. For example, if a member has identified that a self-interest or undue influence threat exists during a professional service for a client, the member should assess and evaluate the significance of the threat.

But what is exactly meant by assessing the significance? Clearly one member can very easily come to a different conclusion about the significance of an identified threat compared to another member and whether or not that threat would prevent the member from complying with the rules within the Code. For starters, a member should determine whether the threat is at an acceptable level. Recall from Exhibit 1-6 that an acceptable level is one in which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the threat would not compromise the member's compliance with the rules. In other words, if a reasonable and informed third party does not take issue with a given situation/arrangement (i.e. a threat), then it's likely that a member can safely conclude that the threat is at an acceptable level. Refer to Exhibit 1-7 below which provides some expanded information with respect to this step in the process.

Exhibit 1-7: Evaluating Significance of a Threat (1.000.010.07b)

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

Step 3 – Identify and Apply Safeguards

In the previous step, it was noted that a member that should evaluate the significance of an identified threat and determine whether the threat is at an acceptable level. In situations where a member concludes that the threat is in fact at an acceptable level, the conceptual framework process ends. In other words, the member is not precluded from performing the professional service for the client, even if there is a threat, because a reasonable and informed third party would not take exception to the identified threat. However, what if it were the case where the identified threat was not at an acceptable level? In this instance, a member would proceed to the third and final step of the conceptual framework process – identifying and applying safeguards.

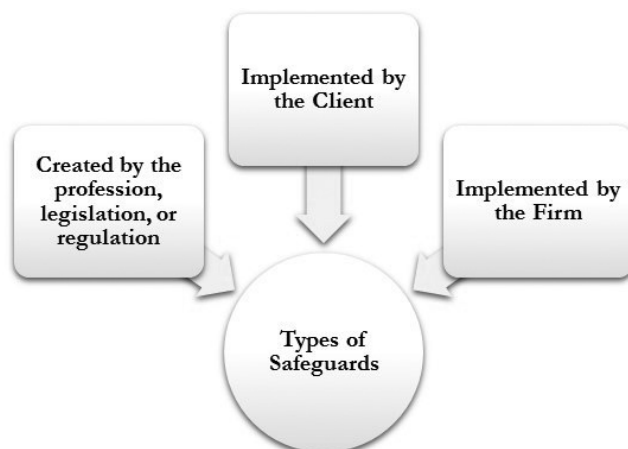
Recall from Exhibit 1-6 that a safeguard is an action or other measure that may eliminate a threat or reduce a threat to an acceptable level. In other words, while a threat may be identified and it may not be at an acceptable level, a member can perform an action (think of it as a type of compensating control) to reduce the threat to an acceptable level. In short, a member is recognizing that a significant threat exists but they are taking certain actions to reduce that threat to an acceptable level.

The Code notes that safeguards may partially or completely eliminate a threat or diminish the potential influence of a threat (1.000.010.17). The nature and extent of the safeguards applied will depend on many factors, however, the important point to note with respect to safeguards is that the goal is to reduce a threat to an acceptable level (i.e. an effective safeguard). To that end, the effectiveness of a safeguard depends on many factors, including the following (1.000.010.19):

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

Similar to how there were seven broad categories of threats previously discussed, the Code identifies three

different types of safeguards. These types of safeguards are provided in the illustration below and discussed in additional detail in the following sections.



Safeguards Created by the Profession, Legislation, or Regulation

As noted in the illustration above, there are three types of safeguards. Within the Code, several examples of the various types of safeguards are included for members to review. Important to note however, like the previously examples listed for threats, the examples of safeguards are also not all-inclusive. The first type of safeguards as noted above is one that is created by either the profession, legislation, or regulation. The Code notes the following as examples of this type of safeguard (1.000.010.21):

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

Safeguards Implemented by the Client

The second type of safeguard is one that is implemented by the client which serves to reduce a threat to an acceptable level. Similar to those safeguards created by the profession, legislation, or regulation discussed

above, the Code also provides a listing of examples of these type of safeguards. This includes the following (1.000.010.22):

- The client has personnel with suitable skill, knowledge, or experience who make managerial decisions about the delivery of professional services and makes use of third-party resources for consultation as needed.
- The tone at the top emphasizes the client's commitment to fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.
- Policies and procedures are in place to achieve fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.
- Policies and procedures are in place to address ethical conduct.
- A governance structure, such as an active audit committee, is in place to ensure appropriate decision making, oversight, and communications regarding a firm's services.
- Policies are in place that bar the entity from hiring a firm to provide services that do not serve the public interest or that would cause the firm's independence or objectivity to be considered impaired.
- Internal policies and procedures that are designed to monitor compliance with the firm's policies and procedures. Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and the firm's clients.
- The use of different partners, partner equivalents, and engagement teams from different offices or that report to different supervisors.
- Training on, and timely communication of, a firm's policies and procedures and any changes to them for all partners and professional staff.
- Policies and procedures that are designed to monitor the firm's, partner's, or partner equivalent's reliance on revenue from a single client and that, if necessary, trigger action to address excessive reliance.
- Designation of someone from senior management as the person responsible for overseeing the adequate functioning of the firm's quality control system.
- A means for informing partners and professional staff of attest clients and related entities from which they must be independent.
- A disciplinary mechanism that is designed to promote compliance with policies and procedures.
- Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution.

Safeguards Implemented by the Firm

Turning our attention now to the final type of safeguards prescribes within the Code, we now discuss those safeguards implemented by the firm. You will note that the listing of examples within the Code for these type of safeguards is extensive, granted they are still not all-inclusive. However, given the importance of understanding the types of safeguards that can be implemented by a firm to reduce a threat to an acceptable level, these examples are presented in their entirety for your review. This includes the following examples (1.000.010.23):

- Firm leadership that stresses the importance of complying with the rules and the expectation that engagement teams will act in the public interest.
- Policies and procedures that are designed to implement and monitor engagement quality control.
- Documented policies regarding the identification of threats to compliance with the rules, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate identified threats or reduce them to an acceptable level.
- Policies and procedures relating to independence and ethics communications with audit committees or others charged with client governance.
- Discussion of independence and ethics issues with the audit committee or others responsible for the client's governance.
- Disclosures to the audit committee or others responsible for the client's governance regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged.
- The involvement of another professional accountant who (a) reviews the work that is done for a client or (b) otherwise advises the engagement team. This individual could be someone from outside the firm or someone from within the firm who is not otherwise associated with the engagement.
- Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant.

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

Summarizing the Conceptual Framework Process

Included within the Code is a link to a nonauthoritative Conceptual Framework toolkit for Members in Public Practice published by the AICPA. The purpose of the toolkit is to provide the following:²

- Steps of the conceptual framework to provide members with detailed guidance on what to do when applying the conceptual framework approach.
- A flowchart that serves as a visual aid for breaking down the steps of the conceptual framework approach. A worksheet to aid members with applying the steps of the conceptual framework. An example of how to use this worksheet is included in the toolkit.

² Source: AICPA Publication, *Conceptual Framework Toolkit for Members in Public Practice*, Introduction section.

- Examples of relationships or circumstances that are not addressed in the AICPA code and how the conceptual framework may be applied in such situations.

While the toolkit presents much of the same information as prescribed by the Code, notably the three steps described in detail previously, the toolkit takes the application of the conceptual framework to another level. Notably, the toolkit prescribes the use of two additional steps in applying the conceptual framework. This includes the following steps:

- Step 4: Evaluate the Effectiveness of Safeguards
- Step 5: Document Threats and Safeguards

Step 4: Evaluation of the Effectiveness of Safeguards

Previously, we addressed several factors that influence the effectiveness of a given safeguard. Recall, this included factors such as whether the safeguard is suitably designed to meet its objectives, the consistency with which the safeguard is applied, who applies the safeguard, how the safeguard interacts with a safeguard from another category, and so on. Similar to how threats were evaluated for significance, so to should the effectiveness of safeguards be measured. Refer to Exhibit 1-8 which provides expanded guidance with respect to evaluating safeguards as noted within the toolkit.

Exhibit 1-8: Evaluating Effectiveness of Safeguards (AICPA Toolkit)

If the member concludes that threats are at an acceptable level after applying the identified safeguards, then the member may proceed with the professional service. However, if there are no safeguards that would eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the circumstance or relationship creating the threat should be changed, or the member should decline or terminate the professional engagement. If the member provides professional services under such circumstances, the member would compromise his or her compliance with the rules.

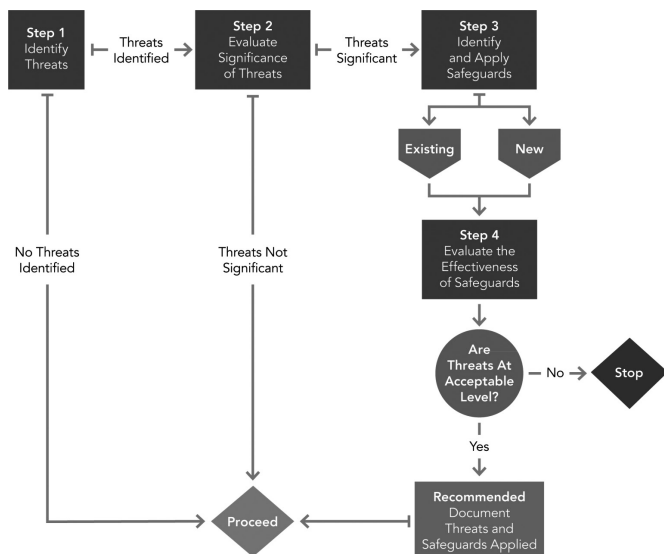
Step 5: Documentation

The final step in the conceptual framework process, as noted in the toolkit, relates to the documentation of both the threats and safeguards. As a result, the toolkit recommends the following:

“When safeguards are applied to eliminate or reduce significant threats to an acceptable level, the member is encouraged to document the identified threats and safeguards applied.”

Conceptual Framework Flowchart

As a complement to the information presented thus far in several of the previous sections of this course, the AICPA, within the referenced toolkit, provides a helpful flowchart which summarize the process. As you'll note in the illustration below, the three main steps discussed extensively earlier are discussed, along with Steps 4 and 5 specific to the toolkit. The end result, ultimately, is whether or not a member should proceed with a certain professional service or stop.



Illustrative Examples

Also included within the toolkit are three illustrative examples which assist members in understanding how the conceptual framework is actually applied in practice. These illustrative examples are helpful because up until this point, the Code generally provides only concepts (hence the term “conceptual”), but the actual application of these concepts is something the Code lacks. Admittedly, this is not surprising because in order to address various situations a member would encounter in practice, the Code would undoubtedly have to be much lengthier of a document compared to its current state.

To this end, we provide three examples of situations (sourced from the toolkit) where a member applies the conceptual framework, including identifying threats as and the application of possible safeguards. Each of these examples are presented in the following three exhibits and include consideration of the following example situations:

- Contingent fee arrangement for a consulting engagement
- Commission received by a partner’s son
- Assisting with the sale of a client’s business

It’s important to note that some of the rules/interpretations included within these examples will be discussed more extensively throughout the remainder of this course, but for now, these examples serve to illustrate the practical application of the conceptual framework that has been extensively discussed.

Exhibit 1-9: Contingent Fee Arrangement for a Consulting Engagement

Facts

A furniture manufacturer has a program that reimburses retailers a portion of the amount paid for advertisements placed in newspapers, circulars, and on websites if the advertising promotes the manufacturer’s products. To obtain reimbursement, the retailer supplies the manufacturer copies of the advertisements and its paid invoices. The manufacturer wants to periodically check the accuracy and validity of these reimbursements and engages the member to perform a consulting engagement whereby the member would review and confirm the accuracy of the information the retailers submit. The manufacturer agrees to pay the member 25 percent of any costs it recoups as a result of erroneous reimbursements.

The member understands that there is not a direct prohibition for entering into a contingent fee arrangement with a nonattest client but decides to consider the matter under the conceptual framework to determine whether such a contingent fee arrangement may threaten his compliance with the rules. In doing so, the member identifies the following threats and safeguards that he will evaluate.

Identified Threats

Self-interest threats to compliance with the “Contingent Fees Rule” and the “Integrity and Objectivity Rule” (AICPA, Professional Standards, ET secs. 1.510.001 and 1.100.001) are present. Specifically, so that the member might maximize the fees earned, the member may act in his or her own self-interest by seeking to obtain a larger refund claim from the manufacturer’s retailers than might otherwise be appropriate in order to generate a larger contingent fee, which may compromise the member’s objectivity and integrity.

Possible Safeguards

If the member concludes that the threats to compliance with the rules are significant, examples of safeguards the member may consider include the following:

- Have the work reviewed by an individual within (or outside) the firm who is not associated with the consulting engagement.
- The retailer will receive specific information from the manufacturer permitting it to review the validity of the remuneration claims.

Exhibit 1-10: Commission Received by a Partner's Son

Facts

A partner's nondependent son is a full-time broker and earned a significant commission for securing a prime rental property for a large local retailer. The retailer has now contacted the partner's firm to ask if the firm would perform its year-end financial statement audit.

Although the AICPA code provides guidance regarding the receipt of a commission by a spouse in the "Services Performed by a Member's Spouse for a Commission" interpretation (AICPA, Professional Standards, ET sec. 1.520.030), the member found no guidance on commissions earned by nondependent children.

Conclusion

Because the fee earned by the son was significant, the member decided to consider the matter under the conceptual framework to determine whether the receipt of his son's commission may threaten his compliance with the rules. In doing so, the member concludes that no threats are present because (1) the commission was already paid to his son before the firm was contacted about the potential audit services, and (2) the son has no involvement in the firm's business or activities. Although no threats were identified, the member has decided to disclose the parental relationship to the prospective client to confirm that the retailer does not have any concerns.

Exhibit 1-11: Assisting with the Sale of a Client's Business

Facts

A business-consulting client approaches the member to assist, in return for a success fee, with the identification of prospective buyers to purchase the client's business and to represent the client during negotiations with any prospective buyers. Although the AICPA code provides independence guidance on providing corporate finance services to an attest client and prohibits (to a large degree) the receipt of a contingent fee from an attest client, the member cannot locate specific guidance on such services and contingent fee arrangements when the client is a nonattest client. The member decides to consider the matter under the conceptual framework to determine whether providing such services may threaten her compliance with the rules. In doing so, the member identifies the following possible threats and safeguards that she will evaluate.

Identified Threats

The self-interest and advocacy threats to compliance with the "Integrity and Objectivity Rule" and the "Contingent Fees Rule" are present because the member may promote the client to the point that her objectivity is compromised in order to obtain a potential buyer and negotiate a purchase price that maximizes the success fee.

Possible Safeguards

If the member concludes that the threats to compliance with the rules are significant, examples of safeguards the member may consider include the following:

- Have the work reviewed by an individual within (or outside) the firm who is not associated with the corporate finance services engagement.
- Have client management establish the criteria and specifications for the identification of potential buyers.
- Have client management make all significant decisions, including decisions during the negotiation process.

Ethical Conflicts

One of the other key areas discussed within the Code relates to ethical conflicts, both how these conflicts are identified and the specific steps to perform when an ethical conflict in fact arises. For starters, let's define what is meant by the term ethical conflict. To this end, an ethical conflict arises when a member encounters one of the following (1.000.020.01):

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

The Code references the situation of fraud as one potential ethical conflict. For example, when a member suspects fraud may have occurred, but reporting the suspected fraud would violate the member's responsibility to maintain client confidentiality (1.000.020.01). So what should a member do when they encounter an ethical conflict? Firstly, the member should consider all the factors involved in the situation to include, but not limited to, the following (1.000.020.02):

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

It's also important to note that a member should be prepared to justify any departure that a member believes were appropriate in applying the relevant rules and law (1.000.020.03). To that end, if a member cannot justify the departure, the member will undoubtedly put themselves in a precarious position and may have to address the consequences of any associated violations. Furthermore, a member should consult with appropriate persons within the firm and may include additional consultations with legal counsel. Important also to note is that the member should document the substance of the issue as well as the parties the member discussed the situation with and any decisions made (1.000.020.05).

review questions...

4. Which of the following steps identifies the first step in the conceptual framework process?
 - a. Identify and apply safeguards.
 - b. Identify threats.
 - c. Evaluate the effectiveness of safeguards.
 - d. Document threats and safeguards applied.
5. A client expressing an intention to commence litigation against a member in public practice is an example of which of the following types of threats?
 - a. Adverse interest threat.
 - b. Familiarity threat.
 - c. Self-interest threat.
 - d. Undue influence threat.
6. If an officer, director, or significant shareholder of a client participates in litigation against a member's firm, then this is an example of which of the following types of threats for a member in public practice?
 - a. Undue influence threat.
 - b. Self-interest threat.
 - c. Adverse interest threat.
 - d. Advocacy threat.
7. If a member in public practice provides forensic accounting services to a client in litigation or a dispute with third parties is an example of which of the following types of threats?
 - a. Advocacy threat.
 - b. Undue influence threat.
 - c. Self-interest threat.
 - d. Familiarity threat.
8. Which of the following identifies a safeguard implemented by a client?
 - a. Policies and procedures are in place to address ethical conflicts.
 - b. External review of a firm's quality control system.
 - c. Professional resources, such as hotlines, for consultation on ethical issues.
 - d. Policies and procedures that are designed to implement and monitor engagement quality control.

Please refer to solution/answer pages at back of booklet

Rules for Members in Public Practice

Throughout the previous sections of this course, we have extensively discussed the conceptual framework approach and have also introduced several of the key principles addressed within the Code. In this section of the course, we turn our attention to a more detailed analysis of the key topics addressed within Part 1 for members in public practice and discuss the actual rules and interpretations for members in public practice (our discussion up to this point has been focused primarily on some of the key principles). This includes a discussion of the following rules along with their placement within the Code:

- Integrity and Objectivity (1.100)
- Independence (1.200)
- General Standards (1.300)
- Compliance with Standards (1.310)
- Accounting Principles (1.320)
- Acts Discreditable (1.400)
- Contingent Fees Rule (1.510)
- Advertising and Other Forms of Solicitations (1.600)
- Confidential Information (1.700)
- Form of Organization and Name (1.800)

Included within each rule prescribed above are additional interpretations (which make up the majority of the volume of content included within the Code) that members should review when assessing their compliance with the rules. An interpretation, as defined by the Code, is pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct. Simply put, while interpretations are not rules per se, a member who departs from the interpretations shall have the burden of justifying such departure in any disciplinary hearing (0.100.020.01).

Integrity and Objectivity Rule

Earlier in this course, we introduced both the integrity principle and the objectivity principle outlined within the Preface to the Code (i.e. the part of the Code applicable to members in public practice, members in business, and all others). Here we turn our attention to the actual rule with respect to integrity and objectivity. An overview of the integrity and objectivity rule is included in Exhibit 1-12 below.

Exhibit 1-12: Integrity and Objectivity Rule (1.100.001.01)

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

As you will note for this discussion, as well as the discussion of subsequent rules, the integrity and objective rule has several subtopics that are discussed. This includes each of the five following topics:

- Conflicts of Interest (1.110)
- Gift and Entertainment (1.120)
- Preparing and Reporting Information (1.130)
- Client Advocacy (1.140)
- Use of a Third-Party Service Provider (1.150)

Each of these above subtopics are discussed in additional detail in the following sections.

Conflicts of Interest

Conflicts of interest, including examples, identification, evaluation, and disclosure, are discussed extensively within the Code. But for starters, what specifically is a conflict of interest? Simply put, a conflict of interest arises when a member is involved in multiple interests with a client which could possibly alter their motivation. Specific to the Code, a conflict of interest creates adverse interest and self-interest threats to a member's compliance with the integrity and objective rule discussed in Exhibit 1-12. For example, these threats can be created by either of the following (1.110.010.02):

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

Again, we fall back on this more conceptual type guidance on what a conflict of interest is, but have not discussed actual examples of situations of a conflict of interest. Fortunately, the Code provides a pretty extensive listing of examples of situations in which conflicts of interest arise. These include the following (1.110.010.04):

- Providing corporate finance services to a client seeking to acquire an audit client of the firm, when the firm has obtained confidential information during the course of the audit that may be relevant to the transaction Advising two clients at the same time who are competing to acquire the same company when the advice might be relevant to the parties' competitive positions
- Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction
- Preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership
- Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement
- Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest in the business
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client
- Advising a client on the acquisition of a business which the firm is also interested in acquiring
- Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service
- Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm
- Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests

While you should have a good understanding now of examples of conflicts of interest and how they create both adverse interest and self-interest threats, the important point to note is that before accepting a new client engagement or other type of business relationship, a member should take certain steps to identify circumstances that may create a conflict to interest (1.100.010.05). Furthermore, a member should be attune to the fact that the relevant interests and relationships and the services may in fact change during the course of the engagement (1.100.010.06).

Identification of a potential conflict of interest is paramount, but the Code also recognizes that the process to identify actual or potential conflicts of interest will depend on several factors such as the following (1.110.010.07):

- The nature of the professional services provided
- The size of the firm
- The size and nature of the client base
- The structure of the firm, for example the number and geographic location of offices

Consistent with the processes described with respect to the conceptual framework around the significance of threats, so to should a member evaluate the significance of the threat created by the conflict of interest. The goal being, you guessed it, to determine if the threat is at an acceptable level. If a member concludes it is at an acceptable level, then the member can proceed with the engagement. However, if it's not at an acceptable level, then certain safeguards have to be applied to reduce the threat to an acceptable level. A detailed discussion of all the safeguards that can be applied is outside the scope of this course, but the Code does include examples of safeguards that can be applied. Refer to Exhibit 1-13 below for a few examples of the types of safeguards that can be applied to certain conflicts of interest.

Exhibit 1-13: Conflicts of Interest Safeguard Examples (1.100.010.10)

Example 1

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

- Using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality
- Creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm
- Establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners

Example 2

Regularly reviewing the application of safeguards by a senior individual not involved with the client engagement or engagements.

Example 3

Having a member of the firm who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.

One of the final important points to be made with respect to conflicts of interests is the related disclosure. To this end, when a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional Services. Additionally, the member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

Gifts and Entertainment

In general, when a member either offers to a client or accepts certain gifts and entertainment from a client, certain threats may be created as a result. This includes self-interest, familiarity, or undue influence threats (1.120.010.02). Similar to previous discussions, a member should evaluate the facts and circumstances of the situation to determine if the associated threat is at an acceptable level. In certain circumstances, these threats will generally be at an acceptable level when the associated gifts or entertainment are reasonable (1.120.010.04). Other times, however, threats cannot be reduced to an acceptable level even with the application of certain safeguards. Such is the case when a member

offers or accepts gifts or entertainment from a client that violates the member's or client's policies or applicable laws, rules, and regulations, and the member knows of the violation, or demonstrates recklessness in not knowing (1.120.010.03).

So what specifically should a member evaluate when faced with the situation where a client offers certain gifts or entertainment? The Code notes the following as relevant factors to consider (1.120.010.04):

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

One final point to note is just simply to emphasize the use of the word "reasonable" within the Code as it relates to gifts or entertainment. In summary, generally when a gift or entertainment is considered reasonable, a member can usually reduce the possible threat to an acceptable level. However, no amount of safeguards can be applied to reduce the threat created by a gift or entertainment that is not considered reasonable (1.120.010.05). In other words, when a gift or entertainment is not considered reasonable in light of the circumstances, a member is presumed to lack objectivity (i.e. the member violates the integrity and objectivity rule).

Preparing and Reporting Information

The Code prescribes three specific situations where threats to compliance with the integrity and objectivity rule cannot be reduced to an acceptable level, nor can these threats be reduced to an acceptable level through the application of safeguards. This includes the following three situations (1.130.010.01):

- If a member makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records
- If a member fails to correct an entity's financial statements or records that are materially false and misleading when the member has the authority to record the entries

- If a member signs, or permits or directs another to sign, a document containing materially false and misleading information

While the situations above discuss those instances of noncompliance related to misrepresentations in the preparation of financial statements, members should also be attune to potential issues with respect to subordination of judgment. In other words, threats such as self-interest, familiarity, and undue influence may exist when a member and his or her supervisor (or any other person with the member's firm) have a difference of opinion relating to the application of accounting principle, auditing standards, or other relevant standards (1.130.020.02). The critical point to be aware of in this situation is that a member should make a determination of whether the position taken results in a material misrepresentation of fact or a violation of applicable laws or regulations (1.130.020.03). If it does not, then the threats can be concluded to be at an acceptable level. If it is material though, the threats are not at an acceptable level and additional evaluations and/or consultations should be performed by the member. In summary, a member should discuss their concerns with their supervisor, or higher-level management as appropriate. Potentially, if the situation is not resolved and a member concludes that threats continue to not be at an acceptable level, the member may potentially consider resigning from the organization as a result.

Client Advocacy

Recall from our previous discussions that an advocacy threat exists when a member promotes a client's interests or positions to the point that his or her objective or independence is compromised. Specifically, this may be the case when a member is engaged to perform nonattest services (i.e. tax or consulting) that involve acting as an advocate for the client or to support a client's position on accounting or financial reporting issues with standard setters or regulators (1.140.010.01). Refer to Exhibit 1-14 below which provides some additional guidance with respect to this situation as noted by the Code.

Exhibit 1-14: Client Advocacy (1.140.010.03)

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

Use of a Third-Party Service Provider

The final subtopic discussed with respect to the integrity and objectivity rule relates to a member's use of a third-party service provider. By definition, a third-party service provider is an entity the member does not control (individually or collectively) and assists the member in providing professional services clients (e.g. bookkeeping, tax return preparation, consulting, etc.).

Simply put, while a member may routinely engage third-party service providers to assist in certain professional services for various clients, those client may not have an expectation that the member is using these third-party service providers. Accordingly, the important point to note is that before disclosing confidential client information to a third-party service provider, the member should inform the client, preferably in writing, that the member may use a third-party service provider (1.150.040.02). However, there's one important exception to this rule – a member is not required to inform a client when he or she uses a third-party service provider to provide certain administrative support service, such as record storage, software application hosting, or authorized e-file tax transmittal services (1.150.040.03).

So what happens if a client objects to the use of third-party service provider? One of two options are available to the member. The member can either 1) choose not to use the third-party service provider, or 2) decline to perform the engagement for the client.

Independence Rule

Independence, undoubtedly, is one of the cornerstones of a member's compliance with the Code. As a result, a significant amount of content within the Code is dedicated to the topic of independence. For example, of the more than 150 pages of text within the Code (not including table of contents and other administrative pages), roughly 67 pages are dedicated to independence interpretations. While the independence topic will be discussed extensively in the following sections, a comprehensive review of the interpretations with respect to independence is simply outside the scope of this course.

The independence rule within the Code states that a member in public practice should be independent in the performance of professional services as required by the respective standards (1.200.001.01). Refer to Exhibit 1-15 for an expanded discussion of the independence interpretations included within the Code.

Exhibit 1-15: Independence Interpretations (1.210.010.01)

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

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



While each of the above threats were discussed from a general standpoint in a previous section of this course, additional examples of each as it relates more specifically to independence are included within the Code. As an example, in the initial discussion of the conceptual framework approach, management participation threat was simply described as the threat a member will take on a role of client management or assume management responsibilities. However, no specific examples were provided to assist members. In the independence interpretations section of the Code, three specific examples are provided and each example is cross-referenced to a subtopic section within the independence section where specific application guidance is provided. As a result, the discussion of threats as it relates to independence is much more extensive. Exhibit 1-16 below provides additional detail regarding the organization of the code with respect to independence.

Conceptual Framework Approach for Independence

Earlier in the course, we discussed the conceptual framework approach. You'll recall that this framework approach entails identifying and evaluating threats along with applying safeguards with the goal of reducing the identified threats to an acceptable level. Recall also that this conceptual framework approach included a reference to an acceptable level as one in which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the threat would not compromise the member's compliance with the rules. The conceptual framework approach, specific to independence, adopts this same approach but instead of making reference to the compliance with the rules, reference is made to whether or not this same third party would perceive a member as being independent.

Also included within the discussion of the conceptual framework approach was the identification, definition, and examples of the various threats. While a description of these threats will not be repeated here, it's important to recall the various types of threats as noted in the illustration below.

Exhibit 1-16: Conceptual Framework Approach for Independence (1.210.010.10 thru 11)

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

In certain circumstances, the code specifies that because of the type of threat and its potential effect, either no safeguards can eliminate or reduce the threat to an acceptable level, or a member would need to apply specific safeguards to eliminate or reduce an independence threat to an acceptable level. When independence interpretations in the code address one of these examples, a specific reference to the independence interpretation is provided in brackets after that example. If an example does not contain a specific reference to an independence interpretation, a member should use this “Conceptual Framework for Independence” interpretation to evaluate whether a threat is significant.

As you can note from Exhibit 1-16, there are times when the Code prescribes specific application guidance with respect to an example of a given threat, and other times, the Code does not. When it does not, the member should default to the overall conceptual framework approach to independence.

In the following sections of this course, we dive back into the various categories of threats and discuss the specific interpretive guidance applicable to situations where that type of threat is identified and what steps are required to be taken by a member to avoid being reviewed as not independent. A full discussion of all threats, examples, and interpretive guidance is outside the scope of this course given the extensive requirements found within the Code, however, some of the key areas are presented and should help users better understand the requirements when faced with certain independence situations.

Adverse Interest Threat

This type of threat, specific to independence considerations, relates to a situation where either an attest client or the member commences litigation (or expresses the intent to) against the other. It’s important to further emphasize here the organization of the Code and how this discussion directs the user to the specific guidance with respect to litigation. Refer to the illustration (screen shot from the Code) which provides this cross-referencing.

¹² *Adverse interest threat.* The threat that a member will not act with objectivity because the member’s interests are in opposition to the interests of an attest client. An example is either the attest client or the member commencing litigation against the other or expressing the intent to commence litigation. [1.290.010]

Note from the illustration above that the member is directed to 1.290.010 within the Code, which discusses actual or threatened litigation, as discussed in the following sections. This type of cross referencing is also used for the other six categories of threats identified in the Code where the threat includes related interpretations.

Simply put, when an attest client’s present management commences, or expresses an intention to commence, legal action against a covered member, the covered member and the attest client’s management may be placed in adversarial positions in which self-interest may affect the covered member’s objectivity and management’s willingness to make complete disclosures (1.290.010.04). On account of this, independence may be impaired whenever the covered member and the covered member’s attest client or its management are in threatened or actual positions of material adverse interests due to threatened or actual litigation (1.290.010.05). Refer to Exhibit 1-17 below which provides additional discussion with respect to threatened or actual litigation.

Exhibit 1-17: Litigation between the Attest Client and Member (1.290.010.06)

Situations involving threatened or actual litigation are complex and diverse, making it difficult to identify precise points at which threats to the covered member’s compliance with the “Independence Rule” [1.200.001] would be at an acceptable level. There are situations regarding litigation between covered members and attest clients in which threats to the covered member’s compliance with the “Independence Rule” would not be at an acceptable level and could not be reduced to an acceptable level by safeguards and independence would be impaired. Examples of these situations are:

- An attest client’s present management commences litigation alleging deficiencies in audit work performed for the attest client or expresses its intention to commence such litigation, and the covered member concludes that it is probable that such a claim will be filed.
- A covered member commences litigation against an attest client’s present management alleging management fraud or deceit.

As noted in Exhibit 1-17 above, there are certain situations wherein the significance of the actual or threatened litigation is so severe that no safeguard can be applied to reduce the threat to an acceptable level. Conversely, in situations wherein the actual or threatened is not significant, a member would be considered to be independent because the threat is at an acceptable level.

In addition to actual or threatened litigation between an attest client and a member, there are also situations

where a covered member and the client are defendants in litigation. As example, this may be the case where one or more stockholders bring a derivative action or class-action lawsuit against the attest client or its management, and may include covered members on the engagement (1.290.010.08). In these potential situations, this type of litigation by itself would not threaten the covered member's independence (1.290.010.09).

You will note, in the preceding section, the use of the term "covered member" as opposed to simply "member" as used previously. Let's clarify what is meant by this term before proceeding further. A covered member is any of the following (0.400.12):

- An individual on the attest engagement team
- An individual in a position to influence the attest engagement
- Partner, partner equivalent, or manager who provides more than 10 hours of nonattest services to the attest client within any fiscal year. Designation as covered member ends on the later of (i) the date that the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) the date he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis
- A partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest engagement
- The firm, including the firm's employee benefit plans
- An entity who's operating, financial, or accounting policies can be controlled by any of the individuals or entities described above or two or more such individuals or entities if they act together

Advocacy Threat

In certain situations, a member will promote an attest client's interests or position to the point that the member's independence may be compromised. This is an example of an advocacy threat. With respect to the guidance around independence, the Code cites the following three examples of an advocacy threat to independence (1.210.010.13):

- A member promotes the attest client's securities as part of an initial public offering (IPO)
- A member provides expert witness services to an attest client
- A member represents an attest client in U.S. tax court or other public forum

Before embarking on a more expansive discussion of some of the examples above, we need to spend some time understanding the general requirements for a member performing nonattest services for an attest client. Given the nature of certain nonattest services, this introduces potential risks to a member's compliance with independence requirements.

Included within the independence topic within the Code is a subtopic that discusses the general requirements for performing nonattest services (1.295.040). Specifically, these rules state that unless a specific interpretation states otherwise, threats to independence would be considered to be at an acceptable level (i.e. independence would not be impaired) when a member obtains agreement that the attest client and its management agree to assume all management responsibilities (i.e. the member should have no management responsibility), oversee the service, evaluate the adequacy and results of the services performed, and accept responsibility for the results of the services (1.295.040.01). In addition, before performing the nonattest service, the member is required to establish in writing his or her understanding with the client regarding the following:

- Objective of the engagement
- Services to be performed
- Attest client's acceptance of its responsibilities
- Member's responsibilities
- Any limitations of the engagement

So what happens if the attest client is unable or unwilling to assume this responsibility noted above? Simply put, in this situation a member's independence would be impaired if the member continues with the nonattest service. There is really no flexibility here.

Promoting Securities as part of IPO

When a member promotes a client's securities during an IPO, along with other corporate finance consulting arrangements, certain threats to a member's independence may exist. Accordingly, it's important to distinguish between those activities that would be acceptable and not impair independence and those activities that would not be acceptable and would in turn impair a member's independence. Refer to Exhibit 1-18 below which identifies the activities that would and would not impair independence. However, it's important to note that for the activities that would not impair independence, these are only permissible (i.e. would not impair independence) if a member adheres to the general requirements for nonattest services as discussed prior.

Exhibit 1-18: Corporate Finance Consulting Activities (1.295.130.02 thru .03)

Activities That Would Not Impair Independence

- Assist management in developing its corporate strategies
- Assist management in identifying possible sources of capital that meet the attest client's specifications or criteria
- Introduce management to possible sources of capital that meet the attest client's specifications or criteria
- Assist management in analyzing the effects of proposed transactions with potential buyers, sellers, or capital sources
- Advise an attest client during its negotiations with potential buyers, sellers, or capital sources
- Assist the attest client in drafting its offering document or memorandum
- Participate with management in its transaction negotiations in an advisory capacity
- Be named as a financial adviser in an attest client's private placement memoranda or offering documents.

Activities That Would Impair Independence

- Commits the attest client to the terms of a transaction
- Consummates a transaction on behalf of the attest client
- Acts as a promoter, an underwriter, a broker-dealer, or a guarantor of an attest client's securities or as a distributor of private placement memoranda or offering documents
- Maintains custody of an attest client's securities

You will note based on review of the activities noted in Exhibit 1-18 that a majority of the activities that are permissible use terminology such as assist, advise, participate, etc. This is compared to the terminology used in the activities that would impair independence where it would suggest the member is taking on more of an active management type role related to these activities.

Expert Witness Services to a Client

A member who is engaged to be an expert witness for an attest client is considered to be a type of forensic accounting service. By definition, a forensic accounting service is a nonattest service that involves the application of special skills in either accounting, auditing, quantitative methods, etc. along with investigative

skills to collect, analyze, and evaluate evidential matter (1.295.140.01). The goal of this service is for the member to interpret and communicate findings as necessary to a client.

Specifically to expert witness type activities, this is a situation where a member is engaged to render an opinion before a tier of fact about certain matters in dispute based on the member's expertise, rather than their direct knowledge of the facts or events (1.295.140.04). With respect to independence, because being an expert witness would create the appearance that a member is advocating or promoting an attest client's position, this advocacy threat cannot be reduced to an acceptable level even with the application of certain safeguards (1.295.140.04). As a result independence would be impaired in this situation.

However, there is an exception to this rule wherein independence would not be impaired if specific requirements are met. Accordingly, independence would not be impaired (i.e. the threat would be at an acceptable level) if a member provides expert witness services for a large group of plaintiffs that includes one or more attest clients of the firm and each of the following true (1.295.140.04):

- The member's attest clients constitutes less than 20 percent of the members of the group, voting interests of the group, and the claim
- No attest client within the group is designated as the lead plaintiff or defendant of the group
- No attest client has the sole-decision making power to select or approve the selection of the expert witness

Familiarity Threat

A familiarity threats exists when, because of a long or close relationship with an attest client, a member may become too sympathetic to the attest client's interest or too accepting of the attest client's work on a product (1.210.010.14). Specific to the interpretations around independence, the Code includes the following examples of situations when a familiarity threat may exist. These include the following (1.210.010.14):

- A member of the attest engagement team has an immediate family member or close relative in a key position at the attest client, such as the attest client's CEO
- A partner or partner equivalent of the firm has been a member of the attest engagement team for a prolonged period
- A member of the firm has recently been a director or an officer of the attest client

- A member of the attest engagement team has a close friend who is in a key position at the attest client

Family Members in Key Positions at Attest Client

In certain situations, a member of an attest engagement team may have a family member or close relative who works at the client. Take for example a covered member of an attest engagement team for a client who employs his or her dad as the assistant controller. The rules with respect to these types of situations are pretty clear cut within the interpretations. Accordingly, the primary consideration comes down to whether or not the family member is in a key position.

Fortunately, the Code provides a fairly clear definition of what is meant by the term key position. A key position is when the individual has any of the following responsibilities (0.400.27):

- Primary responsibility for significant accounting functions that support material components of the financial statements
- Primary responsibility for the preparation of the financial statements
- The ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

Now that we have an understanding of what does and does not constitute a position being key, let's address the considerations with respect to independence. First off, if a covered member's immediate family member is employed by an attest client, but it is determined that that person is not in a key position, then the covered member's independence would not be impaired (i.e. the threats to independence would be at an acceptable level). Conversely, if an immediate family member of a covered member is in fact employed by the attest client in that of a key position (for example, as the Controller or CFO), then independence would be impaired. Furthermore, given these situations where the immediate family member is determined to be in a key position, no amount of safeguards can be applied to reduce threat to an acceptable level.

Former Employment or Association with an Attest Client

There may also be situations where a covered member on an attest engagement was formerly employed by the client, or associated with it in the capacity of an officer, director, promoter, underwriter, etc. As a result,

this type of past association undoubtedly calls into question whether or not a familiarity threat exists as a result. Exhibit 1-19 below provides an overview of the interpretations with respect to this situation.

Exhibit 1-19: Litigation between the Attest Client and Member (1.290.010.06)

If a covered member participates on the client's attest engagement or is an individual in a position to influence the attest engagement covering any period that includes the covered member's former employment or association with the attest client, threats to the member's compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

Additional consideration with respect to former associations relate to situation where a covered member may fail to dissociate from the attest client before becoming a covered member on the attest engagement. Simply put, if a member fails to disassociate from the attest client before becoming a covered member, threats to the member's compliance with the independence rule would not be at an acceptable level and independence would be impaired unless all of the following safeguards are met (1.277.010.04):

- The covered member ceases to participate in all employee health and welfare plans sponsored by the attest client, unless the attest client is legally required to allow the member to participate in the plan (for example, the Consolidated Omnibus Budget Reconciliation Act [COBRA]) and the member pays 100 percent of the member's portion of the cost of participation on a current basis
- The covered member ceases to participate in all other employee benefit plans by liquidating or transferring, at the earliest date permitted under the plan, all vested benefits in the attest client's defined benefit plans, defined contribution plans, share-based compensation arrangements, deferred compensation plans, and other similar arrangements
- The covered member disposes of any direct financial interest or material indirect financial interests in the attest client
- The covered member collects or repays any loans to or from the attest client, except for loans specifically permitted or grandfathered
- Covered members should evaluate whether other relationships with the attest client create threats that require the member to apply safeguards to reduce those threats to an acceptable level

Management Participation Threat

As is evident from the description of this threat, along with the previous definition presented earlier in the course, this threat exists when a member will take on

the role of an attest client management or otherwise assume management responsibilities for an attest client. The Code includes three examples that should be specifically considered as it relates to independence assessments (1.210.010.15):

- A member serves as an officer or a director of the attest client
- A member accepts responsibility for designing, implementing, or maintaining internal controls for the attest client
- A member hires, supervises, or terminates the attest client's employees

Simultaneous Employment or Association with an Attest Client

Undoubtedly, when a partner or professional employee of the member's firm is simultaneously employed or associated with an attest client, there are potentially multiple threats that a member's compliance with the independence rule. While this section is specific to management participation threats, in this situation, other threats such as familiarity, advocacy, and self-review threats may be present. On account of the presence of multiple threats to a member's independence given the simultaneous employee or association with an attest client, a member's independence would be impaired (i.e. not at an acceptable level) and could not be resolved even with the application of safeguards (1.275.005.02).

However, there is one specific exception outlined within the Code where a member's independence would not be impaired on account of this employment or association with an attest client. This exception relates to situations where a partner or professional employee of a firm serves as an adjunct faculty member of an educational institution that is also an attest client of the firm. However, this is not a default exception. In other words, there are additional safeguards that must be met in order for independence to not be impaired. These are summarized in Exhibit 1-20 below.

Exhibit 1-20: Adjunct Faculty Member Exception (1.275.005.03)

Threats will be at an acceptable level and independence will not be impaired if a partner or professional employee of a firm serves as an adjunct faculty member of an educational institution that is an attest client of the firm, provided that the partner or professional employee meets all of the following safeguards:

- Does not hold a key position at the educational institution
- Does not participate on the attest engagement team
- Is not an individual in a position to influence the attest engagement
- Is employed by the educational institution on a part-time and non-tenure basis
- Does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required
- Does not assume any management responsibilities or set policies for the educational institution

Accepting Responsibility for Internal Controls for an Attest Client

In general, when a member assumes any form of management responsibility or an attest client, the management participation threat is so significant that no amount of safeguards can be applied to reduce the threat to an acceptable level and prevent independence from being impaired (1.295.030.01). While the Code notes that it is not possible to identify every potential situation involving management participation, it does identify several examples where certain activities would be considered management activities, and in turn, would impair independence. These include the following examples (1.295.030.02):

- Setting policy or strategic direction for the attest client
- Directing or accepting responsibility for actions of the attest client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards
- Authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of an attest client or having the authority to do so
- Preparing source documents, in electronic or other form, that evidence the occurrence of a transaction

- Having custody of an attest client's assets
- Deciding which recommendations of the member or other third parties to implement or prioritize
- Reporting to those charged with governance on behalf of management
- Serving as an attest client's stock transfer or escrow agent, registrar, general counsel or equivalent
- Accepting responsibility for the management of an attest client's project
- Accepting responsibility for the preparation and fair presentation of the attest client's financial statements in accordance with the applicable financial reporting framework
- Accepting responsibility for designing, implementing, or maintaining internal control
- Performing ongoing evaluations of the attest client's internal control as part of its monitoring activities

You will note that the second to last example in the listing above clearly specifies that a member accepting any form of responsibility for designing, implementing, or maintaining control for an attest client is a situation in which the member's independence would absolutely be impaired. As a reminder, no safeguards can be applied in this situations, or any other situation identified above, that would prevent independence of the member from being impaired.

Self-Interest Threat

As you recall, a self-interest threat relates to a situation in which a member could benefit financially (or by other means) from an attest client. The Code identifies the following as examples of a self-interest threat as it relates to independence (1.210.010.16):

- A member has a direct financial interest or material indirect financial interest in the attest client
- A member has a loan from the attest client, an officer or a director of the attest client, or an individual who owns 10 percent or more of the attest client's outstanding equity securities
- A member or his or her firm relies excessively on revenue from a single attest client
- A member or member's firm has a material joint venture or other material joint business arrangement with the attest client

Financial Interest in Attest Client

On this topic, if a covered member has, or commits to

acquire, a direct financial interest in an attest client during the period of the engagement, the self-interest threat would not be able to be reduced to an acceptable level. Furthermore, even with the application of safeguards, independence would still be impaired (1.240.010.01). Additionally, this same principle holds true for material indirect financial interests. Refer to Exhibit 1-21 below which provides additional clarifications between that of direct financial interests and indirect financial interests.

Exhibit 1-21: Direct vs. Indirect Financial Interests

Direct Financial Interest

A financial interest that is

- Owned directly by an individual or entity, including those managed on a discretionary basis by others
- Under the control of an individual or entity, including those managed on a discretionary basis by others
- Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary
 - Controls the intermediary or
 - Has the authority to supervise or participate in the intermediary's investment decisions.

Indirect Financial Interest

A financial interest beneficially owned through an investment vehicle, an estate, a trust, or another intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions. When used in this definition, control includes situations in which the covered member has the ability to exercise such control, either individually or acting together with his or her firm or other partners or professional employees of his or her firm.

Loans and Leases with Lending Institutions

In general, a covered member's independence would be impaired if the covered member has a loan from an attest client, from any officer or director of the attest client, or any individual owning 10 percent or more of the attest client's outstanding securities (1.260.020.01). However, like other interpretations discussed so far, there are certain exceptions to this general rule. Primarily, this relates to home mortgages, secured loans, and other immaterial unsecured loans a covered member may have with a financial institution. In order for independence to not be impaired, the home mortgage, secured loan, or immaterial unsecured loan by a covered member must be covered by all of the following safeguards (1.260.020.02):

- The home mortgage, secured loan, or immaterial unsecured loan was obtained under the lending

institution's normal lending procedures, terms, and requirements. In determining when the home mortgage, secured loan, or immaterial unsecured loan was obtained, the date a commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained

- The home mortgage, secured loan, or immaterial unsecured loan was obtained
 - From the lending institution prior to its becoming an attest client
 - From a lending institution for which independence was not required and was later sold to an attest client
 - After May 31, 2002, from a lending institution attest client by a borrower prior to his or her becoming a covered member with respect to that attest client, or
 - Prior to May 31, 2002 with certain requirements of the loan transition provision met by the member
- After becoming a covered member, any home mortgage, secured loan, or immaterial unsecured loan must be kept current regarding all terms at all times, and the terms may not change in any manner not provided for in the original agreement. Examples of changed terms are a new or extended maturity date, a new interest rate or formula, revised collateral, and revised or waived covenants.
- The estimated fair value of the collateral for a home mortgage or other secured loan must equal or exceed the outstanding balance during the term of the home mortgage or other secured loan. If the estimated fair value of the collateral is less than the outstanding balance of the home mortgage or other secured loan, the portion that exceeds the estimated fair value of the collateral may not be material to the covered member's net worth.

In addition to the types of loan included above, other loans and leases, assuming they are under the lending institution's normal lending procedures, terms, and requirements, would not impair a covered member's independence. These include the following (1.260.020.04):

- Automobile loans and leases collateralized by the automobile
- Loans fully collateralized by the cash surrender value of an insurance policy
- Loans fully collateralized by cash deposits at the same lending institution (for example, passbook loans)

- Aggregate outstanding balances from credit cards and overdraft reserve accounts that have a balance of \$10,000 or less after payment of the most recent monthly statement made by the due date or within any available grace period

With respect to leases, this is another type of transaction that would not impair the independence of a covered member so long as certain safeguards are appropriately applied. Specifically, if a covered member enters into a leasing agreement with an attest client during the period of an engagement, independence would not be impaired if all of the following safeguards are met (1.260.040.01):

- The lease meets the criteria of an operating lease (as described in GAAP)
- The terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature
- All amounts are paid in accordance with the lease terms or provisions

Self-Review Threat

A self-review threat exists when a member may not appropriately evaluate the results of a previous judgment made, or service performed or supervised by the member, and that member will rely on that service in forming a judgment as part of an attest engagement. An example of this situation relates to a situation where a member prepares source documents used to generate the attest client's financial statements. In this situation, no safeguards can be applied to reduce the threat to an acceptable level and as a result, independence would be impaired in this situation.

It's important to distinguish, however, between those types of activities that would pose a significant self-review threat (one which could not be reduced to an acceptable level) and those that pose a threat but can be reduced to an acceptable level if a member applies the requirements for performing nonattest services (previously discussed). Exhibit 1-22 below provides an overview of those activities that would and would not impair independence.

Exhibit 1-22: Self-Review Threat Examples (1.295.120.02 thru .03)

Activities That Would NOT Impair Independence

- Recording transactions to an attest client's general ledger when management has determined or approved the account classifications for the transaction
- Posting client-coded transactions to an attest client's general ledger
- Preparing financial statements based on information in the attest client's trial balance
- Posting client-approved journal or other entries to an attest client's trial balance
- Proposing standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the attest client. Prior to the member posting these journal entries or changes, the member should be satisfied that management has reviewed the entries and understands the nature of the proposed entries and the effect the entries will have on the attest client's financial statements
- Generating unsigned checks using source documents or other records provided and approved by the attest client
- Processing an attest client's payroll using payroll time records that the attest client has provided and approved
- Transmitting client-approved payroll or other disbursement information to a bank or similar entity subsequent to the attest client's review and authorization for the member to make the transmission. Prior to such transmission, the attest client is responsible for making the arrangements with the bank or similar entity to limit the corresponding individual payments regarding the amount and payee. In addition, once transmitted, the attest client must authorize the bank or similar entity to process the payroll information.
- Preparing a reconciliation (for example, bank and accounts receivable) that identifies reconciling items for the client's evaluation.

Activities That Would Impair Independence

- Determining or changing journal entries, any account coding or classification of transactions, or any other accounting records without first obtaining the attest client's approval.
- Authorizing or approving transactions.
- Preparing source documents.
- Making changes to source documents without the attest client's approval.
- Accepting responsibility to authorize payment of attest client funds, electronically or otherwise, except for electronic payroll tax payments when the member complies with the requirements of the "Tax Services" interpretation [1.295.160] of the "Independence Rule."
- Accepting responsibility to sign or cosign an attest client's checks, even if only in emergency situations.
- Maintaining an attest client's bank account or otherwise has custody of an attest client's funds or makes credit or banking decisions for the attest client.
- Approving vendor invoices for payment.

Undue Influence Threat

The final threat with respect independence considerations relates to that of undue influence. This type of threat occurs when a member subordinates his or her judgment to that of an individual associated with an attest client or any relevant third party due to that individual's reputation expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member (1.210.010.18). Examples cited within the Code related to this type of threat include the following:

- Management threatens to replace the member or member's firm over a disagreement on the application of an accounting principle
- Management pressures the member to reduce necessary audit procedures in order to reduce audit fees
- The member receives a gift from the attest client, its management, or its significant shareholders

Offering or Accepting Gifts or Entertainment

Of the three examples prescribed above and included within the Code, the last example is the only one that cross references to specific interpretive guidance. The general principle with respect to accepting a gift from a client is that unless the gift is clearly insignificant, independence would be impaired. This is true whether a member's firm, a member of the attest engagement

team, or an individual in a position to influence the engagement accepts the gift. This same overall principle holds true for that of entertainment. Refer to Exhibit 1-23 below which discusses the guidance with respect to entertainment.

Exhibit 1-23: Accepting Entertainment (1.285.010.03)

Accepting entertainment from an attest client during the period of the professional engagement may create undue influence or self-interest threats to a member's compliance with the "Independence Rule" [1.200.001]. If a covered member accepts entertainment from an attest client that is not reasonable in the circumstances, the threats to the member's compliance with the "Independence Rule" would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

In addition to accepting gifts or entertainment, a member should also consider the implications on independence with respect to offering gifts or entertainment to a client. Similarly, if a covered member offers a gift or entertainment to an attest client that is not reasonable in the circumstances, independence would be impaired and no application of safeguard could prevent this (1.285.010.04).

So what is considered reasonable you may be asking? Fortunately, the Code provides examples of relevant facts and circumstances that should be considered. This includes the following (1.285.010.05):

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

review questions...

9. Which of the following situations identify a familiarity threat with respect to a member's independence?
 - a. A member promotes an attest client's securities as part of an initial public offering.
 - b. A member represents an attest client in U.S. tax court or other public forum.
 - c. A member has a direct financial interest in the attest client.
 - d. A member of an attest engagement team has a close friend who is in a key position at the attest client.
10. Which of the following activities, if performed by a member of an attest engagement team for the attest client, would impair the member's independence?
 - a. Posting client-coded transactions to the attest client's general ledger.
 - b. Changing journal entries without first obtaining the client's approval.
 - c. Preparing financial statements based on information in the attest client's trial balance.
 - d. Processing the attest client's payroll using records approved by the client.

Please refer to solution/answer pages at back of booklet

General Standards Rule

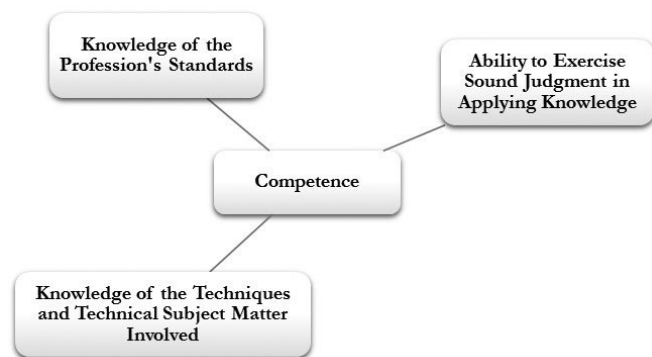
In previous section of the course, we focused primarily on various independence interpretations that related to the overall independence rule prescribed within the Code. Now we shift gears to discuss the General Standards rules found within Code related to members in public practice.

The General Standards rule states simply that a member should comply with the following standards and with any related interpretations of the following (1.300.001):

- Professional Competence
- Due Professional Care
- Planning and Supervision
- Sufficient Relevant Data

Competence

In its simplest form, competence implies that a member (or their staff) possesses the appropriate technical qualifications to perform certain professional services and that member, if required, supervises and evaluates the quality of work performed (1.300.010). Competence can be summarized as illustrated in the figure below.



The important point to note is that a member's agreement to perform professional services implies that the member has the necessary competence to complete the services according to the professional standards and to apply the member's knowledge and skill with reasonable care and diligence (1.300.010.02). Furthermore, if a member does not have this knowledge, and is unable to gain the sufficient competence as a result, the member should suggest another competence member/firm to perform the professional service (1.300.010.04).

Compliance with Standards Rule

Where the previous section touched on a member's awareness of the standards with which they are held accountable, and the related competence considerations, the next rule addresses the actual compliance aspect. In short, the Compliance with Standards Rule states that a member who performs auditing, review, compilation, management consulting, tax, or other professional services are required to comply with the applicable standards (1.310.001.01).

This particular rule, contrasted with that of the Independence Rule previously discussed, does not contain significant interpretive guidance. In fact, the interpretive guidance section with respect to this rule only contains three paragraphs and primarily addresses the member's use of the conceptual framework and consideration of ethical conflicts. Given the brevity of this guidance, it is presented in full in Exhibit 1-24 below.

Exhibit 1-24: Interpretations under the Compliance with Standards Rule (1.310.005.01 thru .03)

.01 In the absence of an interpretation of the "Compliance With Standards Rule" [1.310.001] that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A member would be considered in violation of the "Compliance With Standards Rule" [1.310.001] if the member cannot demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

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

Accounting Principles Rule

The Accounting Principles Rule states in part that a member should not do either of the following if statements or data contain any departure from an accounting principle prescribed by a recognized accounting body (1.320.001.01):

- Express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles, or
- State that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles

Further to the points above, the recognized accounting bodies include each of the following (1.320.040.01):

- Financial Accounting Standards Advisory Board (FASAB)
- Financial Accounting Standards Board (FASB)
- Governmental Accounting Standards Board (GASB)
- International Accounting Standards Board (IASB)

Departures from GAAP

There is a presumption that when an entity adheres to GAAP, the risk that an entity's financial statements would be misleading is very minimal. However, the Accounting Principles Rule noted above recognizes that,

on certain occasions, there may be unusual circumstances when the literal application of GAAP would have the effect of rendering financial statements misleading (1.320.030.01). In this situation, the question of what constitutes these unusual circumstances is undoubtedly a matter of professional judgment.

Financial Statements Prepared Under Frameworks other than GAAP

The Accounting Principles Rule does not preclude a member from preparing or reporting on client financial statements that have been prepared pursuant to financial reporting frameworks other than GAAP (1.320.040.03). This would be the case with any of the following:

- Financial reporting frameworks generally accepted in another country, including jurisdictional variations of IFRS such that the client's financial statements do not meet the requirements for full compliance with IFRS, as promulgated by the IASB
- Financial reporting frameworks prescribed by an agreement or a contract
- Other special purpose frameworks, including statutory financial reporting provisions required by law or a U.S. or foreign governmental regulatory body to whose jurisdiction the entity is subject

Acts Discreditable Rule

This rule states simply that a member should not commit an act discreditable to the profession. So the next obvious question is, what is a discreditable act? There unfortunately is not a very specific listing of those acts that are discreditable. Instead, a member must review all the interpretations under 1.400.001 included within the Code to determine where a member's act would be considered discreditable.

There are several discreditable acts that are prescribed within the Code. These are summarized in the following listing:

- A member has violated any antidiscrimination laws of the United States, a state, or a municipality, including those related to sexual and other forms of harassment (assuming it is no longer subject to appeal)
- A member who solicits or knowingly discloses the Uniform CPA Examination questions or answers without the AICPA's written authorization
- A member who fails to comply with applicable federal, state, or local laws or regulations regarding (a) the timely filing of the member's personal tax returns or tax returns of the member's firm that the member has the authority to timely file or (b) the timely remittance of all payroll and other taxes collected on behalf of others

- A member makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity
- A member fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry
- A member signs, or permits or directs another to sign, a document containing materially false and misleading information
- A member materially departs from the standards of governmental bodies or other regulatory agencies and does not make appropriate disclosure regarding the departure
- A member accepts a governmental audit engagement and fails to follow specified government audit standards, guides, procedures, statutes, rules, and regulations the member is obligated to follow
- A member discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the member may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information
- A member promotes or markets the member's abilities to provide professional services or makes claims about the member's experience or qualifications in a manner that is false, misleading, or deceptive
- A member fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices
- A member fails to comply with records requests rules and interpretations
- A member discloses confidential information obtained from a prospective client without consent

Contingent Fees Rule

Different types of payment arrangements are made routinely within professional services performed by members. However, it is important to distinguish between those types of activities where a member can accept a contingent fee and where they cannot. For starters, refer to Exhibit 1-25 below which provides additional context on what is meant by a contingent fee.

Exhibit 1-25: Contingent Fee (1.510.001.03)

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

For starters, a member in public practice is not allowed to accept a contingent fee for any professional service for, or receive such a fee from a client for whom the member or the member's firm perform any of the following (1.510.001.01):

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

In addition to the above, a member is also precluded from preparing an original or amended tax return or claim for a tax refund for a contingent fee for any client (1.510.001.01). However, the Code also prescribes certain services that can be performed for a contingent fee. These include the following (1.510.010.04):

- Representing a client in connection with a revenue agent's examination of the client's federal or state income tax return
- Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is the subject of a test case involving a different taxpayer or with respect to which the taxing authority is developing a position
- Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Taxation or state taxing authority
- Requesting a refund of either overpayments of interest or penalties charged to a client's account or tax deposits that a federal or state taxing authority improperly accounted for in circumstances in which the taxing authority has established procedures for the substantive review of such refund requests
- Requesting, by means of a protest or similar document, the state or local taxing authority's consideration of a reduction in a property's assessed

value under an established taxing authority's review process for hearing all taxpayer arguments relating to assessed value

- Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute

Advertising and Other Forms of Solicitation Rule

This rule prescribes that a member in public practice should not seek to obtain clients by using any form of advertising that is false, misleading, or deception (1.600.001). Equally, solicitation by the use of coercion, harassing conduct, and over-reaching is also strongly prohibited by this rule.

In general, promotional efforts would be considered misleading, or deceptive, if they do any of the following (1.600.010.02):

- Create false or unjustified expectations of favorable results
- Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official
- Contain a representation that the member will perform specific professional services in current or future periods for a stated fee, estimated fee, or fee range when it was likely at the time of the representation that such fees would be substantially increased and the member failed to advise the prospective client of that likelihood
- Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived

Confidential Client Information Rule

The overall rule is that a member in public practice should not disclose any confidential client information without the specific consent of the client (1.700.001.01). Refer to Exhibit 1-26 below for an expansive discussion of this rule and how it relates to other previously discussed rules.

Exhibit 1-26: Confidential Client Information Rule (1.700.001.02)

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

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member’s confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members’ exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

In addition to the guidance above, this section of Code includes interpretations and related guidance with respect to disclosing the following:

- Client competitors
- Information from previous engagements
- Information to persons or entities associated with clients
- Information to a third-party service provider
- Client information in connection with a review of a member’s practice
- Client information to third parties, disclosing client information during litigation
- Client information in director positions
- Client names
- Confidential client information as a result of a subpoena or summons

A detailed discussion of each of the above subtopics is outside the scope of this course, however, it is encouraged that members understand and review the related interpretations and ensure compliance as appropriate.

Form of Organization and Name Rule

The final rule included within the members in public practice section of the Code relates to rules and interpretations as it relates to form of organization and the related naming conventions (1.800.001.01-02). To this end, a member may practice public accounting only in a form of organization permitted by law or regulation and under a firm name that is not misleading. Select subtopics under this rule are discussed in additional detail in the following sections.

Partner Designation

The Code requires that only members of a firm who are legally partners should use the designation of partner (1.810.020.01). Accordingly, members who are not parties to the firm’s partnership agreement should not hold themselves out in any manner that might lead clients or the public to believe that they are partners (1.810.00.01).

Firm Name

For starters, the Code allows the use of the names of former partners in a firm’s name (1.820.010.01). Additionally, unless there are laws, rules, or regulation that are applicable to the member that conclude otherwise, a CPA member who is in a partnership with non-CPAs may sign reports in the firm’s name and also affix the CPA designation to the member’s signature if it is clear that the partnership itself is not being held out as entirely comprising CPAs (1.820.020.01).

Members in Business

Up to this point in the course, we have focused the discussion on members in public practice. Rightfully so, as the members in public practice guidance accounts for a significant majority of the rules and interpretations included within the Code. However, it’s important that we address at a high level some of requirements for members in business. You will note when reviewing the table of contents of the Code that Part 2 (members in business) includes much of the same information that is extensively discussed within the members in public practice section. For example, the primary topics (rules and interpretations) under Part 2 includes the following:

- Integrity and Objectivity
- General Standards
- Compliance With Standards
- Accounting Principles
- Acts Discreditable

As you can note from the list above, all of these topics are included in the members in public practice part of the Code. However, the following sections are not

discussed within Part 2 as they are only applicable to members in public practice:

- Independence
- Fees and Other Types of Remuneration
- Advertising and Other Forms of Solicitation
- Confidential Information
- Form of Organization and Name

Given the rules and interpretations included within the members in business part of the Code are very similar in principle to those presented in the members in public practice part, we will not repeat information already presented. Instead, select topics will be addressed to highlight some of the differences where apparent between members in public practice and members in business.

Conceptual Framework - Threats

The conceptual framework approach for members in business is very similar to that of members in public practice. For example, the same three step process as previously presented is also applicable to members in business. However, there are subtle differences included within the Code with respect to the examples presented for each of the categories of threats. For starters, the members in business section only contains six, not seven, primary categories of threats as there are no threats of management participation for members in business. Each of the six threats are described below and include examples of each. Note the subtle, yet important differences in wording in the descriptions and examples of each threat compared to those presented previously for members in public practice.

Adverse Interest Threat

An adverse interest threat for a member in business is a threat that a member will not act with objectivity because the member's interests are opposed to the interests of the employing organization (2.000.010.09). While this definition may appear very similar to that of the adverse interest threat for a member in public practice, there is a subtle, yet important distinction between the two. Swap out the term "employing organization" above with "client" and you would have the definition for an adverse interest threat for a member in public practice. This type of substitution, as you read the Code in more detail, is one of the common differences between the two types of members and the associated threats to their compliance with the Code.

Further to this point, the following are identified as examples of an adverse interest threat for a member in business (2.000.010.09):

- A member has charged, or expressed an intention to charge, the employing organization with violations of law
- A member or the member's immediate family or close relative has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the employing organization
- A member has sued or expressed an intention to sue the employing organization or its officers, directors, or employees

Advocacy Threat

The threat that a member will promote an employing organization's interests or position to the point that his or her objectivity is compromised is the textbook definition of an advocacy threat. And you guessed it, swap out employing organization with client and you would have the definition for an advocacy threat for a member in public practice. Examples of this threat include the following (2.000.010.10):

- Obtaining favorable financing or additional capital is dependent upon the information that the member includes in, or excludes from, a prospectus, an offering, a business plan, a financing application, or a regulatory filing
- The member gives or fails to give information that the member knows will unduly influence the conclusions reached by an external service provider or other third party

As you will note from the examples above for advocacy threat, as well as those presented previously for adverse interest, the examples for members in public practice and members in business are distinctly different. Eventhough definition wise the threats are very similar, it's clear that members in public practice and members in business encounter different types of threats.

Familiarity Threat

Given the definition of this threat mirrors that of a member in public practice (exception being the use of the term "employing organization), it need not be presented here. However, the examples of this threat are different and warrant mention below. These include the following (2.000.010.11):

- A member uses an immediate family's or a close relative's company as a supplier to the employing organization
- A member may accept an individual's work product with little or no review because the individual has been producing an acceptable work product for an extended period of time

- A member's immediate family or close relative is employed as a member's subordinate
- A member regularly accepts gifts or entertainment from a vendor or customer of the employing organization
- A member is pressured to change a conclusion regarding an accounting or a tax position
- A member is pressured to hire an unqualified individual

Self-Interest Threat

Similar to the familiarity threat, the definition of this threat is the same as that of a member in public practice with the exception of being tailored to a member in business. Examples of this threat include the following (2.000.010.12):

- A member's immediate family or close relative has a financial interest in the employing organization
- A member holds a financial interest (for example, shares or share options) in the employing organization, and the value of that financial interest is directly affected by the member's decisions
- A member is eligible for a profit or other performance-related bonus, and the value of that bonus is directly affected by the member's decisions

Self-Review Threat

Examples of self-review threats for a member in business include the following (2.000.010.13):

- When performing an internal audit procedure, an internal auditor accepts work that he or she previously performed in a different position
- The member accepts the work previously performed by the member, alone or with others that will be the basis for providing another professional service

Undue Influence Threat

The sixth and final threat (recall there were seven threats for members in public practice) relates to undue influence. Similar to the definition of this threat for a member in public practice, this is the threat that a member will subordinate his or her judgment to that of an individual associated with the employing organization or any relevant third party due to that individual's position, reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member (2.000.010.14). Examples of this type of threat include the following (2.000.010.14):

- A member is pressured to become associated with misleading information
- A member is pressured to deviate from a company policy

Conceptual Framework - Safeguards

Recall that the discussion of safeguards for members in public practice involved the following three categories:

- Safeguards created by the profession, legislation, or regulation
- Safeguards implemented by the client
- Safeguards implemented by the firm

With respect to members in business, there are only two categories as follows (2.000.010.16):

- Safeguards created by the profession, legislation, or regulation
- Safeguards implemented by the employing organization

As you will note, rightfully so there are no safeguards implemented by the client related to members in business. Similarly, there are safeguards implemented by the employing organization (instead of the firm). Given that the safeguards created by the profession, legislation, or regulation are very similar for members in public practice and members in business (with the exception of the external review of a firm's quality control system is not applicable to members in business), these will not be repeated. However, we will focus specifically on examples of safeguards that are implemented by the employing organization.

The examples of safeguards implemented by an employing organization for members in business is fairly extensive, but is not meant to be exhaustive. Refer to these examples presented within Exhibit 1-27 below.

Exhibit 1-27: Safeguards Implemented by the Employing Organization (2.000.010.20)

- A tone at the top emphasizing a commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies
- Policies and procedures addressing ethical conduct and compliance with laws, rules, and regulations
- Audit committee charter, including independent audit committee members
- Internal policies and procedures requiring disclosure of identified interests or relationships among the employing organization, its directors or officers, and vendors, suppliers, or customers
- Internal policies and procedures related to purchasing controls
- Internal policies and procedures related to customer acceptance or credit limits
- Dissemination of corporate ethical compliance policies and procedures, including whistle-blower hotlines, the reporting structure, dispute resolution, or other similar policies, to promote compliance with laws, rules, regulations, and other professional requirements
- Human resource policies and procedures safeguarding against discrimination or harassment, such as those concerning a worker's religion, sexual orientation, gender, or disability
- Human resource policies and procedures stressing the hiring and retention of technically competent employees
- Policies and procedures for implementing and monitoring ethical policies
- Assigning sufficient staff with the necessary competencies to projects and other tasks
- Policies segregating personal assets from company assets
- Staff training on applicable laws, rules, and regulations
- Regular monitoring of internal policies and procedures
- A reporting structure whereby the internal auditor does not report to the financial reporting group
- Policies and procedures that do not allow an internal auditor to monitor areas where the internal auditor has operational or functional responsibilities
- Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity
- Use of third-party resources for consultation as needed on significant matters of professional judgment

Other Members

As was noted in the introduction to this course, the Code is segregated between that of members in public practice, members in business, and all others. All others, as you recall, is simply those members that are not in either business or public practice.

As you can note from a quick review of the table of contents of the Code, this section of the Code (Part 3) is very short. In fact, the only rules prescribed specifically to these members relates to discreditable acts. However, it's important to note that this is not the only requirement applicable to these other members. Recall that the Preface to the Code prescribes requirements that are applicable to all members, whether they be in public practice, in business, or neither.

Acts Discreditable Rule

The various subtopics included within the Acts Discreditable Rule for other members is very similar to that of members in public practice and members in business. In short, the listing of subtopics is simply trimmed down. For example, there are no interpretations for subtopics relating to records request or removing client files or proprietary information from a firm such is the case with members in public practice. Instead, the Acts Discreditable Rule related to other members includes the following interpretations:

- Discrimination and Harassment in Employment
- Solicitation or Disclosure of CPA Examination Questions and Answers
- Failure to File a Tax Return or Pay a Tax Liability
- Confidential Information Obtained from Former Employment or Previous Volunteer Activities
- False, Misleading, or Deceptive Act in Promoting or Marketing Services
- Use of the CPA Credential

review questions...

11. Which of the following rules prescribes that a member in public practice should not state affirmatively that the financial statements of any entity are presented in conformity with GAAP if those financial statements contain a material departure from GAAP?
- Accounting Principles Rule.
 - Act Discreditable Rule.
 - General Standards Rule.
 - Compliance with Standards Rule.
12. Which of the following identifies an example of an advocacy threat for a member in business?
- A member is pressured to become associated with misleading information.
 - A member is pressured to change a conclusion regarding an accounting or tax policy position.
 - An internal auditor accepts work that he or she previously performed in a different position.
 - A member gives information that the member knows will unduly influence the conclusions reached by an external service provider.

Please refer to solution/answer pages at back of booklet

Glossary

Acceptable level

In connection with independence, an acceptable level is a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a member's independence is not impaired.

Adverse interest threat

The threat that a member will not act with objectivity because the member's interests are opposed to the client's interests.

Advocacy threat

The threat that a member will promote a client's interests or position to the point that his or her objectivity or independence is compromised.

Attest client

A client that engages a member to perform an attest engagement or with respect to which a member performs an attest engagement

Client

Any person or entity, other than the member's employer, that engages a member or member's firm to perform professional services and, if different, the person or entity with respect to which professional services are performed.

Covered member

All of the following: a. an individual on the attest engagement team. b. an individual in a position to influence the attest engagement. c. a partner, partner equivalent, or manager who provides more than 10 hours of nonattest services to the attest client within any fiscal year. Designation as covered member ends on the later of (i) the date that the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) the date he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis. d. a partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest engagement. e. the firm, including the firm's employee benefit plans. f. an entity whose operating, financial, or accounting policies can be controlled by any of the individuals or entities described in items a-e or two or more such individuals or entities if they act together.

Familiarity threat

The threat that, due to a long or close relationship with a client, a member will become too sympathetic to the client's interests or too accepting of the client's work or product.

Firm

A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council and that is engaged in public practice.

Interpretation

Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct.

Key position

A position in which an individual has a. primary responsibility for significant accounting functions that support material components of the financial statements; b. primary responsibility for the preparation of the financial statements; or c. the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

Management participation threat

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

Member

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

Member(s) in business

A member who is employed or engaged on a contractual or volunteer basis in a(n) executive, staff, governance, advisory, or administrative capacity in such areas as industry, the public sector, education, the not-for-profit sector, and regulatory or professional bodies.

Professional services

Include all services requiring accountancy or related skills that are performed by a member for a client, an employer, or on a volunteer basis.

Safeguards

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

Self-interest threat

The threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client.

Self-review threat

The threat that a member will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the member or an individual in the member's firm and that the member will rely on that service in forming a judgment as part of another service.

Threats

In connection with independence, threats are relationships or circumstances that could impair independence.

Undue influence threat

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

SOLUTIONS TO REVIEW QUESTIONS

1. Which of the following parts within the Code prescribes the professional conduct requirements required by both members in business and members in public practice?
 - a. Preface.
Correct. This Preface includes principles and rules that are applicable to all members, whether they be in public practice or in business. For example, a member in public practice would need to adhere to the rules and principles included in both the Preface and Part 1 of the code.
 - b. Part 1.
Incorrect. While Part 1 is applicable to members in public practice, it does not prescribe those requirements that should also be followed by members in business.
 - c. Part 2.
Incorrect. While Part 2 is applicable to members in business, it does not prescribe those requirements that should also be followed by members in public practice.
 - d. Part 3.
Incorrect. Part 3 prescribes the specific requirements with respect to members that are not in public practice or in business. As a result, this part of the Code does not prescribe requirements for either members in business or those members in public practice.
2. Which of the following identifies a professional service performed by a member where the requirements prescribed by the Code would not be applicable?
 - a. A member in public practice is performing a management consulting engagement for a nonpublic entity.
Incorrect. A member in public practice performing a management consulting engagement, whether it be for a public business entity or a nonpublic entity, is required to follow the rules of professional conduct. Other professional services where the member must follow the Code is for auditing engagements.
 - b. A member in business is performing litigation support services for his or her employing organization.
Incorrect. A member in public practice performing a litigation support services is required to follow the rules of professional conduct. Other professional services where the member must follow the Code is for tax or bookkeeping services.
 - c. A member practicing outside the United States as long as the member's conduct is in accordance with that country's rules of the organized accounting profession.
Correct. The rules of professional conduct prescribed by the Code do not apply to a member is practicing outside the United States as long as the member's conduct is in accordance with the rules of the organized accounting profession in the country in which he or she is practicing. However, when a member is associated with financial statements under circumstances that would lead the reader to assume that practices of the United States were followed, the member must comply with the Code.
 - d. A member in public practice is performing personal financial planning in the United States for an individual who holds international assets.
Incorrect. A member in public practice performing personal financial planning in the United States for an individual who holds international assets is required to follow the rules of professional conduct. Other professional services where the member must follow the Code is for other accounting or attest services.
3. Which of the following principles outlined within the Code states in part that a member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability?
 - a. Due care principle.
Correct. The due care principle requires that a member perform with both competence and diligence. Competence is derived from a synthesis of education and experience whereas diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.
 - b. Integrity principle.
Incorrect. The integrity principles notes that integrity is an element of character fundamental recognition and is the quality from which the public trust derives. In other words, it is the benchmark which a member must ultimately test all decisions. Furthermore, integrity commonly includes the traits of honesty and candidness within the constraints of client confidentiality.
 - c. Scope and nature of services principle.
Incorrect. The scope of nature of services principle requires that a member in public practice should observe the other principles within the Code in determining the scope and nature of services to be provided within an engagement. This principle essentially ties all the other principles together and requires each member's service performed be consistent with all principles.

- d. Responsibilities principle.
Incorrect. The overall belief related to this principle is that a member should exercise sensitive professional and moral judgment in all of their activities. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services.
4. Which of the following steps identifies the first step in the conceptual framework process?
- a. Identify and apply safeguards.
Incorrect. Identifying and applying safeguards is the third step in the conceptual framework process. A safeguard is an action or other measure that may eliminate a threat or reduce a threat to an acceptable level. In other words, while a threat may be identified and it may not be at an acceptable level, a member can perform an action (think of it as a type of compensating control) to reduce the threat to an acceptable level.
- b. Identify threats.
Correct. Identifying threats is the first step in the conceptual framework process. Threats are anything, such as relationships or circumstances that could compromise a member's compliance with the rules within the Code. Note, emphasis should be added on the word "could" in the preceding sentence. It's important to note that a threat could, instead of would, compromise a member's compliance with the rules within the Code.
- c. Evaluate the effectiveness of safeguards.
Incorrect. The evaluation of the effectiveness of safeguards is not the first step in the conceptual framework process. If the member concludes that threats are at an acceptable level after applying the identified safeguards, then the member may proceed with the professional service. However, if there are no safeguards that would eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the circumstance or relationship creating the threat should be changed, or the member should decline or terminate the professional engagement.
- d. Document threats and safeguards applied.
Incorrect. Documentation of the threats and safeguards applied is the final step in the conceptual framework approach. Simply put, when safeguards are applied to eliminate or reduce significant threats to an acceptable level, the member is encouraged to document the identified threats and safeguards applied.
5. A client expressing an intention to commence litigation against a member in public practice is an example of which of the following types of threats?
- a. Adverse interest threat.
Correct. A client that has commenced, or has expressed an intention to commence, litigation against a member is an example of an adverse interest threat. Another example of an adverse interest threat is a class action lawsuit being filed against the client and its officers and directors and the firm and its professional accountants.
- b. Familiarity threat.
Incorrect. A familiarity threat is a situation where a member will become too sympathetic to a client's interest or too accepting of a client's work or product given a long or closer relationship with the client. An example of this type of threat is a member's close friend being employed by the client.
- c. Self-interest threat.
Incorrect. A self-interest threat is a situation where a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client. An example of this type of threat is excess reliance on revenue from a single client.
- d. Undue influence threat.
Incorrect. An undue influence threat is a situation where a member will subordinate his or her judgment to an individual associated with a client or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. An example of this type of threat includes a firm being threatened with dismissal from a client engagement.
6. If an officer, director, or significant shareholder of a client participates in litigation against a member's firm, then this is an example of which of the following types of threats for a member in public practice?
- a. Undue influence threat.
Incorrect. An undue influence threat is a situation where a member will subordinate his or her judgment to an individual associated with a client or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. An example of this type of threat includes a firm being threatened with dismissal from a client engagement.
- b. Self-interest threat.
Incorrect. A self-interest threat is a situation where a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client. An example of this type of threat is excess reliance on revenue from a single client.

- c. **Adverse interest threat.**
Correct. An adverse interest threat occurs in situations where a member will not act with objectivity because the member's interests are opposed to the client's interest. As a result, if an officer, director, or significant shareholder of a client participates in litigation against the member's firm, this is an example of an adverse interest threat.
- d. **Advocacy threat.**
Incorrect. An advocacy threat occurs in situations where a member will promote a client's interests or positions to the point that his or her objectivity or independence is compromised. An example of this type of threat is if a member underwrites or promotes a client's shares.
- 7. If a member in public practice provides forensic accounting services to a client in litigation or a dispute with third parties is an example of which of the following types of threats?**
- a. **Advocacy threat.**
Correct. An advocacy threat occurs in situations where a member will promote a client's interests or positions to the point that his or her objectivity or independence is compromised. Another example of this type of threat is if a member acts as a registered agent for a client.
- b. **Undue influence threat.**
Incorrect. An undue influence threat is a situation where a member will subordinate his or her judgment to an individual associated with a client or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. An example of this type of threat is if a client indicates that it will not award additional engagements to the firm if the firm continues to disagree with the client on an accounting or tax matter.
- c. **Self-interest threat.**
Incorrect. A self-interest threat is a situation where a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client. An example of this type of threat is if a firm enters into a contingent fee arrangement for a tax refund claim that is not a predetermined fee.
- d. **Familiarity threat.**
Incorrect. A familiarity threat occurs in situations where a member will become too sympathetic to a client's interest or too accepting of a client's work or product given a long or closer relationship with the client. An example of this type of threat is if a member has a significant close business relationship with an officer, a director, or a 10 percent shareholder of a client.
- 8. Which of the following identifies a safeguard implemented by a client?**
- a. **Policies and procedures are in place to address ethical conflicts.**
Correct. Policies and procedures that are in place to address ethical conflicts is an example of a safeguard implemented by a client. An additional example of a safeguard implemented by a client includes the tone at the top emphasizing the client's commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies.
- b. **External review of a firm's quality control system.**
Incorrect. External review of a firm's quality control system is an example of a safeguard created by the profession, legislation, or regulation. An additional example of this type of safeguard includes legislation establishing prohibitions and requirements for a firm or a firm's professional employees.
- c. **Professional resources, such as hotlines, for consultation on ethical issues.**
Incorrect. Professional resources, such as hotlines, for consultation on ethical issues is an example of a safeguard created by the profession, legislation, or regulation. An additional example of this type of safeguard includes competency and experience requirements for professional licensure.
- d. **Policies and procedures that are designed to implement and monitor engagement quality control.**
Incorrect. These types of procedures that are designed to implement and monitor engagement quality control is an example of a safeguard implemented by a firm. An additional example of this type of safeguard is the use of different partners, partner equivalents, and engagement teams from different offices or that report to different supervisors.
- 9. Which of the following situations identify a familiarity threat with respect to a member's independence?**
- a. **A member promotes an attest client's securities as part of an initial public offering.**
Incorrect. This is an example of an advocacy threat, not a familiarity threat. An additional example of this type of threat is if a member provides expert witness services to an attest client.
- b. **A member represents an attest client in U.S. tax court or other public forum.**
Incorrect. This is an example of an advocacy threat, not a familiarity threat. An example of a familiarity threat is if a partner or partner equivalent of the firm has been a member of the attest engagement team for a prolonged period of time.
- c. **A member has a direct financial interest in the attest client.**
Incorrect. This is an example of a self-interest threat, not a familiarity threat. An additional example of this type of threat is if a member has a material indirect financial interest in the attest client.

- d. A member of an attest engagement team has a close friend who is in a key position at the attest client.
Correct. A member of the attest engagement team that has a close friend who is in a key position at the attest is an example of a familiarity threat with respect to a member's independence. Another example of this type of threat is if a member of the firm has recently been an officer or director of an attest client.
10. Which of the following activities, if performed by a member of an attest engagement team for the attest client, would impair the member's independence?
- Posting client-coded transactions to the attest client's general ledger.
Incorrect. This is an example of an activity that would not impair a member's independence. An additional example of an activity that would not impair independence is generating unsigned checks using source documents or other records provided and approved by the attest client.
 - Changing journal entries without first obtaining the client's approval.
Correct. This is an example of an activity that impair a member's independence. An additional example of an activity that would impair independence would be if a member accepted responsibility to sign or cosign the attest client's checks, even if only in emergency situations.
 - Preparing financial statements based on information in the attest client's trial balance.
Incorrect. This is an example of an activity that would not impair a member's independence. An additional example of an activity that would not impair independence is transmitting client-approved payroll or other disbursement information to a bank or similar entity subsequent to the attest client's review and authorization.
 - Processing the attest client's payroll using records approved by the client.
Incorrect. This is an example of an activity that would not impair a member's independence. An additional example of an activity that would not impair independence is preparing a reconciliation that identifies reconciling items for the client's evaluation.
11. Which of the following rules prescribes that a member in public practice should not state affirmatively that the financial statements of any entity are presented in conformity with GAAP if those financial statements contain a material departure from GAAP?
- Accounting Principles Rule.
Correct. The Accounting Principles Rule states in part that a member should not do either of the following if statements or data contain any departure from an accounting principle prescribed by a recognized accounting body: 1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles; or 2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles.
 - Act Discreditable Rule.
Incorrect. This rule states simply a member should not commit an act discreditable to the profession. Example of these types of act include, but are not limited to, a member violating any antidiscrimination laws of the United States, a state, or a municipality, including those related to sexual and other forms of harassment (assuming it is no longer subject to appeal) and a member who solicits or knowingly discloses the Uniform CPA Examination questions or answers without the AICPA's written authorization.
 - General Standards Rule.
Incorrect. The General Standards rule states simply that a member should comply with the following standards and with any related interpretations of the following: professional competence, due professional care, planning and supervision, and sufficient relevant data.
 - Compliance with Standards Rule.
Incorrect. The Compliance with Standards Rule states that a member who performs auditing, review, compilation, management consulting, tax, or other professional service are required to comply with the applicable standards. This particular rule does not contain significant interpretive guidance. In fact, the interpretive guidance section with respect to this rule only contains three paragraphs and primarily addresses the member's use of the conceptual framework and consideration of ethical conflicts.

12. Which of the following identifies an example of an advocacy threat for a member in business?

- a. A member is pressured to become associated with misleading information.
Incorrect. This is an example of an undue influence threat. An additional example of an undue influence threat is a member being pressured to deviate from a company policy.
- b. A member is pressured to change a conclusion regarding an accounting or tax policy position.
Incorrect. This is an example of an undue influence threat. An additional example of an undue influence threat is a member being pressured to hire an unqualified individual.
- c. An internal auditor accepts work that he or she previously performed in a different position.
Incorrect. This is an example of a self-review threat. An additional example of a self-review threat is a member accepting work previously performed by the member, alone or with others, which will be the basis for providing another professional service.
- d. **A member gives information that the member knows will unduly influence the conclusions reached by an external service provider.**
Correct. This is an example of an advocacy threat for a member in business. An additional example includes obtaining favorable financing or additional capital that is dependent upon the information that the member includes in, or excludes from, a prospectus, an offering, a business plan, a financing application, or a regulatory filing.

PROFESSIONAL ETHICS FOR CPAs

(4 CE HOURS)

FINAL EXAM

- Which of the following parts within the Code prescribes the professional conduct requirements required by only members in business?
 - Preface.
 - Part 1.
 - Part 2.
 - Part 3.
- Which of the following parts within the Code prescribes the professional conduct requirements required by only members in public practice?
 - Preface.
 - Part 1.
 - Part 2.
 - Part 3.
- Which of the following principles outlined within the Code states in part that a member should perform all professional responsibilities with the highest sense of integrity?
 - Objectivity and independence principle.
 - Public interest principle.
 - Due care principle.
 - Integrity principle.
- Which of the following principles within the Code notes that a member should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism?
 - Responsibilities principle.
 - Public interest principle.
 - Due care principle.
 - Scope and nature of services principle.
- Which of the following terms represent the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen?
 - Independence.
 - Integrity.
 - Competence.
 - Due care.
- Which of the following identifies the second step in the conceptual framework process?
 - Identify and apply safeguards.
 - Evaluate significance of threats.
 - Evaluate the effectiveness of safeguards.
 - Document threats and safeguards applied.
- Which of the following represents a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a member's compliance with the rules is not compromised?
 - Acceptable level.
 - Reasonable level.
 - Responsible level.
 - Moderate level.
- If a class action lawsuit is filed against the client and its officers and directors and the firm and its professional accountants, then this is an example of the following types of threats?
 - Adverse interest threat.
 - Advocacy threat.
 - Familiarity threat.
 - Self-interest threat.
- Which of the following is an example of a familiarity threat?
 - A firm acts as an investment adviser for an officer, a director, or a 10 percent shareholder of a client.
 - A firm underwrites or promotes a client's shares.
 - A firm acts as a registered agent for a client.
 - A member has a significant close business relationship with an officer, a director, or a 10 percent shareholder of a client.
- If a member relies on the work product of the member's firm, then this is an example of which of the following types of threats?
 - Undue influence threat.
 - Self-interest threat.
 - Advocacy threat.
 - Self-review threat.

11. If an individual associated with a client or any relevant third party threatens to withdraw or terminate a professional service unless the member reaches certain judgments or conclusions, then this is an example of which of the following types of threats?
- Undue influence threat.
 - Management participation threat.
 - Advocacy threat.
 - Familiarity threat.
12. Which of the following is an example of a safeguard created by the professional, legislation, or regulation?
- Policies and procedures that are designed to implement and monitor engagement quality control.
 - Documented policies regarding the identification of threats to compliance.
 - Competency and experience requirements for professional licensure.
 - The client has personnel with suitable skill, knowledge, or experience.
13. Which of the following identifies an example of a safeguard implemented by a client?
- Education and training requirements on independence and ethics rules.
 - External review of a firm's quality control system.
 - Policies and procedures in place to address ethical conflicts.
 - Firm leadership that stresses the importance of complying with the rules.
14. Which of the following identifies an example of a safeguard implemented by the firm?
- Designation of someone from senior management as the person responsible for overseeing the adequate functioning of the firm's quality control system.
 - A governance structure, such as an active audit committee, is in place to ensure appropriate decision making, oversight, and communications regarding a firm's services.
 - Policies are in place that bar the entity from hiring a firm to provide services that do not serve the public interest or that would cause the firm's independence or objectivity to be considered impaired.
 - Legislation establishing prohibitions and requirements for a firm or a firm's professional employees.
15. Which of the following rules prescribe that a member in public practice be free of conflicts of interest and not knowingly misrepresent facts or subordinate his or her judgment to others?
- Compliance with Standards Rule.
 - Integrity and Objectivity Rule.
 - Independence Rule.
 - Accounting Principles Rule.
16. Which of the following identifies an advocacy threat to independence for a member in public practice?
- A member provides expert witness services to an attest client.
 - A member of the attest engagement team has an immediate family member or close relative in a key position at the attest client, such as the attest client's CEO.
 - A partner or partner equivalent of the firm has been a member of the attest engagement team for a prolonged period.
 - A member of the firm has recently been a director or an officer of the attest client.
17. Which of the following identifies a familiarity threat to independence for a member in public practice?
- A member serves as an officer or a director of the attest client.
 - A member accepts responsibility for designing, implementing, or maintaining internal controls for the attest client.
 - A member hires, supervises, or terminates the attest client's employees.
 - A member of the attest engagement team has a close friend who is in a key position at the attest client.
18. Which of the following identifies a self-interest threat to independence for a member in public practice?
- A member or his or her firm relies excessively on revenue from a single attest client.
 - Management threatens to replace the member or member's firm over a disagreement on the application of an accounting principle.
 - Management pressures the member to reduce necessary audit procedures in order to reduce audit fees.
 - The member receives a gift from the attest client, its management, or its significant shareholders.

19. Which of the following identifies an exception to the management participation threat to independence that would not impair a member's independence so long as certain conditions are met?
- The member is employed as an adjunct faculty member.
 - The member is employed as a consultant to the client's chief financial officer.
 - The member participates in only non-routine but significant capital decisions by the client.
 - The member provides less than 20 hours per week of management oversight of the client.
20. Which of the following activities, if performed by a member of an attest engagement team for the attest client, would not impair the member's independence?
- Posting client-coded transactions to an attest client's general ledger
 - Preparing financial statements based on information in the attest client's trial balance
 - Posting client-approved journal or other entries to an attest client's trial balance
 - Making changes to source documents without the attest client's approval.
21. Which of the following rules for a member in public practice state that a member should comply with the standards of professional competence and due professional care?
- General Standards Rule.
 - Accounting Principles Rule.
 - Acts Discreditable Rule.
 - Contingent Fees Rule.
22. Specific interpretations with respect to gifts and entertainment can be found under which of the following rules for members in public practice?
- Integrity and Objectivity Rule.
 - Independence Rule.
 - Compliance with Standards Rule.
 - Contingent Fees Rule.
23. A member in public practice that makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity has committed which of the following?
- Felony.
 - Rules violation.
 - Discreditable act.
 - Ethics violation.
24. In which of the following professional services can a member in public practice accept a contingent fee?
- Representing a client in connection with a revenue agent's examination of the client's federal income tax return.
 - An audit of a client's financial statements.
 - A review of a client's financial statements.
 - An examination of prospective financial information.
25. Which of the following professional services is a member in public practice precluded from performing for a contingent fee?
- Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Taxation or state taxing authority.
 - Requesting a refund of either overpayments of interest or penalties charged to a client's account or tax deposits that a federal or state taxing authority improperly accounted for in circumstances in which the taxing authority has established procedures for the substantive review of such refund requests.
 - Requesting, by means of a protest or similar document, the state or local taxing authority's consideration of a reduction in a property's assessed value under an established taxing authority's review process for hearing all taxpayer arguments relating to assessed value.
 - A compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence.
26. Which of the following threats is not applicable to members in business compared to members in public practice?
- Adverse interest threat.
 - Self-interest threat.
 - Management participation threat.
 - Familiarity threat.

27. Which of the following identifies an example of an adverse interest threat for a member in business?
- A member uses an immediate family's or a close relative's company as a supplier to the employing organization.
 - A member may accept an individual's work product with little or no review because the individual has been producing an acceptable work product for an extended period of time.
 - A member's immediate family or close relative is employed as a member's subordinate.
 - A member or the member's immediate family or close relative has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the employing organization.
28. Which of the following identifies an example of an undue influence threat for a member in business?
- A member has charged, or expressed an intention to charge, the employing organization with violations of law.
 - A member is pressured to change a conclusion regarding an accounting or a tax position.
 - A member or the member's immediate family or close relative has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the employing organization.
 - A member has sued or expressed an intention to sue the employing organization or its officers, directors, or employees.
29. Which of the following identifies a safeguard implemented by an employing organization for a member in business?
- Internal policies and procedures related to purchasing controls.
 - The use of different partners, partner equivalents, and engagement teams from different offices or that report to different supervisors.
 - Training on, and timely communication of, a firm's policies and procedures and any changes to them for all partners and professional staff.
 - Policies and procedures that are designed to monitor the firm's, partners, or partner equivalent's reliance on revenue from a single client and that, if necessary, trigger action to address excessive reliance.
30. Which of the following identifies the only rule and related interpretation noted within the Code for other members, in addition to those rule applicable to all members?
- Compliance with Standards Rule.
 - Independence Rule.
 - Acts Discreditable Rule.
 - Accounting Principles Rule.
31. The revised Code, excluding the Conceptual Framework sections, is effective on what date?
- December 15, 2014.
 - December 15, 2015.
 - December 15, 2016.
 - December 15, 2017.
32. Members not in business or public practice should refer to which of the following parts of the Code for specific interpretations?
- Part 1.
 - Part 2.
 - Part 3.
 - Part 4.



Course Evaluation Form

Program Title: _____

Program Date: _____

Participant Name: _____

Please indicate your agreement with the following statements:	Agree	Disagree	Don't Know
1. Stated Learning Objectives were met	_____	_____	_____
2. Stated prerequisite requirements were appropriate and sufficient	_____	_____	_____
3. Program materials were relevant and contributed to the achievement of the learning objectives	_____	_____	_____
4. Time allotted to the learning activity was appropriate	_____	_____	_____
5. If applicable, individual instructors were effective	_____	_____	_____

Additional Comments:

Thank you for your comments!