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Course #4825F

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ETHICS AND PROFESSIONAL CONDUCT FOR NORTH CAROLINA CPAS
(COURSE #4825F)

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Special Note

This course is valid for renewal purposes for North Carolina CPAs only. This course is not the Accountancy Law course required by 21 NCAC 08F.0504 and does not qualify one to obtain an original or reciprocal certificate. The Accountancy Law course required for certification is an 8-hour course and should not be confused with this ethics course that is required for license renewal. If you have any questions, please contact Professional Education Services, LP (800) 990-2731 or the North Carolina CPA Board staff at (919) 733-1423.

INTRODUCTION

Organization

The North Carolina State Board of Certified Public Accountant Examiners is the body responsible for regulating CPAs in North Carolina. The Board's Professional Standards section is the unit with responsibility for professional ethics and the conduct of CPAs. That body is responsible for the enforcement of the Rules of Professional Ethics and Conduct provided in detail in Chapter 4.

The section can be contacted as follows:

> **Mailing Address**: NC State Board of CPA Examiners, Attn.: Professional Standards, PO Box 12827, Raleigh, NC 27605-2827
>
> **Fax Number**: (919) 733-4209, Attn.: Professional Standards
>
> **E-Mail**: ahhinkle@nccpaboard.gov (Ann Hinkle, Manager)

Conduct and Ethics

The reliance of the public and the business community on sound financial reporting and advice on business affairs imposes on the accounting profession an obligation to maintain a high standard of technical competence, morality, and integrity. To this end, a CPA should at all times maintain independence of thought and action, hold the affairs of clients in strict confidence, strive continuously to improve professional skills, observe generally accepted principles and standards, promote sound and informative financial reporting, uphold the dignity and honor of the accounting profession, and maintain high standards of personal conduct.

The Rules of Professional Ethics and Conduct adopted and enforced by the Board cover a broad range of behaviors but do not enumerate every possible unethical act. These rules are applicable to all certificate holders. When interpreting or enforcing these rules, the Board may give consideration, but not necessarily dispositive weight, to relevant interpretations, rulings, and opinions issued by other boards of accountancy and by appropriately authorized ethics committees of professional organizations such as the North Carolina Association of CPAs (NCACPA) and the American Institute of CPAs (AICPA).

Under the North Carolina rules, CPAs are responsible for their own conduct as well as those of any partners (or, in the case of a professional corporation, fellow shareholders). The law also makes CPAs responsible for the conduct of anyone the CPA supervises.

Use of CPA Licensed Credential

North Carolina Accountancy Law is unique in that anyone can practice public accountancy by paying a minimal privilege license fee to the North Carolina Department of Revenue. However, persons who are not licensed by the NC State Board of CPA Examiners are limited to using the title “accountant” while in North Carolina. As a result,

- It is unlawful for any person who has not received a certificate of qualification or not been granted a practice privilege under G.S. 93-10 admitting the person to practice as a certified public accountant to assume the use of such a title, or to use any words, letters, abbreviations, symbols or other means of identification to indicate that the person has been admitted to practice as a CPA;

- It is unlawful for any firm, co-partnership, or association to assume or use the title of certified public accountant, or to use any words, letters, abbreviations, symbols, or other means of identification that the members of the firm, co-partnership, or association have been admitted to practice as CPAs, unless each of the members of the firm, co-partnership, or association have indeed received a certificate of qualification from the Board or been granted a practice privilege admitting each member of the firm, co-partnership, or association to practice as a CPA. However, the Board may exempt those persons who do not actually practice or reside in the State of North Carolina from registering and receiving certificates of qualification; and

- It is unlawful for any corporation to assume or use the title of certified public accountant, or to use any words, letters, abbreviations, symbols, or other means of identification that such corporation has received a certificate of qualification from the Board admitting it to practice as a CPA.

CPA Mobility Legislation

In July 2009, the General Assembly passed CPA mobility legislation. A CPA holding a license or permit, whose principal place of business is outside North Carolina, is granted the privilege to perform services as a CPA without notice to the Board. By exercising the practice privilege, an individual or firm consents to the disciplinary authority of the Board.

Publication of Consent Orders and Other Disciplinary Actions

Under 21 NCAC 08I.0101(d), the Board, at its discretion, may publish all disciplinary actions and Consent Orders. Unless otherwise determined, the Board publishes all disciplinary actions and Consent Orders. As a matter of policy, the Board publishes by name and geographic location all of the following:

- Board Orders involving censure, revocation, assessment of a civil penalty, or denial of examination or certificate application based upon ethics violations

- Consent Orders in third-party or staff complaint matters regarding active or stayed disciplinary action involving any of the following:
  - censure
  - revocation
  - assessment of a civil penalty
  - suspension (revocation for a specific period of time)
  - preissuance review of attest services
  - payment of administrative costs
  - condition to take additional CPE in excess of 19 hours over and above the annual requirement

- Letter Orders pursuant to 21 NCAC 08J .0111(3)

- Certificate forfeitures (after four-month reinstatement period)

As a service to the public, the Board has made its public record/disciplinary action files available on its website.

<u>Rules Effective July 1, 2010</u>

The Board's website has details on repealed and revised regulations effective July 1, 2010. Among other things, these rules impact and implement the mobility legislation enacted in 2009. The changes generally make the rules more clear and effective.

<u>Rules Effective February 1, 2011</u>

In October 2010, the Board considered minor rule changes to: Adopt rules that reflect current hearing procedures, new procedures due to a statutory change, and new accounting standards.

CHAPTER 1: INTRODUCTION TO THE STUDY OF ETHICS

Objectives: After completing this chapter you will be able to:

- Explain the function of ethics.
- Discuss the theory of utilitarianism.
- Explain the history of ethics in Western civilization.
- Explain the term “positive laws” as contrasted with “natural laws.”
- Discuss whether the AICPA code of ethics is a positive law or natural law.
- Explain why people follow rules of laws.

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

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

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

The modern professional rules of conduct that govern CPAs -- like those governing attorneys and other professionals -- have developed out of those schools of thought with an eye toward establishing a set of norms that benefit and promote the profession while protecting consumers. A general understanding of some of the background of this field of study is helpful to more fully understand the goal of the rules of professional conduct governing CPAs. This type of understanding is also useful in analyzing situations that may arise that do not fall squarely within the parameters of one of the specific professional rules. The ethical CPA should be able to determine the appropriate course of action regardless of the circumstances in which she finds herself. We will begin our discussion with a brief overview of a few of the major philosophical ethical constructs and then examine how those constructs can be used as models in guiding the behavior of CPAs.

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

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

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

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

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

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

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

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

CHAPTER 1 – REVIEW QUESTIONS

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

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Laws established by God are commonly referred to as:

   a) divine laws
   b) positive laws
   c) natural laws
   d) ethical laws

2. Austin believed that the primary reason people follow rules or laws is:

   a) fear of sanction
   b) a desire to do the moral thing
   c) fear of stigmatism
   d) a desire to conform to societal norms

CHAPTER 1 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Divine laws are not discussed in this course.

   B: Incorrect. Positive laws are established by men.

   C: Correct. Natural laws are laid out by God to govern man.

   D: Incorrect. Ethics are not laws.

   (See page 1-2 of the course material.)

2. **A: Correct.** Austin believed that people are motivated most by fear of sanction for non-compliance.

   B: Incorrect. Austin believed that more people act out of fear than out of a desire to do the right thing.

   C: Incorrect. A stigmatism can be a type of sanction. However, it is not nearly as broad as a sanction.

   D: Incorrect. According to Austin, many people act in order to conform to societal norms. However, more act in order to avoid being punished.

   (See page 1-2 of the course material.)

CHAPTER 2: THE VALUE OF PROFESSIONAL CODES OF ETHICS

<u>Objectives</u>: After completing this chapter, you will be able to:

- Discuss how professional codes of ethics protect consumers and promote the CPA profession.
- Explain how being ethical will lead to greater professional success.
- Describe the difference between blindly following the ethical rules and truly applying the ethical concepts to one's thought process.

As we discussed in Chapter 1, professional ethical codes have been developed to both protect consumers and promote particular professions. While not expressly set forth in codes such as the AICPA Code of Professional Conduct, these practical, often very specific ethical rules are based at least in part on abstract philosophical theories.

It is easy to say that professional ethical codes have been developed to protect consumers and to promote the business whose ethics are being regulated. Stated in the abstract, however, this is of limited value. To truly understand the ethical rules governing CPAs that will be detailed in later chapters, it is important to have a better understanding of the value that the rules provide. As we discussed in Chapter 1, the field of ethics is involved in defining behavior as good or bad. People in business generally have as their primary motivation increasing profits. If we assume, contrary to some philosophical theories, that people will not behave ethically simply because it is the right thing to do, then there must be some additional incentive or motivation for people to act in an ethical manner. One obvious motivation is the fear of sanction or punishment that can come with non-compliance (Austin's theory discussed in Chapter 1). No CPA would reasonably do something that he knew could result in the loss of his license to practice because such action would threaten the person's livelihood. But there are other reasons that the CPA should be concerned about following ethical rules. First, being ethical is the right thing to do. Second, being ethical will often lead to greater professional success.

In the ideal world, ethical rules governing CPAs are available as guideposts, tools to turn to when one is faced with a predicament and is trying to determine the best, most ethical course of action. For example, if John, a CPA, has a client, Company Y, that offers John a bonus if he will agree not to report all of Company Y's income, John might be faced with a predicament. John might ask: "Who does it really hurt if we underreport our income and pay less corporate tax?" At the same time, John might need the extra money being offered by Company Y so that his son can get a potentially life-saving operation. It would certainly be tempting for anyone in John's position to take the money. In making his decision, John must carefully examine the true consequences of taking the money. There is little doubt that to accept the payment in return for signing a knowingly false return violates the professional rules of ethics (the specific rules are the subject of later chapters). But what else might motivate John to reject the payment?

If John is willing to accept payment in exchange for signing a false return, this means that there are probably other CPAs who would be willing to do the same thing. Once John does it the first time, it becomes easier for him to do it again. The more frequently CPAs are willing to sign false returns, the less value there is in having the return signed by a CPA. Why? The tendency to rely on the signature as an affirmation of its truthfulness is diminished. Once enough people feel that the accuracy of a return cannot be relied on, the return will in fact have little practical value. In the absence of value, few people will be willing to pay for the preparation of the return. By a certain point in time, there will not be enough clients to keep John in business. What started out as a decision to lie on one return for an ostensibly good motive leads to the loss of his business.

Does it matter that John's decision not to sign the false return is motivated by a fear of sanction for violation of the professional rule of ethics? Certainly it is easy to say in the abstract that it would be better if John's decision not to sign the false return were motivated by his desire to do the right thing. And there will always be some people whose motivation in following the ethical rules is an altruistic desire to do the right thing rather than a fear of sanction. People who blindly adhere to the rules out of fear of sanction may indeed be ethical accountants, but on some level, there will always be those who decide to break the rules if they think they can get away with it. Therefore, in the ideal world accountants will follow ethical rules out of a desire to be an ethical accountant. And in the long run, the profession is benefited by such motivation because it will generally mean that less time is spent on policing professional conduct. In the long run, the profession also wins because the public recognizes CPAs as ethical people and is more likely to engage their services.

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

<u>CHAPTER 2 – REVIEW QUESTIONS</u>

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

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Which of the following is <u>not</u> a reason to have a Code of Professional Conduct for CPAs:

   a) to foster consumer confidence
   b) to create an administrative structure to police CPAs
   c) to promote the profession
   d) to make CPAs act ethically

2. What is the most important reason CPAs should follow professional ethics:

   a) to avoid monetary sanctions
   b) to avoid losing one's license
   c) to make the most money
   d) to behave in the most ethical way

CHAPTER 2 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Codes of ethics do foster consumer confidence.

   B: Correct. Boards of accountancy police CPAs. The Code of Professional Conduct should reduce the need to police CPAs.

   C: Incorrect. A code of conduct does promote the profession.

   D: Incorrect. A code of conduct can help CPAs act ethically.

   (See page 2-1 of the course material.)

2. A: Incorrect. The professional ethics rules do not have monetary sanctions.

   B: Incorrect. The board of accountancy is the only entity with the authority to revoke one's license.

   C: Incorrect. Making money is not the most important reason to act ethically.

   D: Correct. Following professional ethics rules will guide the CPA to behave in the most ethical way.

   (See page 2-2 of the course material.)

CHAPTER 3: THE CODE OF PROFESSIONAL CONDUCT

Objectives: After completing this chapter you will be able to:

- List the six guiding principles in the AICPA Code of Professional Conduct.
- Explain the difference between the principles and the rules.
- Describe how to apply the rules to specific actions common to the CPA community.

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

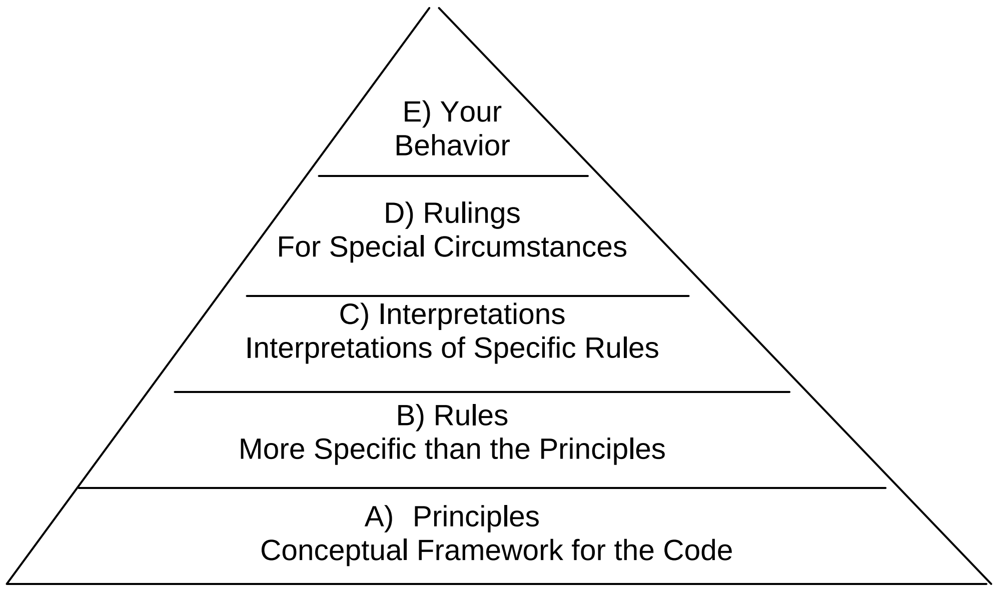
A member of the AICPA also must be aware of Interpretations of the AICPA Rules of Conduct. After public exposure, Interpretations of the AICPA Rules of Conduct are published by the Executive Committee of the Professional Ethics Division. Interpretations are not intended to limit the scope or application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

Question: Why do I care about the AICPA rules if I am not a member of the AICPA?

Answer: Most states pattern their rules after the AICPA. In addition, when courts look at professional negligence, they will look to national standards such as the AICPA Code of Professional Conduct.

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

AICPA ETHICS PYRAMID



The AICPA ethics pronouncements can be thought of as a pyramid.

A) Principles
The six principles of the code of professional conduct provide the conceptual framework for the code. They are the cornerstone of ethical behavior.

B) Rules
The rules of the code of professional conduct are more specific than the six principles. Members must observe the rules.

C) Interpretations
Interpretations are issued by the AICPA to better explain the code of professional conduct. Only the principles and rules are considered part of the code of professional conduct. Interpretations explain the code but are not part of it.

D) Rulings
The rulings apply the rules of conduct and interpretations to particular circumstances. AICPA members who depart from such rulings must justify their departures.

E) Your Behavior
The code, interpretations and rulings are meaningless if they do not impact your behavior. For this reason, your behavior is at the top of the pyramid.

PRINCIPLES

The Principles of the Code of Professional Conduct:

I. Responsibilities

In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.

II. The Public Interest

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

III. Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

IV. Objectivity and Independence

A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

V. Due Care

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

VI. Scope and Nature of Services

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

These articles establish the basis for characterizing the responsibilities the CPA has to clients, colleagues and the public at large. The fundamental theme of the six articles is *to be committed to honorable behavior, even at the sacrifice of personal advantage*.

RULES

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

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

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

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

Below is a listing of the applicable rules followed by a discussion of each rule:

Rule 101	Independence
Rule 102	Integrity and Objectivity
Rule 201	General Standards
Rule 202	Compliance with Standards
Rule 203	Accounting Principles
Rule 301	Confidential Client Information
Rule 302	Contingent Fees
Rule 501	Acts Discreditable
Rule 502	Advertising and Other Forms of Solicitation
Rule 503	Commissions and Referral Fees
Rule 505	Form of Organization and Name

Rule 101 - Independence

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

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

Rule 101 is applicable to all professional services provided by a CPA that require independence.

OBSERVATION: *A CPA <u>may conduct</u> a compilation engagement when he or she is not independent, but the compilation report must be modified to disclose the lack of independence.*

Rule 102 - Integrity and Objectivity

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.

Rule 102 is very broad on purpose. The Code of Professional Conduct could not possibly proscribe every action that is to be avoided. Thus, Rule 102 could cover a variety of misconduct.

<u>**Case Study**</u>

Integrity and Objectivity

Brown CPA provided tax services to Mr. and Mrs. Taylor for the last 14 years of their marriage. Brown CPA had knowledge of financial information that related to both husband and wife based on Brown's prior services to Mr. and Mrs. Taylor.

When the couple decided to divorce, Brown CPA accepted an engagement from Mr. Taylor to assist him with consultation and tax matters related to the divorce proceedings.

Brown CPA prepared the final joint tax return for Mr. and Mrs. Taylor after the date of the divorce.

While Brown CPA represented the couple, Brown CPA was also representing Mr. Taylor with services that were related to the divorce proceedings. These separate services were adversarial to Mrs. Taylor.

Brown CPA did not request permission of Mrs. Taylor to represent only Mr. Taylor. Brown CPA accepted the engagement with Mr. Taylor even though it was adverse to Mrs. Taylor.

Brown CPA violated the rule on integrity and objectivity by accepting a separate engagement from Mr. Taylor which was adversarial to his engagement to Mr. and Mrs. Taylor.

Rule 201 - General Standards

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

A. ***Professional Competence***. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

B. ***Due Professional Care***. Exercise due professional care in the performance of professional services.

C. ***Planning and Supervision***. Adequately plan and supervise the performance of professional services.

D. ***Sufficient Relevant Data***. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

In general, these standards are applicable to all professional services rendered by an accounting firm. For example, an accountant who performs a consulting services engagement must properly plan and supervise the job (ET 201.01).

Rule 201 requires that a firm have a certain level of expertise before an audit, tax, or consulting engagement is accepted. This does not suggest that an accounting firm must have complete knowledge in an area before the engagement is accepted -- a lack of competence is not apparent just because an accounting firm accepts a client knowing that additional research may be necessary to complete the job.

Rule 202 - Compliance with Standards

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

Rule 202 requires members to observe technical standards promulgated by bodies designated by the AICPA Council. To date, the bodies designated by the Council are the Auditing Standards Board (ASB), Accounting and Review Services Committee (ARSC), and Management Consulting Services Executive Committee (MCSEC).

OBSERVATION: *The Code of Professional Conduct does not refer to Audit and Accounting Guides that may be issued by a committee or task force established by the AICPA. Although each Audit Guide contains a preamble that states that a Guide does not have the authority of a pronouncement by the ASB, it does note that a member may be called upon to justify departures from the Guide if the member's work is challenged.*

Rule 203 - Accounting Principles

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

OBSERVATION: *The AICPA Council has designated FASB, GASB IASB, and FASAB as bodies to promulgate accounting principles. In addition, several AICPA committees have been designated to promulgate standards in their respective subject areas.*

Rule 203 also provides flexibility in the application of accounting principles.

When the auditor concludes that a written accounting rule should not be followed, the auditor's standard report must be expanded to include an explanatory paragraph. The explanatory paragraph would describe the nature of the departure; however, the opinion expressed would be an unqualified opinion and no reference to the explanatory paragraph would be made in the opinion paragraph.

Rule 301 - Confidential Client Information

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

This rule shall not be construed (1) to relieve a member of his or her professional obligations under Rules 202 and 203, (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 the 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.

NOTE: An auditor should have access to a variety of information held by the client if the engagement is to be successful. The client will grant the auditor access to sensitive files and reports only if it can expect the auditor to hold the information in confidence. The purpose of Rule 301 is to encourage a free flow of information from the client to the CPA; however, the rule makes it clear that the principle of confidentiality is not absolute. The confidentiality concept does not allow the client to omit information that is required by generally accepted accounting principles. SAS-32 (Adequacy of Disclosure in Financial Statements) reinforces this position by stating that if a client omits information that is required by GAAP, a qualified or adverse opinion must be expressed. On the other hand, SAS-32 does note that an auditor ordinarily should not make available information that is not required to be disclosed to comply with GAAP.

Rule 301 recognizes the confidentiality of client information, but makes it clear that the information does not constitute privileged communication. In most states, and most federal courts, the CPA can be forced to testify in a case involving the client. Thus, the rule recognizes that an auditor must respond to a subpoena or summons.

In recent years, the concept of peer review has been accepted by the profession. Rule 301 allows a peer or quality review of a CPA's professional practice as part of an AICPA or state society of CPAs program.

Finally, Rule 301 states that it is not a violation of confidentiality when a member initiates a complaint with or responds to inquiries from a recognized investigative or disciplinary body such as the AICPA's Professional Ethics Division or Trial Board.

Note: The following was adapted from an article written by the North Carolina State Board of Certified Public Accountant Examiners.

Your Laptop: Physical Security, Data Protection, and Tracking/Recovery

The theft of laptop computers and the sensitive data they contain is a growing problem for North Carolina CPAs – in one week, three CPAs contacted the Board regarding the theft of laptops from their firms.

There are three major aspects to laptop security – physical security, data protection, and tracking/recovery.

One of the first things to do after purchasing a laptop is to make a copy of the purchase receipt, serial number, and description of the laptop and keep that information in a location separate from the laptop. This information will be invaluable if the laptop is lost or stolen.

In addition, asset tag or engrave the laptop. Engraving your firm name and phone number or address may increase the likelihood of getting the laptop returned if it is stolen and recovered. Tamper-proof asset tags may serve as a deterrent to a thief who must choose between stealing an unmarked laptop or a marked laptop. Why? Asset tags are difficult to remove and may hamper the thief's ability to sell the laptop on the open market.

Industry experts estimate that one in eight laptops is at risk of theft. With such a daunting statistic, laptop users may feel resigned to being the victim of theft. However, one of the cheapest and most cost-effective solutions to deter the theft of a laptop is to attach a security cable (similar to the locks used on bicycles) to the laptop.

With cable locks, a steel clip provided by the manufacturer is installed in a security slot on the back or side of the laptop and a steel cable is threaded through the clip and wrapped around a heavy object such as a desk leg or support pole. The two ends of the cable are then secured with a locking device. If the laptop does not contain a security slot or if the desk does not provide a location for suitable anchorage, special adhesive pads containing an anchorage slot are available. Although cable locks are not infallible, they will at least make the thief work a little harder to get the laptop.

Another effective method of protecting a laptop is to use a laptop safe. An advantage of a laptop safe is that when the laptop is locked in a safe, the PC cards and peripherals are secure, a protection that is not available with cable locks.

The two main types of safes available are portable safes that can safely attach to most work surfaces and car safes which are designed to protect valuables while they are stored in the trunk of a vehicle. (**NOTE:** Never leave a laptop in plain sight in a vehicle; doing so is inviting a thief to break in the vehicle and take the laptop.)

Whereas cable locks and safes are designed to stop (or at least slow down) an opportunistic thief, alarms and motion detectors are intended to make the potential robber so conspicuous that he or she aborts the crime.

Products range from simple motion detectors to sensors that detect the unplugging of cables. Some products are designed to lock down the laptop if it is moved out of a designated range. Other products rely on nothing more than movement of the object to which it is attached; if the laptop to which the sensor is attached is moved, an alarm will sound.

Let's assume that, despite taking the appropriate physical security measures, your laptop has been stolen. How worried would you be about the security of the data on the machine?

Safeguarding data when it is in unauthorized hands is a matter of controlling access and encrypting data. If the first thing a thief sees when turning on a laptop is, "please enter boot password," he or she knows that it will take some effort to access the information on the machine.

Many machines allow the owner to set a boot password and a user will be prompted three times to enter the correct password. If there are three password failures, the machine will refuse to boot. However, if the machine is restarted, the user will have three more chances to enter the right password.

Removing a password-protected BIOS (basic input output system) and boot sequence typically involves physically opening the computer and removing the CMOS (complementary metal oxide semiconductor) battery (which may clear the BIOS information) or shorting some jumpers to reset the BIOS to a default state.

If you are running an operating system that supports proper logins (Windows NT/2000/XP or Linux), setting a password is not only a good idea, it is required. To successfully login to the computer, the user must provide a login name and password. If the information entered is incorrect, the operating system will refuse to allow the user to become an active user.

When creating a password, make sure you create a strong password. For a password to be considered strong, it must be eight or more characters (14 characters or longer is ideal); it must combine letters, numbers, and symbols; it must use a mix of uppercase letters and lowercase letters; and it should use words and phrases that are easy for you to remember, but difficult for others to guess. (**NOTE:** Avoid using your login name, your name, your birthday, anniversary, social security number, telephone number, etc., as part of your password.) Don't forget to change your passwords on a regular basis.

Although applying strong passwords to your laptop will make it more difficult for a casual thief to log in as "you," and therefore gain access to the information on your machine, passwords should not be relied upon as the sole piece of security on a laptop.

Even if an unauthorized user gains access to your laptop, encryption will protect the information stored on your machine. When you encrypt a file or folder, you are converting it to a format that can't be read by another user. When a file or folder is encrypted, an encryption key is added to the files or folder that you selected to encrypt and the key is needed to read the file.

Although Microsoft provides a form of encryption through Windows Encrypted File Service (EFS), that encryption is keyed to your user login. If the intruder is able to login as "you," he or she has access to your data even if it is encrypted with EFS.

Therefore, most firms who go this route will seek a third-party product which relies on encryption techniques above and beyond the Windows operating system.

CPAs using encryption technology need assurances that application databases such as tax, audit automation, and time and billing will operate correctly from encrypted disks or folders. The major software vendors test their products under a variety of scenarios and will be able to advise their customers of encryption solutions which are fully compatible with their products.

While encryption will protect the sensitive information on your laptop, it does nothing to retrieve the data on a lost or stolen machine. To do that, you must back up your files and store them in a secure location. Ideally, files should be backed up on a network server, but if that is not possible, there are other options.

External drives, flash drives, zip drives, and CDs are excellent choices for backing up your files. You can even use your digital music player to back up your data; these players don't just copy music files, they can copy any data. Players are easily hooked up to a laptop through the USB port and have up to 20-gigabyte hard drives.

While encryption strategies will help safeguard the data on a lost or stolen notebook computer, they do nothing to help recover the missing machine – the FBI estimates that just 3% of stolen or lost laptops are recovered.

Until recently, luck was the determining factor in recovering a lost or stolen machine, but new technology is providing users with the ability to track stolen or lost laptops.

With tracking programs, once a computer is reported lost or stolen, the tracking company will wait for the laptop to send a location signal (sent whenever the machine is connected to the Internet). When a signal is retrieved, the program will be instructed to broadcast as much information as it can about the current connection (originating phone number, IP address, service provider, etc.). When enough information has been collected, the tracking company will notify the appropriate law enforcement agency which may be able to recover the machine.

Other programs provide the user with the ability to execute commands remotely to the missing machine (if connected to the Internet), theoretically allowing the user to delete all of the important information on the hard drive.

If you haven't yet experienced the loss of a computer full of sensitive and confidential data, you are living on borrowed time. Plan ahead now to minimize the risk, reduce your exposure, and enhance your chances of recovery. Manage your risks through proactive strategies. Develop a security policy and implement it.

This is not an issue you can address once and have solved forever. Threats will change, risks will change, and requirements will change. Be sure your plans, your people, and your processes change along with them. Conduct periodic training updates, ensure software is kept up to date with the latest versions, and keep your emergency reaction checklists current.

Security Breach Notification

The Identity Theft Act of 2005 (NCGS 75-60, et seq.) requires businesses to notify each individual when there has been a security breach involving his or her personal identifying information. Notification waivers are void and unenforceable. A violation of this provision constitutes an unfair trade practice.

Who Must Notify?

A business that owns or licenses records or data that contain personal information and that personal information has been subject to a security breach must notify the affected parties. A business includes sole proprietorships, partnerships, corporations, associations, charities, or any group, however organized. The business must be located in North Carolina or own/license the personal information (in any form) of North Carolina residents. Businesses that maintain records/data that contain the personal information of North Carolina residents on behalf of an owner/licensee must notify the owner/licensee of a security breach.

What Is A Security Breach?

A “security breach” is defined as the unauthorized access and acquisition of unencrypted or unredacted records/data containing personal information with corresponding names, such as a first initial and last name. The acquisition of encrypted data only constitutes a breach if a confidential process or key is also acquired.

“Personal information” includes an individual’s social security number (SSN), employer taxpayer identification number (TIN), driver’s license or state identification number, passport number, checking/savings account number, credit/debit card number, PIN, digital signature, biometric data, fingerprints, or any number that can be used to access his or her financial resources.

In addition, the access of acquisition of an individual’s e-mail name or address, Internet account number, Internet username, or password may be considered a breach if it would permit access to his or her financial accounts or resources.

Personal information does not include publicly available directories that an individual has consented to have made available to the general public, including name, address, and telephone number.

Notification Requirements

Once a business discovers or is informed of a security breach, the business must notify those individuals affected, regardless of number. The notice must be clear and conspicuous and given without unreasonable delay. Notice may be delayed if law enforcement informs the business that disclosure of the breach would impede a criminal investigation or jeopardize national security.

The notice must include a general description of the security breach incident; the type of personal information that was the subject of the breach; the business' general efforts to protect personal information from further unauthorized access; a telephone number for further information and assistance; and the advice that the affected individuals should remain vigilant by reviewing financial accounts and monitoring their credit reports.

If a security breach involves more than 1,000 persons, the business must provide written notice of the timing, distribution, and content of the notice to the Consumer Protection Division (CPD) of the Attorney General's Office, as well as the three major credit reporting agencies.

The CPD will need a copy of the notice itself, the date of the security breach, the date the notice goes out, and the manner of distribution. The CPD will also need the number of North Carolina residents affected and the total number of persons affected.

For more information, visit www.noscamnc.gov.

Practice Pointer:
The Ethics of Outsourcing Client Tax Returns

Business process outsourcing – contracting business processes to outside service vendors – is not a new concept, and the accounting industry has long taken advantage of the benefits of outsourcing. However, a growing trend among CPA firms is causing concern among regulators.

A number of CPA firms, both multi-state and local, have begun using the burgeoning outsourcing and technology markets in India to process client tax returns. Although the AICPA Code and Rules do not expressly prohibit the practice of outsourcing the preparation of client tax returns, there are several rules a CPA must consider when outsourcing services.

One prime concern is maintaining the confidentiality of client records. Pursuant to Rule 301, a CPA shall not disclose any confidential information except with the consent of the client.

To process the tax return, the preparer must have sensitive client information such as the client's Social Security Number, date of birth, bank and brokerage statements, credit card information, salary, etc. In short, much of the information can be used to perpetrate identity theft.

Ultimately, the CPA firm has the responsibility to ensure the confidentiality of its clients' information. In addition, CPA firms like banks and brokerage firms are covered under the Gramm-Leach-Bliley Act, which governs financial privacy. Under the Act, the mandatory annual privacy notice must state with whom a company shares its clients' non-public information, how the company protects or safeguards that information, and how a client may opt out of having that information shared with other companies like outsourcing centers.

If your CPA firm has professional liability insurance coverage, you should check with your insurance carrier to see if your policy covers the firm when using an outsource center.

The accuracy of the tax return remains the ultimate responsibility of the CPA firm, and all returns prepared by an outsource center must be reviewed by the CPA firm and the signing CPA.

If your CPA firm is considering outsourcing the preparation of client tax returns, remember that a CPA is responsible for ensuring that any partner, shareholder, officer, director, unlicensed principal, proprietor, employee or agent, including outsource personnel, comply with the AICPAs rules on Professional Ethics and Conduct. In 2004, the AICPA adopted revised ethics rulings to address these concerns.

In addition, the IRS and most states impose criminal and civil penalties for the unauthorized disclosure of tax return data.

Rule 302 - Contingent Fees

A member in public practice shall not:

1. Perform for a contingent fee any professional services for, or receive such a fee from, a client for whom the member or the member's firm performs:
   (a) an audit or review of a financial statement; or
   (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
   (c) an examination of prospective financial information; or

2. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

The prohibition in (1) above applies during the period in which the member or the member's firm is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in any such listed services.

Except as stated in the next sentence, a contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. Solely for the 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.

A member's fees may vary depending on the complexity of services rendered.

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

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

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

Before 1991, Rule 302 prohibited contingent fees for all professional engagements (with the exception of certain fees fixed by the judicial or quasi-judicial process). In 1985, The Federal Trade Commission (FTC) challenged the position of the profession concerning contingent fees on the basis of restraint of trade. After prolonged negotiations between the AICPA and the FTC, Rule 301 (as reproduced above) was issued to modify the prior prohibition against contingent fees.

Rule 302 prohibits contingent fees for all additional professional services when the CPA has performed an attestation engagement, which includes audits, reviews, and examinations of prospective financial information. Also, the CPA may not perform any services for a client on a contingent fee basis when the CPA has performed a compilation engagement if the compilation report is expected to be used by a third party and does not disclose that the CPA is not independent with respect to the client.

The period of prohibition includes the date covered by the financial statements and the period during which the attestation service (and compilation service, as described above) is performed. For example, if the CPA is auditing a client's financial statements for the year ended December 31, 2008, and the date of the auditor's report is March 12, 2009, no services could be performed on a contingent fee basis by the auditor for the period from January 1, 2008, through March 12, 2009.

Rule 302 also prohibits the CPA from charging a contingent fee to prepare an original or amended tax return or claim for a refund. While independence is not an issue in performing tax services, the AICPA takes the position that it would be unprofessional to charge a fee, for example, based on the amount of refund that may be claimed on the tax return.

Rule 501 - Acts Discreditable

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

NOTE: Rule 501 is very broad. It is basic to ethical conduct, and only through its observance can the profession expect to win the confidence of the public. What constitutes a discreditable act is highly judgmental. There has been no attempt to be specific about what constitutes a discreditable act; however, the AICPA bylaws (Section 7.3) state that the following actions will lead to membership suspension or termination, without the need for a disciplinary hearing:

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

Rule 502 - Advertising and Other Forms of Solicitation

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

OBSERVATION: *Members who are not in public practice are exempt from much of Rule 502.*

Rule 503 - Commissions and Referral Fees

A. Prohibited Commissions

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

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

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

B. Disclosure of Permitted Commissions

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

C. Referral Fees

Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

NOTE: A CPA cannot receive a commission for recommending a client's product or services if the CPA audits or reviews that client's financial statements or examines that client's prospective financial information. In addition, no commissions can be received when the CPA compiles a client's financial statements if the CPA believes that a third party will rely on the statements, unless any lack of independence is disclosed in the compilation report.

OBSERVATION: *When a CPA sells products that the CPA has title to directly to clients, this is not considered a commission. However, care should be exercised to ensure that the arrangement does not violate Rule 101 (Independence).*

OBSERVATION: *As with contingent fees, the most important point for CPAs in public practice to remember is that the Boards of Accountancy may continue to prohibit commissions. Change is coming. However, the practitioner should not violate the law in anticipation of change.*

OBSERVATION: *The rule has never prohibited calculating the price to be paid for the purchase of an accounting practice as a percentage of fees the purchaser receives from these new clients over some specified period of time such as one, two, three or more years. The AICPA Ethics Executive Committee has stated that the rule does not prohibit the purchase of a portion of a practice (such as the tax practice related to individual returns) or even the purchase of a single client. Further, the purchase may be made through a non-CPA broker who will receive a portion of the purchase price.*

The rule also does not prohibit the payment of bonuses to employees even though practice development efforts on the part of the employee are a factor in determining the amount of the bonus.

Rule 504 - Incompatible Occupations (Withdrawn)

The concept of incompatible occupations now is covered by Rule 101 (Independence).

Rule 505 - Form of Organization and Name

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

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

NOTE: Also, an owner surviving the death or withdrawal of all other owners may continue to practice under a name which includes the name of past owners for up to two years after becoming a sole practitioner.

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

NOTE: Over the past several decades, the character of the practice of accounting has broadened to include a variety of activities that are beyond the scope of accounting. These activities include, among others, environmental auditing, executive recruitment, and the design of sophisticated computer systems that are not part of the client's accounting system. With the expansion of the types of services provided by accounting firms, there is an obvious need to recruit personnel who do not have an accounting/auditing background. For many accounting firms, these nontraditional professionals are increasingly important to their growth and development. However, because of the rules adopted by the AICPA, a nontraditional professional, no matter how competent or important to the firm, could not be an owner of the firm. These rules changed about ten years ago, and the updated rules follow.

Non CPA Ownership of CPA Firms

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

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

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

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

CHAPTER 3 – REVIEW QUESTIONS

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

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Why does this ethics course examine the AICPA Code of Professional Conduct when membership in the AICPA is voluntary:

   a) although membership in the AICPA is voluntary, federal law requires that all CPAs adhere to the AICPA Code of Professional Conduct
   b) most state boards of accountancy pattern their laws and regulations after the AICPA code or refer to it
   c) membership in the AICPA is not voluntary; membership is required for all CPAs and firms doing attest work
   d) most state CPA societies pattern their code of conduct after the AICPA Code, and most states require their licensees belong to their state CPA Society

2. The Rules of the Code of Professional Conduct are not as specific as the six principles that comprise the Principles.

   a) true
   b) false

3. Which of the following is true regarding Rule 102 – Integrity and Objectivity:

   a) Rule 102 is very broad on purpose
   b) Rule 102 provides a "safe harbor" against allegations of possible violations provided a CPA is following the orders of one's boss or another superior
   c) Rule 102 provides a very long list of prohibited actions, but the list does not include every possible instance of possible violations
   d) Rule 102 only applies to CPAs doing attest engagements

4. AICPA Rule 201 requires that a CPA be competent. Nash, CPA seeks to provide services to a new client in an industry that he has not previously served. Which of the following is true regarding Nash, CPA providing services to this client:

   a) Rule 201 requires that Nash, CPA have sufficient professional competence prior to accepting any engagement
   b) Rule 201 would not apply in this case since Nash is a CPA. Rule 201 only applies to non-CPA subordinates
   c) Rule 201 allows Nash, CPA to accept the engagement as long as it can be completed competently
   d) Rule 201 would require Nash, CPA to engage the services of an expert in that industry prior to accepting the engagement but would not require that Nash, CPA be competent in that area

CHAPTER 3 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. Membership in the AICPA is voluntary. Federal law does not explicitly state that CPAs must follow the AICPA Code of Professional Conduct.

   B: Correct. Most state boards of accountancy pattern their regulations on the AICPA Code of Professional Conduct and then address specific instances where their regulations differ.

   C: Incorrect. Membership in the AICPA and state CPA societies is voluntary.

   D: Incorrect. Most state CPA societies pattern their code of conduct after the AICPA Code, but CPA society membership is voluntary.

   (See the introduction to this chapter in the course material.)

2. A: True is incorrect. The rules expand on the principles.

   B: False is correct. The six principles are interpreted by the many rules.

   (See the AICPA ethics pyramid in the course material.)

3. **A: Correct.** The AICPA Code of Professional Conduct could not possibly list every possible violation.

   B: Incorrect. Rule 102 specifies that a CPA must not subordinate his or her judgment to others. There is no "safe harbor."

   C: Incorrect. The AICPA Code of Professional Conduct could not possibly list every possible violation and therefore does not even begin to list possible violations.

   D: Incorrect. Rule 102 applies to all CPAs. CPAs in industry must not subordinate their judgment to others.

   (See Rule 102 in the course material.)

4. A: Incorrect. A CPA should undertake only those engagements that the firm reasonably expects can be completed competently. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate.

   B: Incorrect. Rule 201 clearly applies to all CPAs.

   C: Correct. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate.

   D: Incorrect. Nash, CPA may accept this engagement if he believes he can attain competence prior to completing the engagement. Competence can be attained through training, consulting with colleagues, or other methods deemed appropriate. Nash, CPA is ultimately responsible to ensure that competence is attained.

   (See Rule 201 in the course material.)

CHAPTER 4: NORTH CAROLINA PROFESSIONAL ETHICS AND CONDUCT

Objectives: After completing this chapter, you will be able to:

- Identify the North Carolina Board rules and statutes.
- Explain the differences between the North Carolina rules and the AICPA Code of Professional Conduct.

This chapter provides a look at rules of professional ethics and conduct adopted by the state Board of North Carolina. Established by Chapter 93 of the North Carolina General Statutes (NCGS), the North Carolina State Board of Certified Public Accountant Examiners ("the Board") is an occupational licensing board that grants certificates of qualification as certified public accountants (CPAs) to those individuals who meet the legal requirements. The Board also adopts and enforces the Rules of Professional Ethics and Conduct to be observed by CPAs in this state.

References in the section below are to North Carolina Administrative Code, Title 21 – Occupational Licensing Boards, Chapter 8 – Board of Certified Public Accountant Examiners, as amended through July 1, 2010.

Effective January 1, 2005, all North Carolina licensees must complete, as part of their overall CPE requirement, either a 4-hour self-study course or a 2-hour live course on ethics. Effective January 1, 2008, a non-resident licensee whose primary office is in North Carolina must complete an approved North Carolina ethics course. All other non-resident licensees may take an ethics course for the state in which he or she is licensed as a CPA and works or resides. If there is no ethics CPE requirement in the jurisdiction where he or she is licensed and currently works or resides, he or she must complete an approved North Carolina ethics CPE course. For more information about North Carolina's CPE requirements, visit the North Carolina State Board of Certified Public Accountant Examiners website at **www.cpaboard.state.nc.us**.

Rules of Professional Ethics

SECTION .0100 - SCOPE AND APPLICABILITY

08N .0101 SCOPE OF THESE RULES

(a) The rules in this Subchapter are the rules of professional ethics and conduct which G.S. 93 12(9) authorizes the Board to adopt. As such, they complement the other statutory causes for discipline set out in G.S. 93 12 (9)(a) through (d) and other provisions of G.S. 93, 55B, 57C, and 59 84. These Rules cover a broad range of behavior and do not enumerate every possible unethical act.

(b) In the interpretation and enforcement of these Rules, the Board will give consideration, but not necessarily dispositive weight, to relevant interpretations, rulings and opinions issued by the boards of other jurisdictions and by appropriately authorized ethics committees of professional organizations.

08N .0102 APPLICABILITY AND ORGANIZATION OF RULES

These Rules are generally applicable to all certificate holders. Rules in Section .0200 of this Subchapter relate to CPAs whether or not employed in the public practice of accountancy. Rules in Section .0300 of this Subchapter pertain to CPAs using the CPA title in connection with providing products or services to clients. Rules in Section .0400 of this Subchapter pertain to CPAs whenever engaged in attest services.

08N .0103 RESPONSIBILITY FOR COMPLIANCE BY OTHERS

A CPA and CPA firm shall be responsible for assuring compliance with the rules in this Subchapter by anyone who is the CPA's partner, fellow shareholder, member, officer, director, licensed employee, unlicensed employee or agent or unlicensed principal, or by anyone whom the CPA supervises. A CPA or CPA firm shall not permit others (including affiliated entities) to carry out on the CPA's behalf, with or without compensation, acts which if carried out by the CPA would be a violation of these Rules.

***OBSERVATION**: Even a CPA who carries out his or her practice in an ethical manner can be subject to sanctions for turning a blind eye to the actions of his or her partners. Each CPA has an obligation as well as an interest in ensuring that the entire firm practice in a manner that complies with all ethical rules.*

Case Study

Responsibility for Compliance By Others

Brown, CPA and Able, CPA are partners in the firm Brown & Able, CPAs and employ two unlicensed staff members. Each staff member reports to each of the partners on various assignments. Brown & Able, CPAs took on many new clients including several in which the partners recognized that they would need to learn about their industries. As the tax filing deadline approached, Able was too busy to review several tax returns and instructed one of the unlicensed staff members to sign Able’s name on the returns. Brown was aware of this but did not interfere in his partner’s assignments.

The returns were flawed in a manner that likely would have been detected had they been reviewed by a CPA prior to being signed.

Brown, CPA violated the rule on responsibility for compliance by others in two ways. First, Brown looked the other way when an unlicensed staff member was signing a tax return. Second, Brown failed to act to prevent his partner from violating the rule.

POSSIBLE BOARD ACTION: Violation of 08N.0103 (Responsibility for Compliance By Others).

SECTION .0200 - RULES APPLICABLE TO ALL CPAs

08N .0201 INTEGRITY

The reliance of the public and the business community on sound financial reporting and advice on business affairs imposes on the accounting profession an obligation to maintain high standards of technical competence, morality, and integrity. To this end, a CPA shall at all times maintain independence of thought and action, hold the affairs of clients in strict confidence, strive continuously to improve professional skills, observe generally accepted accounting principles and standards, promote sound and informative financial reporting, uphold the dignity and honor of the accounting profession, and maintain high standards of personal conduct.

Case Study

Integrity and Deceptive Conduct

Joe Taxpayer received a notice from the Internal Revenue Service (IRS) that his 2007 tax return had been selected for audit. Taxpayer asked Green, CPA who had prepared Taxpayer's original return to represent Taxpayer in the audit. Green, CPA stated that he was an expert in representing clients before the IRS. In fact Green, CPA had only represented two clients in previous audits, was not an Enrolled Agent, and had never worked for the IRS as an auditor.

The IRS completed the examination of Taxpayer's 2007 tax return, and proposed a substantial increase in tax as well as interest and several penalties. Taxpayer was very concerned about the increase in tax and the imposition of penalties and interest. Green, CPA stated that this was merely an opening offer and that Green, CPA would almost certainly be able to negotiate the additional tax down to "about half" and would be able to "eliminate all the penalties and most of the interest." Taxpayer, who was now retired and seeking more monthly income, relied upon Green, CPA's assertion that most of his proposed tax liability would go away when he invested a substantial portion of his liquid assets in a home equity mortgage loan program promoted by XYZ Mortgage, a local "hard money "lender and client of Green, CPA.

Green, CPA would not receive any commissions or referral fees from XYZ Mortgage as a result of Taxpayer investing in XYZ's products. Green, CPA knew that the investment Taxpayer was contemplating was somewhat risky but was not asked by Taxpayer to specifically opine on the investment. Green stated that he, "did not see anything wrong " with Taxpayer making the investment, although he knew that XYZ Mortgage's yearly revenue and net income had historically fluctuated widely and was greatly impacted by the real estate market, economic conditions, and changes in interest rates.

After several months and numerous meetings with the IRS, Green, CPA conceded that the IRS findings were substantially correct. Green, CPA informed Taxpayer that Taxpayer would need to pay the full amount demanded by the IRS that was now somewhat higher due to the additional interest accrual.

Green, CPA informed Taxpayer about the results of the audit and suggested that Taxpayer pay the outstanding balance as soon as possible to avoid additional interest. Taxpayer asked XYZ Mortgage about terminating his investment early. Taxpayer was informed that the mortgage portfolio into which he invested was doing poorly and that it was currently worth less than half of its original value.

Taxpayer was forced to liquidate his investment in XYZ Mortgage at a substantial loss in order to pay the IRS assessment and then filed a complaint with the Board.

POSSIBLE BOARD ACTIONS: Violation of 08N.0201 (Integrity) and 08N.0202 (Deceptive Conduct).

08N .0202 DECEPTIVE CONDUCT PROHIBITED

(a) **Deception Defined**. A CPA shall not engage in deceptive conduct. Deception includes fraud or misrepresentation and representations or omissions which a CPA either knows or should know have a capacity or tendency to deceive. Deceptive conduct is prohibited whether or not anyone has been actually deceived.

> ***Example.*** *Walt is a North Carolina CPA who has recently started his own firm. He sends letters to prospective clients indicating that he has "seven years of experience with a major accounting firm." One of the recipients of those letters is familiar with Walt and knows that he only recently passed the CPA exam. Although he was not deceived by the knowing misrepresentation, the letter would nonetheless violate this rule.*

(b) **Prohibited Deception**. Prohibited conduct under this Section includes but is not limited to deception in:

(1) obtaining or maintaining employment;
(2) obtaining or keeping clients;
(3) obtaining or maintaining certification, retired status, or exemption from peer review;
(4) reporting CPE credits;
(5) certifying the character or experience of exam or certificate applicants;
(6) implying abilities not supported by education, professional attainments, or licensing recognition;
(7) asserting that services or products sold in connection with use of the CPA title are of a particular quality or standard when they are not;
(8) creating false or unjustified expectations of favorable results;
(9) using or permitting another to use the CPA title in a form of business not permitted by the accountancy laws or rules;
(10) permitting anyone not certified in this state (including one licensed in another state) to unlawfully use the CPA title in this state or to unlawfully operate as a CPA firm in this state; or
(11) falsifying a review, report, or any required program or checklist of any peer review program.

> ***OBSERVATION:*** *Remember that this list is not exhaustive. The fact that a particular act does not fall squarely within one of the above examples does not mean it will not violate this rule.*

Example

Deceptive Conduct Prohibited

Holding Out as a CPA

While lapsed, CPA submitted a Reinstatement Application to the Board. The application listed an e-mail address that included the CPA designation as part of the e-mail address, as follows:

JaneBrownCPA@internetprovider.com

Using “CPA” in the e-mail address is deceptive.

Case Study

Deceptive Conduct Prohibited

Smith, CPA advertises as follows, “With a dozen years of experience, I can settle your tax debt for pennies on the dollar.” In actuality, Smith, CPA has only been licensed for nine years and submitted his first offer in compromise (OIC) about five years ago. Smith, CPA did submit one OIC for 9% of the debt for a client that was permanently paralyzed in an auto accident. Smith’s success with the OIC program mirrored that of the program in general in that most of the offers were simply rejected. The minority of offers that were accepted averaged a 37% reduction.

Smith, CPA’s actions would likely constitute Prohibited Deception in obtaining clients as well as creating unjustified expectations of favorable results.

POSSIBLE BOARD ACTION: Violation of Rule 08N.0202(b)(2) and (8).

Case Study

Deceptive Conduct Prohibited

Respondent informed the Board on his 2009 individual certificate renewal (2009 renewal) that he had completed the annual CPE ethics course to meet the 2008 CPE requirements.

Based on Respondent’s representations, the Board accepted his renewal.

In May of 2010, Respondent self-reported to the Board that he had failed to complete the annual North Carolina (NC) CPE ethics course between January 1, 2008 and June 30, 2009 despite what was reported on his 2009 renewal to meet his 2008 CPE requirements. Respondent was living in Texas during this period but was not licensed as a CPA in Texas.

POSSIBLE BOARD ACTION: Violation of 08N.0202(b)(4) Deceptive conduct in reporting CPE credits.

08N .0203 DISCREDITABLE CONDUCT PROHIBITED

(a) **Discreditable Conduct**. A CPA shall not engage in conduct discreditable to the accounting profession.

(b) **Prohibited Discreditable Conduct**. Discreditable conduct includes but is not limited to:

(1) acts that reflect adversely on the CPA's honesty, integrity, trustworthiness, good moral character, or fitness as a CPA in other respects;
(2) stating or implying an ability to improperly influence a governmental agency or official;
(3) failing to comply with any order issued by the Board; or
(4) failing to fulfill the terms of a peer review engagement contract.

Comparison with AICPA Rule

AICPA Rule 501 likewise prohibits members from committing "an act discreditable to the profession." Rule 501 is very broad. What constitutes a discreditable act is highly judgmental. There has been no attempt to be specific about what constitutes a discreditable act; however, the AICPA bylaws do state certain acts that will automatically lead to membership suspension or termination, including the commission of a crime that results in imprisonment for more than one year or the filing of a false or fraudulent tax return for themselves or on behalf of a client.

Discreditable Conduct

Brown, CPA owned a bookstore in which he did not provide public accounting services. Brown agreed to sell White the bookstore. Prior to the sale, Brown provided White with a "Statement of Revenue and Expenses."

After the sale, Brown filed a lawsuit against White for breach of contract. Brown was required to submit Form 1040, Schedule C tax returns during arbitration. A comparison of the tax returns to the "Statement of Revenue and Expenses" indicated that the "Statement of Revenue and Expenses" included $84,000 overstatement of income.

Brown admitted that the expenses from a separate but related business owned by Brown were removed from the financial statement and that the income from that other business was included on the financial statement.

POSSIBLE BOARD ACTION: Violation of 08N.0203 Discreditable Conduct Prohibited.

08N .0204 DISCIPLINE BY FEDERAL AND STATE AUTHORITIES

(a) **Violations of Other Authorities' Laws or Rules**. A CPA shall not act in a way that would cause said CPA to be disciplined by federal or state agencies or boards for violations of laws or rules on ethics. CPAs who engage in activities regulated by other federal or state authorities (including but not limited to the following agencies: IRS, Department of Revenue, SEC, State Bar, North Carolina Secretary of State, PCAOB, NASD, Department of Insurance, GAO, HUD, State Auditor, State Treasurer, or Local Government Commission) must comply with all such authorities' ethics laws and rules.

(b) ***Prima Facie* Evidence**. A conviction or final finding of unethical conduct by a competent authority is prima facie evidence of a violation of this Rule.

(c) **Notice to the Board Required**. A CPA shall notify the Board in writing within 30 days of any conviction or finding against him or her of unlawful conduct by any federal or state court or regulatory authority.

Example

A CPA is sanctioned by the Internal Revenue Service for unethical conduct including numerous violations of Circular 230. The CPA was barred from representing clients before the IRS. The CPA did not report the results of the IRS investigation to the North Carolina Board.

LIKELY BOARD ACTION: Violation of 08N.0204 (a) and (c).

08N .0205 CONFIDENTIALITY

(a) **Nondisclosure**. A CPA shall not disclose any confidential information obtained in the course of employment or a professional engagement except with the consent of the employer or client.

(b) **Exceptions**. This Rule shall not be construed:

(1) to relieve a CPA of any report obligations pertaining to Section .0400 of this Subchapter; or
(2) to affect in any way the CPA's compliance with a validly issued subpoena or summons enforceable by this Board or by order of a court; or
(3) to preclude the CPA from responding to any inquiry made by the AICPA Ethics Division or Trial Board, by a duly constituted investigative or disciplinary body of a state CPA society, or under state statutes; or
(4) to preclude the disclosure of confidential client information necessary for the peer review process or for any quality review program; or
(5) to preclude the CPA from assisting the Board in enforcing the accountancy statutes and rules; or
(6) to affect a CPA’s disclosure of confidential information to state or federal authorities when the CPA concludes in good faith based upon professional judgment that a crime is being or is likely to be committed; or
(7) to affect a CPA’s disclosure on confidential information when such disclosure is required by state or federal laws or regulations.

<u>Case Study</u>

Confidentiality

Jones, CPA has two clients that are large roofing contractors in a small town. The two firms compete against each other and the owners know each other from high school. Both owners know that Jones, CPA does work for the other firm. Jones, CPA is discussing the recently completed tax return of Contractor A with the owner. The owner notes that his cost of roofing materials has increased by over 10%, and asks Jones if he has any ideas to help reduce the cost. Contractor A states that he has heard that Contractor B is doing really well, and asks if that is correct. Jones, CPA states that he can’t reveal information about another client. However, when pressed by Contractor A, Jones, CPA reveals that Contractor B has entered into a secret agreement with XYZ, Inc., (the only local building materials supplier), whereby Contractor B receives a 6% rebate on net purchases each quarter. Jones, CPA confirmed that after receiving the rebate, Contractor B’s materials cost rose only 4% for the year and that his gross profit margin increased.

Jones, CPA has a duty to serve both clients. However, in his effort to help Contractor A, he has revealed confidential information about Contractor B.

LIKELY BOARD ACTION: Violation of 08N.0205 Confidentiality.

Digital Copiers Could Be An Identity Theft Threat

While it’s common knowledge that leaving sensitive personal information in trash bins or responding to a spam e-mail raises the risk of identity theft, many consumers are not aware that the innocent looking photocopier in the corner of the office could be a potential wealth of information for identity thieves.

How? Similar to computers, hard drive installations have become routine for mid- to large-size copiers, especially those built since 2005. All images scanned on the machines are stored on the hard drive, including documents with personal data such as medical history, social security numbers, and bank account numbers.

The hard drive stores the unencrypted data until the hard drive is full. When the hard drive becomes full, the old files are simply overwritten with newer files.

Although this has been a known security risk for some time, a CBS News investigation earlier this year brought the issue to the attention of the public.

In its investigative report, “Copy Machines, a Security Risk?,” CBS noted that many copiers contained hard drives filled with images of every document ever copied on the machine. Often, owners don’t wipe these hard drives clean before selling the machines.

[A 2008 survey on copier security commissioned by copier manufacturer Sharp found 60 percent of Americans didn’t know that copiers store images on a hard drive.]

CBS demonstrated how easy it would be for this data, which often includes sensitive information like social security numbers and medical records, to fall into the wrong hands.

CBS, and the founder of a company that sells software to delete data on copier hard drives, purchased four old copiers from a warehouse in New Jersey and found sensitive data stored in the copiers.

Within hours, the hard drives had been removed from the machines, and using forensic software available for free on the Internet, tens of thousands of documents had been retrieved.

The documents ranged in scope from lists of sex offenders and domestic violence complaints to copies of building design plans and employee pay stubs.

One batch of documents included personal medical records – results of lab work, prescription refills, and even a patient's cancer diagnosis.

As a result of the CBS report, Congressman Edward Markey has called for the Federal Trade Commission to investigate the "retention of documents on the hard drives of digital copy machines..."

Adding to the insecurity, these photocopiers are often connected to an office network, and businesses may fail to place a strong password in order to gain access.

Unfortunately, the lack of a password or a weak password can allow web-savvy hackers to gain access to the network and steal stored data.

So what can consumers do to protect themselves? First, before copying sensitive information on your office copier, ask the information technology staff if the copier is one with a hard drive.

According to Rex Davis of the Identity Theft Resource Center, hard drives are usually found only in digital copiers that can handle large copy jobs quickly.

If your employer's copier doesn't have a hard drive, you probably don't need to worry about copying your information.

If your employer does have such a copier, ask if there is a policy in place for scrubbing information off the hard drive or protecting the data, especially when your employer is ready to get rid of the machine.

In recent years, most major copier manufacturers have started publicizing the risk of copier hard drive data breaches and offering security or encryption packages on their products that companies can purchase.

For example, Sharp offers a software package that automatically erases images from the hard drive. The cost? $500.

In addition to "disk scrubbing" software, software to prevent data from being stored at all or to encrypt data can be found online.

If you are unsure if the copier in your office stores images on a hard drive, contact the manufacturer or the company from which you leased (or bought) the copier. If the copier does store images, take the appropriate steps to wipe the hard drive clean – a little extra effort now will prevent big problems later.

Reprinted from the June 2010 issue of Activity Review

Responding to a Subpoena for Client or Employer Records: Disclosure of Confidential Client or Employer Records

Is it ever acceptable to disclose confidential client or employer information or records? 21 NCAC 08N.0205, *Confidentiality*, states, "A CPA shall not disclose any confidential information obtained in the course of employment or a professional engagement except with the consent of the employer or client."

How is this rule applied when a subpoena for client or employer records is served on a CPA? 21 NCAC 08N.0205(b) requires that the confidentiality rule must not be interpreted "to affect in any way the CPA's compliance with a validly issued subpoena or summons enforceable by this Board or by order of a court."

In accordance with the Rules of Civil Procedure, specifically Rule 45, a subpoena signed only by an attorney does not in and of itself compel the disclosure of information held by a CPA which is subject to 21 NCAC 08N.0205. Rule 45(c)(2) provides that, "Nothing contained herein shall be construed…to require any privileged communication under law to be disclosed." Furthermore, Rule 45(c)(4) allows that if a CPA objects to the subpoena, then the CPA can only be forced to produce the documents specified in the subpoena if the party seeking the information obtains an order of the court.

A subpoena or summons issued by the NC Department of Revenue or the IRS qualify under 21 NCAC 08N.0205(b)(7) as exceptions that do not require that the CPA obtain written permission from the client or employer or an order of the court to release the information or records to the Department of Revenue or IRS. However, a CPA may disclose confidential client or employer information without a subpoena if the CPA obtains written permission from the client or employer prior to the disclosure of the records or information to a third-party.

Reprinted from the April 2008 issue of Activity Review

08N .0206 COOPERATION WITH BOARD INQUIRY

A CPA shall fully cooperate with the Board in connection with any inquiry it shall make. Full cooperation includes fully responding in a timely manner to all inquiries of the Board or representatives of the Board and claiming Board correspondence from the U.S. Postal Service.

Example

A CPA receives an inquiry from the Board seeking additional CPE documentation. The CPA, knowing that he has fully complied with the CPE requirements, ignores this request. The CPA subsequently receives a certified letter from the Board that he refuses to accept. The CPA has now violated 08N.0206 twice, and could be subject to enforcement action regardless of the disposition of the original CPE inquiry.

08N .0207 VIOLATION OF TAX LAWS

A CPA shall not knowingly violate any state or federal tax laws in handling the CPA's personal business affairs, or the business affairs of an employer or client, or the business affairs of any company owned by the CPA.

Consequences of Federal and State Tax Code Violations

Despite the requirement that all licensees of the Board comply with North Carolina General Statute (NCGS) 93 and North Carolina Administrative Code (NCAC) Title 21, Chapter 08, the Board has experienced a significant increase in the number of cases resulting from violations of the federal and state tax codes by North Carolina CPAs.

These violations, which are primarily the failure to withhold or pay employment taxes on the Employer's Quarterly Federal tax return (Form 941) and the failure to file or pay personal income tax returns and the failure to supply tax information to the appropriate authorities, may result in a felony or misdemeanor conviction if prosecuted by the Internal Revenue Service (IRS) or the NC Department of Revenue (NCDOR).

Besides criminal prosecution, employers who willfully fail to pay employment taxes may be subject to civil sanctions. Employees suffer because they may not qualify for Social Security, Medicare, or unemployment benefits when an employer does not report or pay employment taxes.

According to Thomas L. Dixon, CPA, Director of the Criminal Investigation Division of the NCDOR, "The Department of Revenue's Criminal Investigation Division takes the willful violation of the state's tax statutes very seriously and has successfully prosecuted a number of CPAs in the past few years."

"As a CPA myself, I am continually amazed that we continue to receive referrals of willful violations by tax professionals," said Dixon.

Even if the licensee is not disciplined or prosecuted and convicted by a federal or state authority for the aforementioned tax code violations, failure to comply with the federal and state tax codes is a violation of NCGS 93-12(9), 21 NCAC 08N .0201, *Integrity*, .0203, *Discreditable Conduct Prohibited*, .0204, *Discipline by Federal and State Authorities*, and .0207, *Violation of Tax Laws*, making the licensee subject to discipline by the Board.

When the Board learns of a tax code violation by a North Carolina CPA (usually in the form of a referral by the IRS or NCDOR), the Board opens a case against the licensee and begins an investigation.

The discipline imposed by the Board against a licensee for failure to pay 941 funds and conviction of willfully failing to file personal tax returns can result in permanent revocation of the licensee's North Carolina CPA certificate.

Reprinted from the June 2009 issue of Activity Review

Case Study

Violation of Tax Laws

A CPA owns and operates a small CPA practice with two employees as well as a large Homeowner Association (HOA) management company. The HOA management company was responsible for making real property tax payments on behalf of the HOA. On numerous occasions, the HOA management company failed to make the required tax payments and instead used the tax money collected from the HOA for company payroll and general expenses. Eventually all past due taxes and penalties were paid by the HOA management company.

POSSIBLE BOARD ACTION: Violation of 08N.0207 Violation of tax laws. CPA was required to make timely tax payments.

08N .0208 REPORTING CONVICTIONS, JUDGMENTS, AND DISCIPLINARY ACTIONS

(a) **Criminal Actions**. A CPA shall notify the Board within 30 days of any conviction or finding of guilt of, pleading of *nolo contendere*, or receiving a prayer for judgment continued to any criminal offense.

Example

David, a North Carolina CPA, was on his way home from a party when he was pulled over by a state trooper. He was arrested on suspicion of drunk driving and eventually pleaded guilty to the charge. He was ordered to serve six months on probation but, because this was his first offense, was not required to serve any time in jail. Although he is not required to serve any jail time, the rule nonetheless requires David to report his conviction within 30 days or face disciplinary action.

(b) **Civil Actions**. A CPA shall notify the Board within 30 days of any judgment or settlement in a civil suit, bankruptcy action, administrative proceeding, or binding arbitration, the basis of which is grounded upon an allegation of professional negligence, gross negligence, dishonesty, fraud, misrepresentation, incompetence, or violation of any federal or state tax law and which was brought against either the CPA or a North Carolina office of a CPA firm of which the CPA was a managing partner.

Example

David, a North Carolina CPA has a large tax return preparation practice. David received notice from a former client who believes David failed to properly report the client's stepped-up basis on the sale of the client's farm four years ago. David promptly notifies his professional liability insurance carrier that investigates the claim. The carrier determines that there is some monetary exposure but that it is less than the client is asking for. The insurance company makes a settlement offer which is accepted and promptly makes the required payment.

David is required to report the settlement to the Board within 30 days.

08N .0209 ACCOUNTING PRINCIPLES

(a) **Generally Accepted Accounting Principles**. A CPA shall not express an opinion that financial statements are presented in conformity with generally accepted accounting principles if such statements contain any departure from an accounting principle which has a material effect on the statements taken as a whole, unless the CPA can demonstrate that due to unusual circumstances the financial statements would otherwise have been misleading.

(b) **Financial Accounting Standards Board Accounting Standard Codification**. The Financial Accounting Standards Board Accounting Standards Codification, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B 21.6, and shall be considered generally accepted accounting principles for the purposes of Paragraph (a) of this Rule.

(c) **Departures**. In such cases the CPA's report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

(d) **Copies of Standards**. Copies of the Financial Accounting Standards Board Accounting Standards Codification may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the FASB, Post Office Box 30816, Stamford, CT 06150 as part of the "FASB Accounting Standards." They are available at cost, which is one hundred ninety five dollars ($195.00) in paperback form as of the effective date of the last amendment to this rule.

08N .0210 FORECASTS

Repealed Eff. July 1, 2010.

08N .0211 RESPONSIBILITIES IN TAX PRACTICE

(a) **Standards for Tax Services**. A CPA shall not render services in the area of taxation unless the CPA has complied with the standards for tax services.

(b) **Statements on Standards for Tax Services**. The Statements on Standards for Tax Services issued by the AICPA, including subsequent amendments and editions, are hereby incorporated by reference, as provided by G.S. 150B-21.6, and shall be considered as the standards for tax services for the purposes of Paragraph (a) of this Rule.

(c) **Departures**. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) **Copies of Standards**. Copies of the Statements on Standards for Tax Services may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty nine dollars ($169.00) in paperback form or four hundred eighty six dollars ($486.00) in looseleaf subscription form as of the effective date of the last amendment to this rule.

Case Study

Responsibilities in Tax Practice

A North Carolina CPA has been preparing the personal and business tax returns for a client for several years. The client asked the CPA about a potential tax shelter that client was considering investing in. CPA stated that “it appeared to be reasonable.” Client invested in the tax shelter December 1, 2008. CPA prepared client’s tax return for 2008 claiming a large tax shelter related deduction.

In early 2010, while CPA is reviewing client’s 2009 tax return for correctness, CPA learns that the tax shelter the client invested in was listed by the IRS as an abusive tax shelter in early 2008. No tax shelter related deduction is claimed in 2009.

CPA decides to “let sleeping dogs lie” and does not inform the client of the error or of the potential penalties that could be assessed on client’s 2008 tax return.

POSSIBLE BOARD ACTIONS: Violation of 08N.0211 Responsibilities in Tax Practice. CPA was required to inform the client of the error in the 2008 return and to advise filing an amended return. In addition, CPA was required to advise client about the potential tax penalties that could be assessed.

Violation of 08N.0212 Competence. CPA should have reasonably known that the tax shelter was a listed transaction and advised client accordingly before investing and before preparing the tax return claiming the tax shelter deduction.

08N .0212 COMPETENCE

A CPA shall perform professional services competently and shall:

(1) undertake only those engagements which the CPA or CPA's firm can reasonably expect to complete with professional competence;
(2) exercise due professional care in the performance of an engagement;
(3) adequately plan and supervise an engagement; and

(4) obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to an engagement.

Case Study

Competence

Brown prepared Client's tax returns and calculated that Client would receive a $6,000 tax refund from Arizona, owe $7,000 in taxes to North Carolina, and owe $6,500 in taxes to Internal Revenue Service. Client took tax information to another Certified Public Accountant who completed the returns and made the following determination: Client would receive a $10,000 refund from Arizona, owe $6,000 to North Carolina, and owe $5,500 to IRS.

Brown agreed that he did not prepare Client's tax return correctly.

LIKELY BOARD ACTION: Violation of 08N.0212 Competence.

08N .0213 OTHER RULES

A CPA shall not willfully violate any other rule in this Chapter nor any other provision of the Accountancy Statutes, the Professional Corporation Act, or the North Carolina Limited Liability Company Act.

08N .0214 OUTSOURCING TO THIRD-PARTY SERVICE PROVIDERS

(a) A CPA shall provide a written disclosure to the client that he or she is using a third-party provider to assist the CPA in providing any professional services to the client.

(b) A CPA shall provide annual disclosures in a written statement of the services to be rendered by the third-party provider's name, address, and phone number. The written statement shall be dated, signed by both the CPA and client in advance of the outsourcing, and a copy provided to the client.

(c) A CPA outsourcing professional services to a third-party provider is responsible for ensuring a third-party provider is in compliance with all rules of Professional Conduct and Ethics in 21 NCAC 08N.

SECTION .0300 - RULES APPLICABLE TO ALL CPAs WHO USE THE CPA TITLE IN OFFERING OR RENDERING PRODUCTS OR SERVICES TO CLIENTS

08N .0301 PROFESSIONAL JUDGMENT

(a) **Professional Judgment**. A CPA shall not subordinate the CPA's professional judgment to non CPAs.

(b) **Tax Practice**. In tax practice, the CPA may resolve doubt in favor of the CPA's client as long as there is reasonable support for the CPA's position.

08N .0302 FORMS OF PRACTICE

(a) **Authorized Forms of Practice**. A CPA who uses CPA in or with the name of the business or offers or renders attest or assurance services in the public practice of accountancy to clients shall do so only through a registered sole proprietorship, partnership, Professional Corporation, Professional Limited Liability Company, or Registered Limited Liability Partnership.

Example

Mark, a North Carolina CPA, is the sole shareholder of a C Corporation that operates a local sporting goods store. Mark decides to open a CPA practice and use his office in the store to meet clients and perform his work. Mark is prohibited from operating his CPA practice under the umbrella of the sporting goods company because it is a C Corporation. Mark may either operate as a sole practitioner or one of the other permissible business forms.

(b) **Authorized Ownership**. A CPA firm may have ownership of up to 49 percent by non-CPAs. A CPA firm shall have ownership of at least 51 percent and be controlled in law and fact by holders of valid CPA certificates who have the unrestricted privilege to use the CPA title and to practice public accountancy in a jurisdiction and at least one whom shall be licensed by this Board.

(c) **CPA Firm Registration Required**. A CPA shall not offer or render professional services through a CPA firm which is in violation of the registration requirements of 21 NCAC 08J .0108, 08J .0110, or 08M .0101.

Example

Unregistered Firm Name

Mr. Black, Mr. White, and Ms. Gray offered public accounting services separately, but had an office sharing agreement. The group purchased tax software that required a single name to be issued on each tax return prepared under the software agreement. The group used the name, Black, White & Gray, LLC for this purpose, to indicate each of the individuals who would be providing tax returns under the software agreement.

Black, White & Gray LLC are required to register the name as a public accounting firm.

Is Your Firm Registered with the Board?

Although more than 50 percent of the CPAs licensed in North Carolina work in business, industry, government, and education, many of these individuals also provide or offer to provide accounting services to the public that would require an individual to register as a CPA firm with the Board.

Even though your accounting practice may be part-time and you operate it out of your home, if you use the CPA title in or with your business name or if you offer to provide or provide attest services, you must register with the Board as a CPA firm pursuant to 21 NCAC 08N.0302.

The Board considers audits, review of financial statements, examinations of prospective financial statements, compilations of financial statements, agreed-upon procedures of prospective financial statements, examinations of written assertions, and agreed-upon procedures of written assertions to be attest services.

An individual can register with the Board as an individual practitioner, partnership, professional corporation, professional limited liability company, or registered limited liability partnership.

Information about registering your CPA firm with the Board as well as the forms necessary for registering your firm with the Board, is available from the Board's website, www.cpaboard.state.nc.us.

In addition to registering your firm with the Board, if you provide attest services you must enroll in the peer review program administered by the NCACPA or AICPA pursuant to 21 NCAC8M.

Reprinted from the July 2005 issue of <u>Activity Review</u>.

(d) **Supervision of CPA Firms**. Every North Carolina office of a CPA firm registered in North Carolina shall be actively and locally supervised by a designated actively licensed North Carolina CPA whose primary responsibility and a corresponding amount of time shall be work performed in that office.

(e) **CPA Firm Requirements for CPA Ownership.** A CPA firm and its designated supervising CPA shall be held accountable for the following in regard to a CPA owner.

(1) A CPA owner shall be a natural person or a general partnership or a limited liability partnership directly owned by natural persons.
(2) A CPA owner shall actively participate in the business of the CPA firm.
(3) A CPA owner who, prior to January 1, 2006, is not actively participating in the CPA firm may continue as an owner until such time as his or her ownership is terminated.

(f) **CPA Firm Requirements for Non-CPA Ownership**. A CPA firm and its designated supervising CPA partner shall be held accountable for the following in regard to a non-CPA owner:

(1) a non-CPA owner shall be a natural person or a general partnership or limited liability partnership directly owned by natural persons;
(2) a non-CPA owner shall actively participate in the business of the firm or an affiliated entity as his or her principal occupation;
(3) a non-CPA owner shall comply with all applicable accountancy statutes and the administrative code;
(4) a non-CPA owner shall be of good moral character and shall be dismissed and disqualified from ownership for any conduct that, if committed by a licensee, would result in a discipline pursuant to G.S. 93-12(9);
(5) a non-CPA owner shall report his or her name, home address, phone number, social security number and Federal Tax ID number (if any) on the CPA firm's registration; and
(6) a non-CPA owner's name may not be used in the name of the CPA firm or held out to clients or the public that implies the non-CPA owner is a CPA.

Non-CPA Ownership – Questions and Answers From the Board

Q. Through which forms of practice may a CPA firm with non-CPA ownership practice?

A. A CPA firm with non-CPA ownership is permitted to practice through a partnership, limited liability partnership, professional corporation, or professional limited liability company.

Q. May I use the name(s) of non-CPA owner(s) in the name of my CPA firm?

A. The name(s) of non-CPA owner(s) may not be used in the name of a CPA firm. The CPA firm name may not use the terms "and associates" or "and company" unless the CPA firm has a minimum of two CPA partners in addition to the non-CPA partner(s).

Q. May I list the name(s) of the non-CPA owner(s) on the CPA firm stationery and business cards? May I list the name(s) of the non-CPA owner(s) in the yellow pages?

A. You are permitted to list the name(s) of any non-CPA owner(s) on the CPA firm stationery. However, if you place the term "partner" beside any partner's name, then the term "partner" must be placed beside every partner's name. The non-CPA owner(s) may have business cards indicating his or her name and title. He or she may also use the term "partner" on business cards. Non-CPA owners may not be listed in any yellow page listing under the heading "Certified Public Accountants." Membership in accounting organizations or their logos may not be used on CPA firm stationery, business cards, or advertising materials unless all partners are members of the organization and have attained the certification indicated by the logo.

Q. Are non-CPA owners required to register with the Board?

A. All non-CPA owners of a CPA firm are required to register with the Board using the ownership form provided by the Board. The name, home address, home telephone number, social security number/tax ID number of each non-CPA owner must be listed on the form. A sample of the CPA firm's stationery must also be provided to the Board.

Q. Who is responsible for ensuring that the non-CPA owners of a CPA firm comply with the Board's rules on professional ethics and conduct?

A. The Board does not have the authority to discipline non-CPA owners of a CPA firm for violations of the Board's rules on professional ethics and conduct. Therefore, the CPA partner who has been designated as the supervising partner of the CPA firm will be held accountable for the non-CPA owners' compliance with the Board's rules on professional ethics and conduct.

Q. If I decide to open an additional office of the firm in another location, may a non-CPA owner supervise that office?

A. The non-CPA owner may manage the office, but a CPA partner or CPA employee must actively and locally supervise the office.

Q. Are there any Board rules that I should read and understand before forming a CPA firm with non-CPA owners?

A. Before forming a CPA firm with non-CPA owners, you should be familiar with the following Board rules found in 21 NCAC:

- 08A .0301 Definitions
- 08J .0108 CPA Firm Registration
- 08N .0202(b)(10) Deceptive Conduct Prohibited
- 08N .0302 Forms of Practice
- 08N .0307 CPA Firm Names

Forms of Practice – Questions and Answers From the Board

Q. How do I know if I am required to register with the Board?

A. If you use "CPA" (or any words, letters, abbreviations, symbols, or other means of identification that indicate CPA) **IN OR WITH** the business name, the CPA must register the CPA firm with the Board. In addition, any CPA who provides, or offers to provide, an audit, a review of a financial statement, a compilation of a financial statement, an examination of a financial statement, or any agreed-upon procedure, must register his or her CPA firm with the Board.

Q. What does "uses CPA in or with the business name" mean?

A. The CPA firm name, "Fred G. Smith, CPA," is an example of using "CPA" **IN** the business name on stationery, business cards, or any form of advertising. The following examples show the use of "CPA" (or any words, letters, abbreviations, symbols, or other means of identification that indicate CPA) **WITH** the CPA firm name:

Fred G. Smith, CPA
Certified Public Accountant & Business Advisor

Fred G. Smith CPA
CPA & Consultant

Q. Am I required to register my firm with the Board if I will only prepare tax returns and will not provide any attest services or use "CPA" in or with my business name?

A. If you will prepare tax returns only and will not provide, or offer to provide, any attest services and will not use "CPA" in or with your business name, it is not necessary to register your firm with the Board.

Q. If I am an owner or an employee of a non-registered firm that provides tax preparation and business consulting services only, am I allowed to use "CPA" (or any words, letters, abbreviations, symbols, or other means of identification that indicate CPA) on the firm stationery, business cards, and any other form of advertising? Am I allowed to sign my name using "CPA"?

A. If you are an owner or an employee of a non-registered firm that provides tax preparation and business consulting services only, you are permitted to use CPA with your name on stationery, business cards, and most forms of advertising. However, you may not list yourself or your firm in **ANY** type of yellow page advertising under the heading "Certified Public Accountants." You also may not list any accounting organization membership or logo on stationery, business cards, or any form of advertising because doing so would imply that the firm is a CPA firm, which it is not. You may sign your name using "CPA."

Q. I am practicing in a firm that is not required to register with the Board. Do the Board's rules on professional ethics and conduct apply to me?

A. You are required to comply with all rules of professional ethics and conduct found in 21 NCAC 08N.0100, .0200, and .0300.

Comparison with AICPA Rule

The AICPA allows a CPA firm to be owned by non-CPAs if the form of ownership is sanctioned by the particular state, as it is in North Carolina, and if the following guidelines are observed: (1) fifty-one percent of the ownership (as measured by financial interest and voting rights) must be held by CPAs; (2) a non-CPA owner must be actively engaged in providing services to clients of the firm, and that participation must be the principal occupation of the non-CPA; (3) a CPA must be ultimately responsible for all services provided by the firm that involve financial statement attestation or other specific services; (4) a non-CPA who becomes an owner after the adoption of the AICPA resolution must have a baccalaureate degree (after 2010, the individual must have completed 150 semester hours of education); (5) a non-CPA owner must observe the AICPA Code of Professional Conduct; and (6) a non-CPA owner must complete the same number of CPE units as CPAs. In addition, a non-CPA may not hold him or herself out as a CPA, but may be referred to as a(n) principal, owner, officer, member, shareholder or other title allowed by state law.

Practice Pointer

FIRM NAMES: Every business organization or sole proprietor that performs attest services, or uses the terms "certified public accountant" or any abbreviation for such terms, or holds out to the public as being engaged in the practice of public accounting, is required to be registered as a public accounting firm with the Board of Accountancy.

False and misleading firm names. The fundamental principle that public accounting firms must keep in mind when considering a firm name relates to the rule that prohibits false and misleading firm names. Firm names that seem to comply with other provisions of the rules must finally be tested by asking the question "Is this name false or misleading to the public?"

Plural firm names. Public accounting firms that have the names of more than one licensed accountant in the firm name must have an equal number of licensed accountants in the firm. Firms that use a plural title or designation, such as "company", "associates" or "accountants", must employ at least one licensed person who works at least 20 hours per week in addition to the number of licensees who are named in the title of the firm.

Retired or deceased names. A public accounting firm may continue to include the names of one or more past partners, shareholders, owners or members in the firm name, so long as the firm name is not false or misleading to the public.

08N .0303 OBJECTIVITY AND CONFLICTS OF INTEREST

(a) **Personal Financial Interest in Advice**. When offering or rendering accounting or related financial, tax, or management advice, a CPA shall be objective and shall not place the CPA's own financial interests nor the financial interests of a third party ahead of the legitimate financial interests of the CPA's client or the public in any context in which a client or the public can reasonably expect objectivity from one using the CPA title.

(b) **Expectation of Objectivity Presumed**. If the CPA uses the CPA title in any way to obtain or maintain a client relationship, the Board will presume the reasonable expectation of objectivity.

Comparison with AICPA Rule

AICPA Rule 102 is less specific in its language mandating integrity and objectivity, but is interpreted in a very broad manner. The rule provides that "[I]n 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."

(c) **Acceptance of a Commission or Referral Fee**. A CPA shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to be supplied by a client, or receive a commission, when the CPA also performs for that client:

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

This prohibition applies during the period in which the CPA is engaged to perform any of the services listed in Subparagraph (c)(2) of this Rule and the period covered by any historical financial statements involved in such listed services.

What Is Meant By "During the Period"

The period of prohibition begins at the time the licensee has accepted an engagement to perform attest or compilation services, includes the period covered by the engagement, and extends through the report date on the engagement.

If the licensee is engaged to do attest or compilation services for a subsequent period, there would be no period of time that the licensee is not covered by this prohibition. The prohibition could extend until it is implicit that the firm is no longer providing attest or compilation services for the client, especially if the firm has been providing such services on an on-going periodic basis. Issuing a letter of resignation from providing the services would be considered reasonable documentation of the termination.

Commissions – Questions and Answers from the Board

Q. What is the difference between a commission and a referral fee?

A. A commission is compensation for recommending a product for sale or service to be provided by the CPA or a third party. The commission is always based on whether the product is purchased or the service is provided. A referral fee is compensation paid by a third party to a CPA for referring a client to the third party for the sale of a product or service to be provided by the third party. The referral fee is usually not based on whether the product is purchased or the service is provided to the client.

Q. Can I accept a commission or referral fee from an audit or review client?

A. Pursuant to 21 NCAC 08N.0303(c), a CPA shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to be supplied by a client, or receive a commission when the CPA also performs for that client an audit or review of a financial statement. In addition, a CPA or firm cannot receive a commission or referral fee from an audit or review client indirectly through another firm, alternative business structure, or affiliated company. This includes asset management fees, which for the purposes of this rule, the Board considers commissions.

A CPA may receive a commission or referral fee from a client to whom the CPA provides a compilation of a financial statement only when the CPA expects, or reasonably might expect, that a third party will not use the financial statement or if the compilation report prepared by the CPA discloses a lack of independence.

The prohibition of commissions and referral fees applies during the period in which the CPA or firm is engaged to perform the services, as well as the period covered by the historical financial statements involved in the services. Pursuant to 21 NCAC 08N.0303(e), a CPA, when accepting a commission, referral fee, or contingent fee, shall provide the client with a written disclosure regarding the service or product to be rendered or referred with the commission, referral fee, or contingent fee, to be charged or received.

Q. I have a friend who is a licensed real estate broker. May I receive a referral fee for referring a client to him? May I receive a commission if my friend sells a house to my client?

A. In North Carolina, only individuals licensed by the NC Real Estate Commission (NCREC) may receive a referral fee for the referral of a client or receive a commission for the sale of real estate, so you may not receive a referral fee or commission from your friend.

Q. My friend is a licensed insurance agent. May I receive a referral fee for referring a client to her? May I receive a commission if the client purchases a policy from my friend?

A. A CPA may receive a referral fee from a licensed agent, agency, or insurance company as long as the fee is not contingent upon the sale of an insurance product or service. The NC Department of Insurance (NCDOI) prohibits referral fees based on a sale. A CPA who is licensed by the NCDOI may be paid a commission by, or split a commission with, a licensed agent, agency, or insurance company for the sale of products or services to a client that is referred to the agent, agency, or insurance company by the CPA.

Q. I have a friend who is a stockbroker. May I receive a referral fee for referring a client to him? May I receive a commission if my friend sells stocks or mutual funds to the client?

A. A stockbroker may not pay a referral fee to any person, other than a licensed employee of the broker/dealer firm. Likewise, a stockbroker may not pay to, or split a commission with, any person other than a licensed employee of the broker/dealer firm.

Q. May a CPA receive a referral fee or commission from a registered investment advisory firm?

A. A CPA may receive a referral fee for referring a client to a registered investment advisory (RIA) firm only if the CPA is properly registered as an investment advisory representative (IA) with the RIA firm. In some cases, there may be an exception to registering as an IA. The Securities Division of the Office of the NC Secretary of State can provide information on registering as an IA or an RIA firm. A CPA may receive a commission from the RIA firm for placement of a client's funds for asset management by the RIA firm. A CPA may be registered with more than one investment advisor only in the following two situations: 1) all of the investment advisers with whom the investment adviser representative wishes to be associated are under common ownership or control, or 2) the investment adviser representative is acting as a "solicitor" for more than one investment advisory firm. A solicitor is a person who receives compensation for referring business to an investment advisory firm.

Q. What, if anything, am I required to disclose to a client if I receive a referral fee or commission?

A. A disclosure to a client regarding a referral fee or commission must meet the following requirements:

- The disclosure must be in writing;
- The disclosure must be dated;
- The disclosure must state the scope of the service or product to be rendered or referred, as well as the amount of the referral fee or commission to be charged;
- The disclosure must be made by the CPA and signed by the client within ten business days of the referral, sale, or performance of services;
- The disclosure must be made on every referral, sale, or service to be provided to the client; and
- A copy of the disclosure must be provided to the client.

(d) **Acceptance of a Contingent Fee**.

(1) The offering or rendering of professional services for, or the receipt of, a contingent fee by a CPA is not prohibited except for engaging to render or rendering by a CPA:

(A) of professional services for any person for whom the CPA also performs attest services, during the period of the attest services engagement and the period covered by any historical financial statements involved in such attest services; and

(B) for the preparation of original or amended tax returns or claims for tax refunds.

(2) (2) 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.

(e) A CPA shall communicate in advance to a client the scope of services or products to be rendered or referred for which the CPA will receive a commission, referral, or contingent fee. A CPA shall provide disclosure in a written statement within ten business days of the service or product to be rendered or referred with the commission, referral, or contingent fee to be charged or received by the CPA.

Comparison with AICPA Rule

AICPA Rule 302, like the North Carolina rule, prohibits the payment of contingent fees in connection with the preparation of an original or amended tax return or a claim for a tax refund. The AICPA rule is broader than the North Carolina rule, however, with respect to contingent fees in other areas. Both prohibit contingent fees for a member in public practice where the member of the firm performs attest services for the client. The AICPA rule also prohibits contingent fees where the member performs either of the following services in public practice: (1) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or (2) an examination of prospective financial information.

08N .0304 CONSULTING SERVICES STANDARDS

(a) **Standards for Consulting Services**. A CPA shall not render consulting services unless the CPA has complied with the standards for consulting services.

(b) **Statements on Standards for Consulting Services**. The Statements on Standards for Consulting Services (including the definition of such services) issued by the AICPA, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B 21.6, and shall be considered as the approved standards for consulting services for the purposes of Paragraph (a) of this Rule.

(c) **Departures**. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) **Copies of Statements**. Copies of the Statements on Standards for Consulting Services may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty nine dollars ($169.00) in paperback form or four hundred eighty six dollars ($486.00) in looseleaf subscription form as of the effective date of the last amendment to this rule.

08N .0305 RETENTION OF CLIENT RECORDS

(a) **Return upon Demand**. A CPA must return client records in his or her possession to the client after a demand is made for their return. The records must be returned immediately upon demand unless circumstances make some delay reasonable in order to retrieve a closed file or to extract the CPA's work papers described in Paragraph (f) of this Rule. If the records cannot be returned immediately upon demand, the CPA shall immediately notify the client of the date the records will be returned. Nothing in this Rule shall be interpreted to require a CPA to pay delivery costs when the records are returned to the client.

(b) **Who may Demand Client Records.** If the client is a partnership, records shall be returned upon request to any of its general partners. If the client is a limited partnership or a registered limited liability partnership, records shall be returned upon request to the general partner(s) and the managing partner or his or her designated individual respectively. If the client is a corporation, records shall be returned upon request to its president. If the client is a limited liability company, records shall be returned upon request to the manager. Joint records shall be returned upon request to any party.

(c) **Return of Original Records**. If the engagement is terminated prior to completion or the CPA's work product has neither been received nor paid for by the client, the CPA is only required to return those records originally given to the CPA by the client.

(d) **Retention to Force Payment**. A CPA shall not retain a client's records in order to force payment of any kind.

Example

Laurie is a North Carolina CPA who operates as a sole practitioner. One of her former clients is a local hardware store for whom she prepared tax returns for several years. The store’s owner has had an unpaid balance of $1,500 for the past several years. He recently sent a letter to Laurie requesting the return of certain records that are not CPA work product. Laurie would like to withhold the records until the remaining $1,500 is paid or at least until the store owner agrees on a repayment plan. Such conduct would violate the rule prohibiting the retention of client records in order to force payment.

(e) **Work Papers Included in Client Records**. Work papers are usually the CPA's property and need not be surrendered to the client. However, in some instances work papers will contain data which should properly be reflected in the client's books and records but for convenience have not been duplicated therein with the result that the client's records are incomplete. In such instances, the portion of the work papers containing such data constitutes part of the client's records, and copies shall be given to the client along with the rest of the client's records. Work papers considered part of the client's records include but are not limited to:

(1) Worksheets in lieu of original entry (e.g., listings and distributions of cash receipts or cash disbursements on columnar work paper);
(2) Worksheets in lieu of general ledger or subsidiary ledgers, such as accounts receivable, job cost and equipment ledgers, or similar types of depreciation records;
(3) All adjusting and closing journal entries and supporting details not fully set forth in the journal entry; and
(4) Consolidating or combining journal entries and worksheets and supporting detail used in arriving at final figures incorporated in an end product such as financial statements or tax returns.

Example

Client Records and Working Papers Requested Records

In 2007, Green decided to close her public accounting office and accept a position in private industry. Green notified clients that she was closing her office and referred clients to another Certified Public Accountant.

Client "A" received the notification from Green. In 2009, Client "A" needed a copy of her depreciation schedule to complete prior year tax returns. Client "A" left telephone messages for Green. Green did not return client's calls and did not provide client with a copy of the requested depreciation schedule.

Green is required to retain client working papers and provide Client "A" with a copy of the depreciation schedule.

(f) **Work Papers Belonging to the CPA**. Work papers developed by the CPA incident to the performance of an engagement which do not result in changes to the client's records, or are not in themselves part of the records ordinarily maintained by such clients, are solely the CPA's work papers and are not the property of the client. For example, the CPA may make extensive analyses of inventory or other accounts as part of the selective audit procedures. These analyses are considered to be a part of the CPA's work papers, even if the analyses have been prepared by client personnel at the request of the CPA. Only to the extent these analyses result in changes to the client's records would the CPA be required to furnish the details from the work papers in support of the journal entries recording the changes, unless the journal entries themselves contain all necessary details.

(g) **Reasonable Fees for Copies**. Nothing in this Rule shall be construed to require the CPA to furnish a client with copies of the client's records already in the client's possession. However, if the client asserts that such records have been lost, or are otherwise not in the client's possession, the CPA shall furnish copies of the records and may charge a reasonable fee.

(h) **Retention of Work Product and Work Papers.** A CPA shall ensure that the work product and the work papers created in the performance of an engagement for a client are retained for a minimum of five (5) years after the date of issuance of the work product unless the CPA is required by law to retain such records for a longer period.

What Happens to Client Records When a CPA Leaves the Firm or the Firm is Sold?

Years ago, a business transaction was often finalized with a handshake that represented the participants' intention to uphold the agreed-upon specifics of the deal.

However, in today's business world, it is inconceivable that weeks or months of negotiations would be concluded with a simple handshake, not a signed contract.

CPAs usually advise their clients that a written agreement among business partners is wise, yet many CPAs fail to obtain a written agreement among the partners or shareholders of their own firms.

Regardless of friendship, health, or the number of years spent working together, firms change, prompting the need for immediate action.

A CPA may decide to become a solo practitioner, join another firm, or retire. He or she may be unable to work due to family obligations or failing health.

Do you know what steps to take regarding client records if the firm is dissolved? Who takes custody of the records if a partner or shareholder leaves the firm?

What action should be taken if a CPA employee leaves the firm? What happens to client records if the firm is sold?

Although there is no single set of rules or laws that directly addresses all considerations and circumstances of such events, there are some well-established professional obligations regarding the notification of clients and the dispensation of client records.

The specific arrangements may vary from firm to firm, but in all cases, the clients must be notified and provisions should be made to allow clients access to their records.

So, what action should be taken if the firm is dissolved?

Prior to the firm's dissolution, each client should be sent a letter explaining the dissolution and offering to send a copy of the client's records elsewhere (at the client's direction and with a signed release).

If, in your firm, clients are serviced primarily by one firm member and do not have a relationship with other firm members, then each firm member may take responsibility for his or her clients' records.

However, clients must not be led to believe that they must continue the current CPA-client relationship – each client should be given the opportunity to choose who will be his or her CPA after the firm's dissolution.

Because the dissolution of a firm may not be completed for several months, arrangements should be made for client records to be centrally maintained both during and after the dissolution.

In the event that a client fails to respond to the notification of the firm's dissolution, his or her records, as well as any records not in the custody of a firm member, must continue to be centrally maintained.

If a partner or shareholder leaves the firm but the firm continues to exist, each client should be notified of the partner or shareholder's departure from the firm.

If the CPA plans to continue practicing, his or her new address and phone number should be made available to those clients who wish to continue the CPA-client relationship with that particular practitioner.

Client records should be given the option to continue receiving service from the firm or to have a copy of their records sent to another firm or CPA.

The client must always be given the opportunity to choose his or her own CPA, and a firm must not obstruct this choice in any way.

If the client no longer wants to receive services from the firm, he or she should sign a written release (or provide other written authorization) that allows the firm to provide a copy of the records to either the client or a new firm.

However, the original firm should maintain the original client record. If a client does not respond to the notification of the partner or shareholder's departure, the firm should continue to maintain all client records.

The action taken if a CPA who is not a partner or shareholder leaves a firm is similar to the action taken when a partner or shareholder leaves a firm.

Clients should be notified of the CPA's departure from the firm and given the opportunity to continue their relationship with the departing CPA.

The clients should also be advised that they may choose to continue a relationship with the firm or transfer their records to another firm.

The sale of a practice presents a unique challenge in the dispensation of client records.

The buyer generally bases his or her decision to purchase the practice on the number of clients the firm services and the revenue generated from those clients.

Although it is advisable that both the seller and the buyer contract the clients to address the continuation of services with the buyer or the dissemination of the client records, either the seller or the buyer should contact the clients to address the issue.

Despite the absence of rules or laws pertaining to the handling of client records following a firm's dissolution, personnel changes, or sale of a practice, firm members must, as always, consider how their actions will affect their clients.

Policies for handling client records should be in place before they are needed. Planning ahead will ensure continuity of quality service to clients while protecting their interests.

Although planning ahead is sometimes unpleasant, it can eliminate a great deal of worry in the future – worry that can include possible disciplinary action by the Board if clients' interests are not protected.

You and your clients will experience significantly fewer problems if there is a written agreement between the partners or shareholders which stipulates what action should be taken when changes occur in the firm.

Reprinted from the July 2005 Activity Review.

08N .0306 ADVERTISING OR OTHER FORMS OF SOLICITATION

(a) **Deceptive Advertising**. A CPA shall not seek to obtain clients by advertising or using other forms of solicitation in a manner that is deceptive.

Example

Deceptive Advertising

Green CPA ran an advertisement stating that the IRS has forgiven taxes owed by Green's clients, and that Green "can do the same for you!"

The advertisement failed to make full disclosure of the fact that in order to achieve the results, the client must qualify for the "offer in compromise" program. The advertisement misleads the public to believe that outcomes were due to Green's unique or special skills, not to the program available to qualifying individuals. Deceptive advertising like this is prohibited.

Example

Deceptive Advertising

Smith CPA LLC circulated an advertisement in a local newspaper that stated the following:

"Professional Service Warranty which guarantees you the largest refund possible with the lowest tax liability."

The advertisement guaranteed the reader the largest refund possible with the lowest tax liability. The advertisement did not state or explain how the services could be verified to provide the largest refund or the lowest tax liability and is deceptive.

(b) **Specialty Designations**. A CPA may advertise the nature of services provided to clients but the CPA shall not advertise or indicate a specialty designation or other title unless the CPA has met the requirements of the granting organization for the separate title or specialty designation and the individual is currently on active status and in good standing with the granting organization for the separate title or specialty designation.

(c) The CPA firm shall offer to perform or advertise professional services only in the exact name of the CPA firm as registered with the Board.

(d) Any CPA or CPA firm offering to or performing professional services via the Internet shall include the following information on the Internet:

(1) CPA business or CPA firm name;
(2) principal place of business;
(3) business phone; and
(4) North Carolina certificate number and North Carolina as state of certification.

Your Firm's Website: Does It Comply With Board Rules?

The Board considers a CPA firm's web site as a form of advertising, and as such, a firm's web site must comply with the Board's rules, including 21 NCAC 08N .0306, *Advertising or Other Forms of Solicitation.*

21 NCAC 08N.0306(d) states, "Any CPA or CPA firm offering to or performing professional services via the Internet shall include the following information on the Internet:

(1) CPA business or CPA firm name;
(2) principal place of business;
(3) the business phone; and
(4) North Carolina certificate number and North Carolina as state of certification."

Pursuant to 21 NCAC 08N.0306(c), a CPA firm can offer to perform or advertise professional services only in the exact name of the CPA firm as registered with the Board.

Therefore, if your firm is registered with the Board as Smith & Jones, LLP, your firm website must list the firm name as Smith & Jones, LLP, not Smith & Jones or Smith & Jones, CPAs, etc.

As with all other forms of advertising, a firm website should contain meaningful information that is not misleading or deceptive to consumers.

For example, qualitative or quantitative terms, such as "expert," "specialist," "reasonable," or "affordable" should not be used because what you consider reasonable or affordable may not be reasonable or affordable to someone else.

However, the Board does permit the use of terms such as "specializing in" or "specialization" in firm advertising, including websites.

Although a CPA may advertise the nature of services provided to clients, the CPA cannot advertise or indicate a designation or other title unless the CPA has met the requirements of the granting organization for the separate title or designation and he or she is currently on active status and in good standing with the granting organization for the separate title or designation.

Note: *The Board does not approve or authorize designations or separate titles, and the use of such designations is for public information only.*

Although the Board allows a CPA firm, on its website, to provide a description of a CPA's position within the firm or his or her professional experience, the Board limits the information that can be provided on unlicensed staff.

In a December 2001 Declaratory Ruling (*Activity Review* No, 4-2002), the Board concluded that unlicensed staff, if listed on the firm's website, must be listed in a separate section from the licensed staff.

In addition, that section must be clearly titled in such a way that the public will not be misled into believing that those staff members are licensed by this Board or otherwise authorized to render professional services without the supervision of an individual licensed by the Board.

In regards to an unlicensed staff member, the Board rules that on the firm's website, a firm can only include the unlicensed staff member's name, his or her position title, the firm's business address, and the staff member's telephone number, fax number, and e-mail address. Resume-type information for an unlicensed staff member cannot be included on the firm's website.

If your firm has a website or is developing a website, it is important to ensure that your website is in compliance with the Board's rules and guidance on advertising.

Remember, the profession and the public are best served when CPA firms and individual CPAs take the appropriate steps to ensure that the public is not confused or misled by a CPA's advertising.

If you have questions regarding your firm's website, please contact the Board's Executive Director, Robert N. Brooks, by telephone at (919) 733-1425 or by e-mail at rbrooks@nccpaboard.gov.

Portion reprinted from the August 2007 and November 2009 issues of <u>Activity Review</u>.

(e) The use of the phrase "certified public accountant(s)" or "CPA(s)" in the name of any business entity on letterhead, reports, business cards, brochures, office signs, telephone directories, or any other advertisements or forms or solicitation is prohibited except for registered CPA firms.

<u>Example</u>

Public Communications and Advertising By Firm

“A” operated as a sole proprietor from 1984 through 1999. In March 2000, “A” registered “A LLC” with the Board. In August 2004, “B” and “C” merged with “A” to form “AB&C LLC.” The website for “AB&C LLC” described the firm as “established in 1984.”

Stating that “AB&C LLC” was established in 1984 is a misrepresentation of fact.

Comparison with AICPA Rule

AICPA Rule 502 is much less specific. It merely forbids any type of solicitation of clients that is “false, misleading, or deceptive” or solicitation by the use of “coercion, overreaching, or harassing conduct.” In addition, members who are not in public practice are exempt from much of Rule 502.

08N .0307 CPA FIRM NAMES

(a) **Deceptive Names Prohibited**. A CPA or CPA firm shall not trade upon the CPA title through use of any name that would have the capacity or tendency to deceive. The name of one or more former members of the CPA firm, as defined in 21 NCAC 8A .0301, may be included in the CPA firm name. The name of a non-CPA owner in a CPA firm name is prohibited.

<u>Example</u>

Requirement to Register a Firm, CPA Firm Names

John Smith CPA was a sole practitioner who purchased the client lists of two other CPAs, Mr. Jones and Ms. Brown. Mr. Jones had recently passed away. Ms. Brown retired when Mr. Smith purchased her client list.

John Smith offered public accounting services under each of the following firm names:

John Smith CPA, LLC
Smith and Jones CPAs, LLC
Smith and Brown CPAs, LLC

CPA Smith may not practice under any of the names above unless they are registered as CPA firms with the Board. The latter two names are deceptive and are not eligible to be registered as CPA firms. Mr. Smith never practiced with Mr. Jones or Ms. Brown, and therefore may not use their names in the firm name.

(b) **Style of Practice**. It is considered misleading if a CPA firm practices under a name or style which would tend to imply the existence of a partnership or registered limited liability partnership or a professional corporation or professional limited liability company of more than one CPA shareholder or CPA member or an association when in fact there is no partnership nor is there more than one CPA shareholder or CPA member of a CPA firm. For example, no CPA firm having just one CPA owner may have as a part of its name the words "associates," “group,” or "company" or their abbreviations. It is also considered misleading if a CPA renders non-attest professional services through a non-CPA firm using a name that implies any non-licensees are CPAs.

<u>Example</u>

Firm Name – Style of Practice

Licensee applied for use of a firm name of Ace, Base & Company, CPAs PC. The Board sent a notice to the licensee declining the application for the use of the firm name because there was only one CPA in the office.

<u>Example</u>

Advertising and Style of Practice

The Board received a copy of an advertising flier used by a licensee who is registered with the Board as a sole proprietor. The flier advertised “Income Tax Preparation by Certified Public Accountants” (plural). A sole practitioner may not use the plural form “accountants.”

(c) Any CPA firm that has continuously used an assumed name approved by the Board prior to April 1, 1999, may continue to use the assumed name, so long as the CPA firm is only owned by the individual practitioner, partners, or shareholders who obtained Board approval for the assumed name. A CPA firm (or a successor firm by sale, merger, or operation of law) may continue to use the surname of a retired or deceased partner or shareholder in the CPA firm's name so long as that use is not deceptive.

Comparison with AICPA Rule

AICPA Rule 505 prohibits members from using any name that is “misleading”. This would certainly encompass any name which, according to the North Carolina rules, would be considered deceptive. The AICPA rule allows names of past owners to be included in successor organizations. In addition, an owner surviving the death or withdrawal of all other owners may continue to practice under a name which includes the names of past owners for up to two years after becoming a sole practitioner.

08N .0308 VALUATION SERVICES STANDARDS

(a) **Standards for Valuation Services.** A CPA shall not render valuation services of a business, a business ownership interest, security, or intangible asset unless the CPA has complied with the standards for valuation services.

(b) **Statements on Standards for Valuation Services.** The Statements on Standards for Valuation Services (including the definition of such services) issued by the AICPA, including amendments and editions, are hereby adopted by reference, as provided by G.S. 150B-21.6, and shall be considered as the approved standards for valuation services for the purposes of Paragraph (a) of this Rule.

(c) **Departures.** Departures from the standards listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) **Copies of Statements.** Copies of the statements on standards for valuation services may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty nine dollars ($169.00) in paperback form or four hundred eighty six dollars ($486.00) in looseleaf subscription form as of the effective date of the last amendment to this rule.

SECTION .0400 RULES APPLICABLE TO CPAs PERFORMING ATTEST SERVICES

08N .0401 PUBLIC RELIANCE

The rules in this Section apply to any CPA who engages in the attest or assurance services, as defined in 21 NCAC 8A .0301(b). CPAs who engage in such services are also subject to the Peer Review requirements of Subchapter 8M.

08N .0402 INDEPENDENCE

(a) A CPA, or the CPA's firm, who is performing an engagement in which the CPA, or the CPA's firm, will issue a report on financial statements of any client (other than a report in which lack of independence is disclosed) must be independent with respect to the client in fact and appearance.

(b) Independence shall be considered to be impaired if, during the period of the professional engagement, a covered person:

- (1) had or was committed to acquire any direct or material indirect financial interest in the client;
- (2) was a trustee of any trust or executor or administrator of any estate that had or was committed to acquire any direct or material indirect financial interest in the client; and
    - (A) The covered person had the authority to make investment decisions for the trust or estate; or
    - (B) The trust or estate owned more than 10 percent of the client's outstanding equity securities or other ownership interests or the value of the trust's or estate's holdings in the client exceeded 10 percent of the total assets of the trust or estate;
- (3) had a joint or closely held investment that was material to the covered person; or
- (4) had any loan to or from the client or any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

(c) Independence shall be considered to be impaired if during the period of the professional engagement, a shareholder, a member, a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than five percent of a client's outstanding equity securities or other ownership interests.

Example

Michael was a North Carolina CPA whose firm assigned him to the audit team of ABC, Inc., a small publicly traded company. Michael's wife, Linda, was a beneficiary of a trust that owns 7 percent of the company. While Linda does not own more than five percent of the company directly, she is clearly a beneficiary when the company performs well. She also has an indirect interest in more than five percent of the company. Thus, Michael would not be independent if he participated on the audit team of the company.

(d) Independence shall be considered to be impaired if, during the period covered by the financial statements, or during the period of the professional engagement, a shareholder, a member, a partner or professional employee of the firm was simultaneously a:

- (1) Director, officer, employee, or in any capacity equivalent to that of a member of management of the client;
- (2) Promoter, underwriter, or voting trustee of the client; or
- (3) Trustee for any pension or profit-sharing trust of the client.

(e) "Covered person" is:

- (1) A person on the attest engagement team;
- (2) A person in a position to influence the attest engagement;
- (3) A partner or manager who provides nonattest services to the attest client beginning once he or she provides 10 hours of nonattest services to the client within any fiscal year and ending on the later of the date:
  - (A) the firm signs the report on the financial statements for the fiscal year during which those services were provided; or
  - (B) he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis;
- (4) A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
- (5) The firm, including the firm's employee benefit plans; or
- (6) An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles (GAAP) for consolidation purposes) by any of the individuals or entities described in Paragraphs (a) through (e) of this Rule or by two or more such individuals or entities if they act together;

(f) The impairments of independence listed in this Rule are not intended to be all-inclusive.

08N .0403 AUDITING STANDARDS

(a) **Standards for Auditing Services**. A CPA shall not render auditing services unless the CPA has complied with the applicable generally accepted auditing standards.

(b) **Statements on Auditing Standards**. The Statements on Auditing Standards issued by the AICPA, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B 21.6, and shall be considered generally accepted auditing standards for the purposes of Paragraph (a) of this Rule.

(c) **Departures**. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) **Copies of Statements**. Copies of the Statements on Auditing Standards may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty nine dollars ($169.00) in paperback form or four hundred eighty six dollars ($486.00) in looseleaf subscription form as of the effective date of the last amendment to this rule.

Case Study

Auditing Standards

Licensee did not ask the predecessor auditor required questions prior to acceptance of the audit engagement. The licensee had some prior knowledge of the client from consulting services performed prior to the audit. This knowledge did not mitigate the violation.

LIKELY BOARD ACTION: Violation of 08N.0403 Auditing Standards.

08N .0404 ACCOUNTING AND REVIEW SERVICES STANDARDS

(a) **Standards for Accounting and Review Services**. A CPA shall not render accounting and review services unless the CPA has complied with the standards for accounting and review services.

(b) **Statements on Standards for Accounting and Review Services**. The Statements on Standards for Accounting and Review Services issued by the AICPA, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B 21.6, and shall be considered as the approved standards for accounting and review services for the purposes of Paragraph (a) of this Rule.

(c) **Departures**. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) **Copies of Statements**. Copies of the Statements on Standards for Accounting and Review Services may be inspected in the offices of the Board, as described in 21 NCAC 8A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty nine dollars ($169.00) in paperback form or four hundred eighty six dollars ($486.00) in looseleaf subscription form as of the effective date of the last amendment to this rule.

When Is a Financial Presentation a Compilation?

The AICPA Professional Standards, specifically SSARS No. 1, AR Section 100, define a compilation of financial statements as “presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements.”

The Standards define a financial statement to be “a presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity’s economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principles (GAAP) or a comprehensive basis of accounting other than GAAP.”

To determine if a compilation engagement has been performed, a CPA must differentiate a financial statement presentation from a trial balance – the Standards provide guidance for differentiating between a financial statement presentation and a trial balance.

According to the Standards, a financial statement features the combination of similar general ledger accounts to create classifications or account groupings with corresponding subtotals and totals, while a trial balance consists of a listing of all of the general ledger accounts and their corresponding balances.

When determining if a financial presentation is a compilation of financial statements, the CPA must ascertain if the financial presentation, regardless of title, intends to present financial position, results of operations, or cash flows.

If the financial presentation intends to present financial position, results of operations, or cash flows, then it is a financial statement.

SSARS No. 1 imposes no requirement on an accountant to report on financial information contained in a tax return.

In other words, if the financial presentation is part of the tax return and used for no other purpose, it would not be considered a financial statement or compilation and as such, no representation concerning such presentation would be required.

The matrix on the following page lists various types of financial data presentations and states if each presentation is a compilation of financial statements and if peer review is required.

Please note that because financial presentation titles may vary, the list is not all-inclusive.

Financial Presentation	Is It a Compilation of Financial Statements?	Is Peer Review Required?
Balance Sheet	Yes	Yes
Statement of Income	Yes	Yes
Statement of Comprehensive Income	Yes	Yes
Statement of Retained Earnings	Yes	Yes
Statement of Cash Flows	Yes	Yes
Statement of Changes in Owners' Equity	Yes	Yes
Statement of Assets and Liability (with or without owners' equity)	Yes	Yes
Statement of Revenue and Expenses	Yes	Yes
Statement of Financial Position	Yes	Yes
Statement of Activities	Yes	Yes
Summary of Operations	Yes	Yes
Statement of Operations by Product Lines	Yes	Yes
Statement of Cash Receipts and Disbursements	Yes	Yes
Trial Balance, without subtotals	No	No
Working Trial Balance, without subtotals	No	No
Adjusted Trial Balance, without subtotals	No	No
Listing of General Ledger Accounts	No	No
Reprinted from the February 2008 issue of Activity Review		

Note: *In 2009, the AICPA's Accounting and Review Services Committee removed a prohibition against stating the reasons why an accountant was not independent when performing a compilation service.*

08N .0405 GOVERNMENTAL ACCOUNTING STANDARDS

(a) **Standards for Governmental Accounting**. A CPA shall not permit the CPA's name to be associated with governmental financial statements for a client unless the CPA has complied with the standards for governmental accounting.

(b) **Statements on Governmental Accounting and Financial Reporting Services**. The Statements on Governmental Accounting and Financial Reporting Services issued by the GASB, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B-21.6, and shall be considered as the approved standards for governmental accounting for the purposes of Paragraph (a) of this Rule.

(c) **Departures**. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) **Copies of Statements**. Copies of the Statements on Governmental Accounting and Financial Reporting Standards, including technical bulletins and interpretations, may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the GASB, Post Office Box 30784, Stamford, CT 06150. They are available at cost, which is two hundred twenty eight dollars ($228.00). In addition to the basic set, an updating subscription service is available for two hundred five dollars ($205.00) annually as of the effective date of the last amendment to this rule.

08N .0406 ATTESTATION STANDARDS

(a) **Standards for Attestation Services**. A CPA shall not render attestation services unless the CPA has complied with the applicable attestation standards.

(b) **Statements on Standards for Attestation Engagements**. The Statements on Standards for Attestation Engagements issued by the AICPA, including subsequent amendments and editions, are hereby adopted by reference, as provided by G.S. 150B 21.6, and shall be considered attestation standards for the purposes of Paragraph (a) of this Rule.

(c) **Departures**. Departures from the statements listed in Paragraph (b) of this Rule must be justified by those who do not follow them as set out in the statements.

(d) **Copies of Statements**. Copies of the Statements on Standards for Attestation Engagements may be inspected in the offices of the Board, as described in 21 NCAC 08A .0102. Copies may be obtained from the AICPA, 220 Leigh Farm Road, Durham, NC 27707 as part of the "AICPA Professional Standards." They are available at cost, which is one hundred sixty nine dollars ($169.00) in paperback form or four hundred eighty six dollars ($486.00) in looseleaf subscription form as of the effective date of the last amendment to this rule.

Responding to Requests for Comfort Letters

CPAs continue to receive requests from clients, lenders, and loan brokers for “comfort letters” in which the CPA confirms client information such as the client’s self-employed status, verification of income from self-employment, profitability of a client’s business, and the impact on a client’s business if money is withdrawn to fund the down payment on a real estate purchase.

The letter at issue is usually associated with stated-income loans, which are mortgages that do not require borrowers to document their income. Such loans usually are sought by self-employed people and individuals with investment income or with sales jobs of varying commissions.

Lenders, lacking documentation to support borrowers’ income claims, take on the risk that borrowers’ claims are inadequate. To gain more comfort in extending loans, some lenders look to the borrowers’ CPA for assurance or comfort about certain information.

Most lenders will simply ask the CPA to write a letter indicating that the prospective borrower is self-employed or is employed in a certain profession. Others may attempt to shift the burden of responsibility for due diligence onto the borrower’s CPA and provide a script of what they want the letter to say.

Such a letter provides third-party verification of details in the application and could transfer some of the potential liability to the CPA in the event of default on the loan.

There are a few issues with this type of letter that should concern CPAs.

First, the proposed letter asks the CPA to attest, when the CPA has not specifically been engaged for that purpose. The report would be issued to a third party that has not contracted with the preparer for that specific purpose.

According to Auditing Standards Board Statement on Standards for Attestation Engagements No. 10, Attest Engagements, an attestation engagement is called for if the client wants a written report providing assurance about a specific subject.

Of course, performing an attestation engagement is not prohibited in the case of a lender's comfort letter request, but CPAs must follow the procedures required in an attestation engagement. The client will likely not want to incur the expense of a formal attestation engagement.

It is also important to know what is not permitted under the standards. AT Section 9101, Attest Engagements: Attest Engagements Interpretations of Section 101, No. 2, ¶ 25 states that practitioners should not provide any form of assurance that an entity is not insolvent or would not be rendered insolvent upon a proposed condition, or that an entity has the ability to pay debts as they mature.

A lender may want the CPA to make an assurance that the applicant's withdrawal of the funds for a down payment or other purposes would not put a financial strain on the applicant's self-employment business. Any representation to that effect could be construed to be a comment on solvency and would thus be prohibited under the standards.

The types of services permitted in a CPA attest report include an audit, a review, or a compilation of the applicant's personal financial statements. The CPA may also report on pro forma financial information or perform an agreed-upon procedures report, as long as those procedures do not provide any assurance on matters of solvency.

The important thing to consider is that this type of engagement requires many procedural steps, which take time and result in significant fees to the client.

If the CPA takes the time to explain to the lender what is involved in presenting a comfort letter in light of professional standards and the related cost to the applicant of issuing any attestation letter, the lender may be convinced to withdraw its request for a comfort letter.

As an alternative, the CPA may offer to send a copy (with the client's written authorization) of the client's tax forms directly to the lender with a simple cover page stating, "Please find attached the tax forms I prepared for Client for the past two years."

Sometimes the broker does not want the tax forms in the application file because the forms do not provide enough information or may provide information that might cause the loan to be rejected.

Another option is to provide the lender with a CPA letter that basically makes no assurances, therefore limiting the CPA's liability. The letter merely says that the CPA prepared the tax forms and that the lender should not construe the letter to be an audited CPA representation.

Although from a risk management perspective it is preferable to avoid confirming any client information to a lender or broker, a CPA, not wanting to alienate or offend a client, may be tempted to send off a quick letter to the lender confirming that the client is self-employed, or retired, or earning a living from the activities addressed on the tax return.

The CPA should be careful about sending such a letter. Does the CPA really know everything that is occurring with that client? Does the client have other activities on the side that the CPA is not aware of and that conflict with the information on the tax forms? A CPA is certain about what he or she puts on tax forms. Saying anything else in the letter advances the tax engagement to a new level.

When asked to provide a comfort letter for a client, a CPA can best avoid risk by sticking to the professional standards and not caving in to pressure from a client or lender. While clients need to have the flexibility to obtain credit, the responsibility for underwriting the loan lies with the lender, not the CPA.

Reprinted from the September 2009 issue of Activity Review

08N .0407 COMPETITIVE BIDDING

Regarding an invitation for competitive bids on attest services, it shall be discreditable for a CPA or CPA firm to knowingly offer to perform said services below cost for the purposes of injuring or destroying competition; provided, it shall not be a violation to do so in order to meet competition. Nothing herein shall be construed to prohibit competitive bidding nor establish a minimum price of any CPA service.

Example

Jones & Jones and Thomson & Thomson are both North Carolina accounting firms offering attest services. XYZ, Inc. recently went public and is now soliciting an outside firm to provide attest services. Jones & Jones and Thomson & Thomson are the main competitors for the contract. Jones & Jones only recently began offering attest services and its partners feel it can attract more customers if it lands this account. It therefore places a bid that, if accepted, will cause the firm to break even on the contract. However, the firm feels it will benefit in the long run by securing similar business from other firms. This practice is not discreditable. It is not aimed at injuring Thomson & Thomson and will not result in a loss of revenue.

08N .0408 PEER REVIEW STANDARDS

A CPA who is engaged to perform a peer review shall not violate the rules or standards as set in Subchapter 8M of the peer review program under which the review is made or the engagement contract connected with that peer review.

North Carolina Statutes: Chapter 93 Certified Public Accountants

References in the section are to General Statutes of North Carolina, 2009, as amended.

Note: Portions of the statutes related to obtaining a CPA certificate have been omitted, as anyone taking this course already has a CPA certificate.

§ 93-1. Definitions; practice of law.

(a) Definitions. – As used in this Chapter certain terms are defined as follows:

(1) An "accountant" is a person engaged in the public practice of accountancy who is not a certified public accountant as defined in this Chapter.

(2) "Board" means the Board of Certified Public Accountant Examiners as provided in this Chapter.

(3) A "certified public accountant" is a person who holds a certificate as a certified public accountant issued under the provisions of this Chapter.

(4) A person is engaged in the "public practice of accountancy" who holds himself out to the public as a certified public accountant or an accountant and in consideration of compensation received or to be received offers to perform or does perform, for other persons, services which involve the auditing or verification of financial transactions, books, accounts, or records, or the preparation, verification or certification of financial, accounting and related statements intended for publication or renders professional services or assistance in or about any and all matters of principle or detail relating to accounting procedure and systems, or the recording, presentation or certification and the interpretation of such service through statements and reports.

(b) Practice of Law. – Nothing in this Chapter shall be construed as authorizing certified public accountants or accountants to engage in the practice of law, and such person shall not engage in the practice of law unless duly licensed so to do.

Are You Practicing Law?

North Carolina General Statute (NCGS) 93-1(b) prohibits CPAs from engaging in the practice of law unless duly licensed to do so; NCGS 84-2.1 and 4 define which activities constitute the practice of law.

The statutes identify certain specific activities as the practice of law, including the organizing of corporations, the preparation and filing of legal pleadings, the preparation and filing of estate inventories and accountings with the Clerk, and the preparation of wills and trusts.

The North Carolina State Bar has consistently held that the preparation of articles of incorporation and corporate bylaws is the practice of law.

The filing of an initial and ninety-day inventory and accountings for an estate with a Clerk of Court is also considered the practice of law.

However, providing assistance to clients in preparation of the information for estate filings is permissible.

Although attorneys also provide these services, CPAs may file fiduciary, federal estate, and North Carolina inheritance tax returns for an estate.

According to the statutes, the statutory listing of activities constituting the practice of law is neither exclusive nor exhaustive.

The statutes also prohibit non-lawyers from representing parties in quasi-judicial proceedings.

Accordingly, the State Bar has previously ruled that representing a third party before the regular Tax Review Board constitutes the practice of law as it is expressly defined as a quasi-judicial proceeding.

Although the State Bar has not had an opportunity to consider representation of third parties before the augmented Tax Review Board, the State Bar states that any proceeding at which evidence and legal arguments are presented with a right of appeal to the courts should be considered as quasi-judicial.

21 NCAC 08N.0204 states that CPAs shall not act in a way that would cause them to be disciplined by a federal or state agency or board for violation of laws, rules, or ethics.

Reprinted from the January 2010 issue of <u>Activity Review</u>.

§ 93-2. Qualifications. Any person who is a citizen of the United States, has declared the intention of becoming a citizen, is a resident alien, or is a citizen of a foreign jurisdiction which extends to citizens of this State like or similar privileges to be examined or certified, and who is over 18 years of age and of good moral character, and who has received from the State Board of Certified Public Accountant Examiners a certificate of qualification to practice as a certified public accountant shall be licensed to practice and be styled and known as a certified public accountant.

§ 93-3. Unlawful use of title "certified public accountant" by individual. It shall be unlawful for any person who has not received a certificate of qualification or not been granted a practice privilege under G.S. 93-10 admitting the person to practice as a certified public accountant to assume or use such a title, or to use any words, letters, abbreviations, symbols or other means of identification to indicate that the person using same has been admitted to practice as a certified public accountant.

§ 93-4. Use of title by firm. It shall be unlawful for any firm, co-partnership, or association to assume or use the title of certified public accountant, or to use any words, letters, abbreviations, symbols or other means of identification to indicate that the members of such firm, co-partnership or association have been admitted to practice as certified public accountants, unless each of the members of such firm, co-partnership or association first shall have received a certificate of qualification from the State Board of Certified Public Accountant Examiners or been granted a practice privilege admitting each member of the firm, co-partnership, or association to practice as a certified public accountant; provided, however, that the Board may exempt those persons who do not actually practice in or reside in the State of North Carolina from registering and receiving a certificate of qualification under this section.

§ 93-5. Use of title by corporation. It shall be unlawful for any corporation to assume or use the title of certified public accountant, or to use any words, letters, abbreviations, symbols or other means of identification to indicate that such corporation has received a certificate of qualification from the State Board of Certified Public Accountant Examiners admitting it to practice as a certified public accountant.

§ 93-6. Practice as accountants permitted; use of misleading titles prohibited. It shall be unlawful for any person to engage in the public practice of accountancy in this State who is not a holder of a certificate as a certified public accountant issued by the Board, unless such person uses the term "accountant" and only the term "accountant" in connection with his name on all reports, letters of transmittal, or advice, and on all stationery and documents used in connection with his services as an accountant, and refrains from the use in any manner of any other title or designation in such practice.

§ 93-8. Public practice of accounting by corporations prohibited. It shall be unlawful for any certified public accountant to engage in the public practice of accountancy in this State through any corporate form, except as provided in General Statutes Chapter 55B.

§ 93-9. Assistants need not be certified. Nothing contained in this Chapter shall be construed to prohibit the employment by a certified public accountant or by any person, firm, copartnership, association, or corporation permitted to engage in the practice of public accounting in the State of North Carolina, of persons who have not received certificates of qualification admitting them to practice as certified public accountants, as assistant accountants or clerks: Provided, that such employees work under the control and supervision of certified public accountants and do not certify to anyone the accuracy or verification of audits or statements; and provided further, that such employees do not hold themselves out as engaged in the practice of public accounting.

§ 93-10. Practice privileges.

(a) An individual whose principal place of business is outside this State is granted the privilege to perform or offer to perform services, whether in person or by mail, telephone, or electronic means, in this State as a certified public accountant without notice to the Board, the submission of any other documentation, or the payment of any fee if the individual meets all of the following conditions:

(1) Holds a valid and unrevoked certificate as a certified public accountant, or its equivalent, issued by another state, a territory of the United States, or the District of Columbia.

(2) Holds a valid and unrevoked license or permit to practice as a certified public accountant issued by another state, a territory of the United States, or the District of Columbia.

(3) Has passed the Uniform CPA Examination.

(4) Has not been convicted of a felony under the laws of the United States, any state, a territory of the United States, or the District of Columbia and has never been convicted of a crime, an essential element of which is dishonesty, deceit, or fraud unless the jurisdiction in which the individual is licensed has determined the felony or other crime has no effect on the individual's license.

(b) An individual who satisfies the requirements of subsection (a) of this section and exercises the privilege afforded under this section by performing or offering to perform services as a certified public accountant in this State simultaneously consents as a condition of the grant of this privilege to:

(1) Comply with the laws of this State, the provisions of this Chapter, and rules adopted by the Board.

(2) Have an administrative notice of hearing served on the licensing board in the individual's principal state of business, notwithstanding the individual notice requirements of G.S. 150B-38.

(3) Be subject to personal jurisdiction, subject matter jurisdiction, and disciplinary authority of the Board.

(c) A firm whose principal place of business is outside this State and has no office in this State is granted the privilege to perform or offer to perform services, whether in person or by mail, telephone, or electronic means, in this State as a firm without notice to the Board, submission of any other documentation, or payment of any fee, except as otherwise provided in subdivision (3) of this subsection. A firm that exercises the privilege afforded under this section simultaneously consents as a condition of the grant of the privilege to:

(1) Comply with the laws of this State, the provisions of this Chapter, and rules adopted by the Board.

(2) Be subject to personal jurisdiction, subject matter jurisdiction, and disciplinary authority of the Board.

(3) Provide notice without a fee to the Board if any individual with the firm who has been granted privileges in North Carolina to practice as a certified public accountant performs any of the following services for a client in this State:

a. A financial statement audit or other engagement performed in accordance with the Statements on Auditing Standards.

b. An examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements.

c. An engagement performed in accordance with the Public Company Accounting Oversight Board auditing standards."

§ 93-11. Not applicable to officers of State, county or municipality. Nothing herein contained shall be construed to restrict or limit the power or authority of any State, county or municipal officer or appointee engaged in or upon the examination of the accounts of any public officer, his employees or appointees.

§ 93-12. Board of Certified Public Accountant Examiners. The name of the State Board of Accountancy is hereby changed to State Board of Certified Public Accountant Examiners and said name State Board of Certified Public Accountant Examiners is hereby substituted for the name State Board of Accountancy wherever the latter name appears or is used in Chapter 93 of the General Statutes. Said Board is created as an agency of the State of North Carolina and shall consist of seven members to be appointed by the Governor, five persons to be holders of valid and unrevoked certificates as certified public accountants issued under the provisions of this Chapter and two persons who are not certified public accountants who shall represent the interest of the public at large. Members of the Board shall hold office for the term of three years and until their successors are appointed. Appointments to the Board shall be made under the provisions of this Chapter as and when the terms of the members of the present State Board of Accountancy expire; provided, that all future appointments to said Board shall be made for a term of three years expiring on the thirtieth day of June. All Board members serving on June 30, 1980, shall be eligible to complete their respective terms. No member appointed to a term on or after July 1, 1980, shall serve more than two complete consecutive terms. The powers and duties of the Board shall be as follows:

(1) To elect from its members a president, vice-president, and secretary-treasurer. The members of the Board shall receive compensation and reimbursement for travel expenses in accordance with G.S. 93B-5.

(2) To employ legal counsel, clerical and technical assistance and to fix the compensation therefore, and to incur such other expenses as may be deemed necessary in the performance of its duties and the enforcement of the provisions of this Chapter. Upon request the Attorney General of North Carolina will advise the Board with respect to the performance of its duties and will assign a member of his staff, or approve the employment of counsel, to represent the Board in any hearing or litigation arising under this Chapter. The Board may, in the exercise of its discretion, cooperate with similar boards of other states, territories and the District of Columbia in activities designed to bring about uniformity in standards of admission to the public practice of accountancy by certified public accountants, and may employ a uniform system of preparation of examinations to be given to candidates for certificates as certified public accountants, including the services and facilities of the American Institute of Certified Public Accountants, or of any other persons or organizations of recognized skill in the field of accountancy, in the preparation of examinations and assistance in establishing and maintaining a uniform system of grading of examination papers, provided however, that all examinations given by said Board shall be adopted and approved by the Board and that the grade or grades given to all persons taking said examinations shall be determined and approved by the Board.

(3) To formulate rules for the government of the Board and for the examination of applicants for certificates of qualification admitting such applicants to practice as certified public accountants.

(4) To hold written, oral, and computer-based examinations of applicants for certificates of qualification at least once a year, or more often, as may be deemed necessary by the Board.

(5) To issue certificates of qualification admitting to practice as certified public accountants, each applicant who, having the qualifications herein specified, has passed an examination to the satisfaction of the Board, in "accounting," "auditing," "business law," and other related subjects.

(6) In its discretion to grant certificates of qualification admitting to practice as certified public accountants such applicants who shall be the holders of valid and unrevoked certificates as certified public accountants, or the equivalent, issued by or under the authority of any state, or territory of the United States or the District of Columbia, when in the judgment of the Board the requirements for the issuing or granting of such certificates or degrees are substantially equivalent to the requirements established by this Chapter: Provided, however, that the state or political subdivision of the United States upon whose certificate the reciprocal action is based grants the same privileges to holders of certificates as certified public

accountants issued pursuant to the provisions of this Chapter. The Board, by general rule, may grant temporary permits to applicants under this subsection pending their qualification for reciprocal certificates.

(7) To charge for each examination provided for in this Chapter a fee not exceeding four hundred dollars ($400.00). In addition to the examination fee, if the Board uses a testing service for the preparation, administration, or grading of examinations, the Board may charge the applicant the actual cost of the examination services. The applicant shall pay all fees and costs associated with the examination at the time the application is filed with the Board. Examination fees and costs shall not be refunded unless the Board deems the applicant ineligible for examination.

(7a) To charge for each initial certificate of qualification provided for in this Chapter a fee not exceeding one hundred fifty dollars ($150.00).

(7b) To require an annual registration of each firm and to charge an annual registration fee not to exceed two hundred dollars ($200.00) for each firm with one office, and a fee not to exceed twenty-five dollars ($25.00) for each additional North Carolina office of the firm, to defray the administrative costs of accounting practice review programs. The Board may charge an annual fee not to exceed twenty-five dollars ($25.00) for each firm application for exemption from the accounting practice review program.

(8) To require the renewal of all certificates of qualification annually on the first day of July, and to charge an annual renewal fee not to exceed one hundred dollars ($100.00).

(8a) To require the registration of certified public accountant firms which have offices both within and outside of North Carolina, and the payment by such firms of an annual registration fee based on the total number of partners in each such firm, but not to exceed two thousand five hundred dollars ($2,500) per firm per year.

(8b) To formulate rules for the continuing professional education of all persons holding the certificate of certified public accountant, subject to the following provisions:

a. After January 1, 1983, any person desiring to obtain or renew a certificate as a certified public accountant must offer evidence satisfactory to the Board that the person has complied with the continuing professional education requirement approved by the Board. The Board may grant a conditional license for not more than 12 months for persons who are being licensed for the first time, or moving into North Carolina, or for other good cause, in order that the person may comply with the continuing professional education requirement.

b. The Board shall adopt rules for the administration of the continuing professional education requirement with a minimum number of hours of 20 and a maximum number of hours of 40 per year, and the Board may exempt persons who are retired or inactive from the continuing professional education requirement. The Board may also permit any certified public accountant to accumulate hours of continuing professional education in any calendar year of as much as two additional years annual requirement in advance of or subsequent to the required calendar year.

c. Any applicant who offers satisfactory evidence on forms promulgated by the Board that the applicant has participated in a continuing professional education program of the type required by the Board shall be deemed to have complied with this subdivision.

Check Your CPE Carryforward Online

Licensees can now verify their CPE carryforward through the Board's website, www.nccpaboard.gov.

To verify your hours, use the "Licensee Search" function of the website to search for yourself using your name, certificate number, or social security number.

After your record is displayed, click on the "details" link. The number of CPE carryforward hours will be displayed below your address and telephone number.

If there is a discrepancy in the number of carryforward hours, please contact Cammie Emery by e-mail at cemery@nccpaboard.gov.

(8c) The Board may formulate rules and regulations for report review and peer review of audits, reviews, compilations, and other reports issued on financial information in the public practice of accountancy of all firms, as herein defined, subject to the following provisions:

a. After June 30, 1992, any firm desiring to obtain or maintain a registration as a firm must offer satisfactory evidence to the Board that such firm has complied with the peer review and report review requirements approved by the Board; provided, however, that the Board shall give to every firm subject to this section not less than 12 months advance notice of each peer review and report review required of the firm.

b. The Board may grant a conditional registration for not more than 24 months for firms which are being registered for the first time, or moving into North Carolina, or for other good cause, in order that such firm may comply with the report review and peer review requirements, and in order that the Board may develop a system of review rotation among the various firms that must comply with this section.

c. The peer review and report review shall be valid for a minimum of three years subject to the power of the Board to require remedial action by any firm with a deficiency in the review according to the rules established by the Board.

d. The Board shall promulgate rules and regulations for the administration of the report review and peer review requirements and the Board shall exempt firms that show to the satisfaction of the Board that they are not engaged in the public practice of accountancy or that the scope of their practice does not come within the peer review and report review guidelines established by the Board.

e. Any firm that offers satisfactory evidence to the Board that the firm has satisfactorily participated in and successfully completed a peer review or a report review of the type required by the Board shall be deemed to have complied with this section and the Board shall promulgate rules and regulations for the administration of this procedure.

f. For purposes of this section, a firm means an entity, sole proprietorship, partnership, registered limited liability partnership, professional limited liability company, or professional corporation through which one or more certificate holders engage in the public practice of accountancy through an office.

(9) Adoption of Rules of Professional Conduct; Disciplinary Action. – The Board shall have the power to adopt rules of professional ethics and conduct to be observed by certified public accountants in this State. The Board shall have the power to revoke, either permanently or for a specified period, any certificate issued under the provisions of this Chapter to a certified public accountant or to censure the holder of any such certificate or to assess a civil penalty not to exceed one thousand dollars ($1,000) for any one or combination of the following causes:

a. Conviction of a felony under the laws of the United States or of any state of the United States.

b. Conviction of any crime, an essential element of which is dishonesty, deceit or fraud.

c. Fraud or deceit in obtaining a certificate as a certified public accountant.

d. Dishonesty, fraud or gross negligence in the public practice of accountancy.

e. Violation of any rule of professional ethics and professional conduct adopted by the Board.

Change of Address

21 NCAC 08J.0107 requires all licensees and firms to notify the Board in writing within 30 days of any change in address or business location.

Licensees and firms can now make address changes online through the “Address Update” link on the Board’s website, www.nccpaboard.gov.

Address changes may also be submitted by fax, e-mail, or U.S. mail.

Exam candidates must submit address changes by fax, e-mail, or U.S. mail.

Any disciplinary action taken shall be in accordance with the provisions of Chapter 150B of the General Statutes. The clear proceeds of any civil penalty assessed under this section shall be remitted to the Civil Penalty and Forfeiture Fund in accordance with G.S. 115C-457.2.

(12) To submit annually on or before the first day of May to the Secretary of Revenue the names of all persons who have qualified under this Chapter as certified public accountants. Privilege license issued under G.S. 105-41 shall designate whether such license is issued to a certified public accountant or an accountant.

(13) The Board shall keep a complete record of all its proceedings and shall annually submit a full report to the Governor.

(14) All fees collected on behalf of the Board and all receipts of every kind and nature, as well as the compensation paid the members of the Board and the necessary expenses incurred by them in the performance of the duties imposed upon them, shall be reported annually to the State Treasurer. All fees and other moneys received by the Board pursuant to the provisions of the General Statutes shall be kept in a separate fund by the treasurer of the Board, to be held and expended only for such purposes as are proper and necessary to the discharge of the duties of the Board and to enforce the provisions of this Chapter. No expense incurred by the Board shall be charged against the State.

(15) Any certificate of qualification issued under the provisions of this Chapter, or issued under the provisions of Chapter 157 of the Public Laws of 1913, shall be forfeited for the failure of the holder to renew same and to pay the renewal fee therefore to the State Board of Accountancy within 30 days after demand for such renewal fee shall have been made by the State Board of Accountancy.

(16) To apply to the courts, in its own name, for injunctive relief to prevent violations of this Chapter or violations of any rules adopted pursuant to this Chapter. Any court may grant injunctive relief regardless of whether criminal prosecution or any other action is instituted as a result of the violation. A single violation is sufficient to invoke the injunctive relief under this subdivision.

(17) The Board shall have the power to acquire, hold, rent, encumber, alienate, and otherwise deal with real property in the same manner as a private person or corporation, subject only to approval of the Governor and the Council of State as to the acquisition, rental, encumbering, leasing, and sale of real property. Collateral pledged by the Board for an encumbrance is limited to the assets, income, and revenues of the Board.

§ 93-12.1. Effect of new requirements. Any person who applies to the Board of Certified Public Accountant Examiners before July 1, 1983, to take the examination, who meets the educational requirement as it existed prior to June 4, 1979, and complies with any of the experience requirements of this Chapter shall be deemed to have met the prerequisites to taking such examination.

§ 93-12.2. Board records are confidential. Records, papers, and other documents containing information collected or compiled by the Board, its members, or employees, as a result of a complaint, investigation, inquiry, or interview in connection with an application for examination, certification, or registration, or in connection with a certificate holder's professional ethics and conduct, shall not be considered public records within the meaning of Chapter 132 of the General Statutes. Any notice or statement of charges against a certificate holder or applicant, or any notice to a certificate holder or applicant of a hearing to be held by the Board is a public record, even though it may contain information collected and compiled as a result of a complaint, investigation, inquiry, or interview conducted by the Board. If any record, paper, or other document containing information collected and compiled by the Board is admitted into evidence in a hearing held by the Board, it shall then be a public record within the meaning of Chapter 132 of the General Statutes.

Disciplinary Actions Available Online

The Board recently updated its website, www.nccpaboard.gov, to include public record information regarding disciplinary action taken against individual CPAs as well as CPA firms.

In the past, this information was available only by submitting a written request to the Board.

If the Board has taken formal disciplinary action against a CPA or CPA firm, the resulting Consent Order or Board Order is included in the record for that individual or firm.

§ 93-13. Violation of Chapter; penalty. A violation of G.S. 93-3, 93-4, 93-5, 93-6, or 93-8 shall be a Class 1 misdemeanor.

Essential Continuing Professional Education Information

General Information – All CPAs on active, "can't use title," or probationary status must comply with the CPE requirements and pay an annual renewal fee. A licensee is required to complete at least 40 hours of CPE per calendar year to renew his or her certificate. The deadline for reporting CPE credit earned is June 30. CPE hours are reported during the online certificate renewal process. Detailed listings of courses taken to meet the requirement are not submitted to the Board unless a licensee receives a letter specifically requesting such documentation. CPE hours must be rounded down to the nearest half-hour after the first full hour of credit has been earned. The Board's CPE rules are found in Title 21, North Carolina Administrative Code (NCAC), Chapter 08G, Section .0400. Please refer to the Board's web site, www.nccpaboard.gov, for the current CPE rules.

Self-Study Courses – At least eight (8) hours of CPE credit earned in any calendar year must be non self-study, excluding any carry-forward hours used to meet the minimum requirement. Another self-study rule stipulates that the amount of credit for all self-study courses is based on the average completion time in 50 minute hours as determined by the sponsor. Questions regarding the way the sponsor calculated the hours recommended must be answered by the course provider.

One example of self-study material that **does not** meet the Board's requirement for appropriate instructional design is a "course" that consists of an examination on periodicals, guides, magazines, subscription services, books, reference manuals, and supplements (e.g., Journal of Accountancy, CPE Direct, tax services and handbooks, audit guides, etc.). Such programs do not meet this requirement because the material studied is not designed primarily for CPE purposes [21 NCAC 08G .0404(e)].

Ethics CPE Requirement – 21 NCAC 08G .0410 requires all licensees to take annually either two hours of Board-approved ethics CPE in a group study format or four hours of Board-approved ethics CPE in a self-study format. Information on courses that will satisfy the requirement is made available to licensees in the Board's newsletter, the Activity Review, and on the Board's web site, www.nccpaboard.gov. A non-resident licensee who does not have an office in North Carolina is considered to have met the Board's ethics requirement if he or she meets the ethics requirement in the jurisdiction where the licensee is licensed and works or resides. If the jurisdiction of employment or residence does not require an ethics program, one of the North Carolina-approved courses must be completed. Submit questions regarding the ethics CPE requirement to Cammie Emery by e-mail at cemery@nccpaboard.gov.

Registered Sponsors – The Board registers sponsors that agree to conduct programs that enhance a CPA's professional skills and meet other minimum standards. These organizations have also agreed to keep records of their programs for five years. This requirement removes some of the burden of recordkeeping for CPAs taking the course, but it does not automatically mean that a CPA may claim credit for a course. A licensee is responsible for selecting the CPE courses he or she attends, and a licensee should pick only those courses that will improve his or her professional competence. The Board's office maintains a database of registered CPE sponsors on its web site, www.nccpaboard.gov. The Board's staff can only confirm that a sponsor is registered, not that a particular course can be used for CPE purposes. Due to the large number of licensees and the volume of courses offered, the Board cannot "pre-approve" CPE courses.

Excerpt taken from the March 2010 issue of Activity Review.

CHAPTER 4 – REVIEW QUESTIONS

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

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

Use the following fact pattern taken from the case history of an actual CPA. Only the names have been changed:

> The Board received information that Mr. Jay Green, CPA (Green) was formerly known as John Grey. John Grey (Grey) legally changed his name to Jay Green sometime between 1980 and 1989. Grey entered a guilty plea to two felony charges for possession of a controlled substance in 1987.
>
> Jay Green sat for the CPA exam and was granted a CPA certificate in 1995. Green did not disclose either the felony convictions or his former name on any application made to the Board for the exam or licensing, or on any renewal form.
>
> Green worked as a controller in private industry. His last employer filed a civil suit against Green alleging breach of contract and breach of duty of good faith and fair dealings (appropriating company information to his own use and benefit, and manipulating the books in order to show a profit by creating a false invoice earning Green a bonus), breach of duty of loyalty (showing his potential partner the financial records of the employer) and conversion of property (charging the employer's credit card for unauthorized purchases and taking items from the employer's premises for his personal use). A summary judgment was issued against Green on each of these charges. Green's CPA license lapsed for failure to complete required CPE.
>
> Green is the sole owner of ABC Tax Services, an unregistered accounting firm, which advertises in the yellow page directory. This advertisement includes misleading information stating that the firm has "Certified public accountants & business advisors specializing in individuals and small business." Green failed to respond to numerous Board letters and requests for information.

Based on the above, Green committed multiple violations of the rules of professional ethics.

1. Green CPA has violated the rules of professional ethics by failing to disclose the two felony guilty pleas.

   a) true
   b) false

2. Although Green was held responsible in a civil suit by his former employer, his actions while employed are not violations of the rules of professional conduct.

   a) true
   b) false

3. Green's failure to complete CPE was not a violation of the rules of professional conduct since Green was employed primarily in private industry.

   a) true
   b) false

4. Green CPA has violated the rules related to CPA firm registration.

   a) true
   b) false

CHAPTER 4 – SOLUTIONS AND SUGGESTED RESPONSES

1. **A: True is correct.** Rule 08N.0202(b)(3) prohibits deception in obtaining or maintaining certification by failing to disclose the two felony guilty pleas. Rule 08N.0208 requires notification of any criminal action.

   B: False is incorrect. Rule 08N.0202 prohibits certain deceptive conduct. Review that rule and reread the question.

   (See Rule 08N.0202 in the course material.)

2. A: True is incorrect. Green has committed numerous violations of the rules. Review Rule 08N.0203, *Discreditable Conduct Prohibited*, and reread the question.

   B: False is correct. Green had committed numerous violations of 08N.0203(b)(1) by acts that reflect adversely on the CPA's honesty and integrity.

   (See Rule 08N.0203 in the course material.)

3. A: True is incorrect. Green still held out as a CPA to obtain clients for his tax preparation business which is deceptive. Read Rule 08N.0202 and 08N.0203 then reread the question.

   B: False is correct. By holding out as a CPA while lapsed, Green violated numerous ethics rules.

   (See pages 4-4 to 4-6 of the course material.)

4. **A: True is correct.** Green violated Rule 08N.0302(a) by being an unregistered firm and 08N.0302(b) by owning the firm while his CPA license was lapsed. He also used deceptive advertising by using the CPA title while his license was lapsed.

   B: False is incorrect. Green has violated numerous rules. Read section .0300 in its entirety and then reread the question.

   (See pages 4-15 to 4-19 of the course material.)

CHAPTER 5: ETHICS AND THE TAX PROFESSIONAL

Objectives: After completing this chapter, you will be able to:

- Discuss the Internal Revenue Service Requirements as outlined in Circular 230.
- Describe the applicable AICPA guidance on tax practice.
- Apply the AICPA standards and the IRS rules to common ethical dilemmas faced by CPAs in tax practice.

Introduction

The tax preparation and tax consulting industry has historically enjoyed less government regulation than the practice of accountancy. In most states (California being a notable exception), no professional license is required to prepare income taxes. One simply hangs out a shingle and begins business. There are currently no federal registration requirements for tax preparers. In 1995, the IRS proposed studying the concept of tax preparer registration in order to combat rising fraud in the earned income credit program. This proposal was dropped because of widespread industry opposition. Instead, the IRS increased the scrutiny applied to firms applying to file tax returns electronically. In 2010, the IRS proposed regulations requiring the registration of tax preparers.

The tax practice field has had less ethical guidance because of the unique relationship between the CPA and client. In an attest engagement, the CPA is ultimately responsible to the users of the client financial statements as well as to the client. In a tax engagement the CPA is an “advocate of the taxpayer.” The courts have held that there is nothing illegal or sinister in a taxpayer arranging one’s affairs so as to pay the lowest tax legally available.

Nevertheless, CPAs in tax practice do have two sets of ethical and legal guidance which governs their tax practice. Circular 230 governs practice before the Internal Revenue Service. The AICPA has issued statements on standards for tax services. We will examine both of these items, pointing out the differences wherever relevant.

Circular 230

Circular 230 is published by the Treasury Department. It prescribes regulations governing the practice of attorneys, CPAs, EAs, Enrolled Actuaries, appraisers, and others before the Internal Revenue Service. Circular 230 has been amended several times recently, and more changes are proposed. This course reprints and discusses most, but not all, of Circular 230.

Explanations of Provisions

Tax advisors play an increasingly important role in the federal tax system, which is founded on principles of voluntary compliance. The tax system is best served when the public has confidence in the honesty and integrity of the professionals providing tax advice. To restore, promote, and maintain the public’s confidence in those individuals and firms, Circular 230 sets forth regulations and best practices applicable to all tax advisors. Circular 230 regulations are limited to practice before the IRS and do not alter or supplant other ethical standards applicable to practitioners.

<u>What is not considered "practice before the IRS"</u>

Section 10.7 of Circular 230 provides a long list of exceptions and exclusions to Circular 230. The following persons and situations are <u>not</u> considered "practicing before the IRS" and therefore are generally exempt from the rules we will discuss later in this course.

A. Representing oneself – individuals may always appear on their own behalf before the IRS.
B. Participating in rulemaking – individuals may participate in rule making.
C. Limited practice – in a number of circumstances an individual who is not a practitioner can represent a taxpayer on a limited basis:

    i. An individual may represent a member of his or her immediate family.
    ii. A regular full-time employee of an individual employer may represent the employer
    iii. A general partner or regular full-time employee of a partnership may represent the partnership
    iv. A bona fide officer or a regular full-time employee of a corporation may represent the corporation
    v. A trustee, receiver, guardian, personal representative, administrator, executor, or regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate
    vi. An individual may represent any individual or entity before personnel of the Internal Revenue Service who are outside of the United States
    vii. An individual who prepares and signs a taxpayer's return as the preparer, or who prepares a return but is not required (by the instructions to the return or regulations) to sign the return, may represent the taxpayer before officers and employees of the Examination Division of the Internal Revenue Service with respect to the tax liability of the taxpayer for the taxable year or period covered by that return.

D. Preparing tax returns and furnishing information. Perhaps the most important exception applies to preparing tax returns. <u>Any individual may prepare a tax return</u>, appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Service or any of its officers or employees. This is not considered practicing before the IRS.

It should be noted that signing a tax return does entail certain responsibilities as discussed later. However, preparing a tax return does not rise to the level of practicing before the IRS.

> ***OBSERVATION****: None of the items above in A-D are considered to be practicing before the IRS.*

A CPA who is practicing before the IRS and does not fall into one of the exception categories above is subject to subpart B of Circular 230 – Duties and Restrictions relating to practice before the IRS. It is reproduced below and should be read in its entirety.

CIRCULAR 230: SUBPART B -- DUTIES AND RESTRICTIONS RELATING TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Table of Contents (this subpart)

<u>Section</u>

SUBPART C -- SANCTIONS FOR VIOLATION OF THE REGULATIONS

SECTION 10.20 Information to be furnished.

(a) To the Internal Revenue Service.

(1) A practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.

(2) Where the requested records or information are not in the possession of, or subject to the control of, the practitioner or the practitioner's client, the practitioner must promptly notify the requesting Internal Revenue Service officer or employee and the practitioner must provide any information that the practitioner has regarding the identity of any person who the practitioner believes may have possession or control of the requested records or information. The practitioner must make reasonable inquiry of his or her client regarding the identity of any person who may have possession or control of

the requested records or information, but the practitioner is not required to make inquiry of any other person or independently verify any information provided by the practitioner's client regarding the identity of such persons.

OBSERVATION: *The paragraph above should be read in light of the recently enacted accountant-client privilege.*

OBSERVATION: *Section 10.20 requires a practitioner to respond promptly to a proper and lawful request for records and information, unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.*

(b) To the Director of the Office of Professional Responsibility.

When a proper and lawful request is made by the Director of the Office of Professional Responsibility, a practitioner must provide the Director of the Office of Professional Responsibility with any information the practitioner has concerning an inquiry by the Director of the Office of Professional Responsibility into an alleged violation of the regulations in this part by any person, and to testify regarding this information in any proceeding instituted under this part, unless the practitioner believes in good faith and on reasonable grounds that the information is privileged.

OBSERVATION: *Sometimes referred to as "snitch laws" these provisions require the cooperation of those practicing before the IRS. Failure to cooperate could result in the loss of the right to practice before the IRS.*

(c) Interference with a proper and lawful request for records or information.

A practitioner may not interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service, its officers or employees, or the Director of the Office of Professional Responsibility, or his or her employees, to obtain any record or information unless the practitioner believes in good faith and on reasonable grounds that the record or information is privileged.

SECTION 10.21 Knowledge of client's omission.

A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.

OBSERVATION: *When you sign a tax return as a paid preparer, your signature is based not only on what is presented in the return but any item that you have knowledge of.*

SECTION 10.22 Diligence as to accuracy.

(a) In general.

A practitioner must exercise due diligence:

(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

(2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and

(3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

(b) Reliance on others.

Except as provided in §§10.34, 10.35, and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

(c) Effective/applicability date. This section is applicable on September 26, 2007.

SECTION 10.23 Prompt disposition of pending matters.

A practitioner may not unreasonably delay the prompt disposition of any matter before the Internal Revenue Service.

EXAMPLE

Nash, CPA is representing a client under audit by the IRS. Nash believes all the factual matters of the audit could be resolved in 6-8 weeks. Nash learns that the auditor assigned to the audit is planning to retire in six months. Nash believes that if he could delay the audit by raising unreasonable objections until after the IRS agent retires, he could possibly get a better result from the new agent. Purposely delaying the conclusion of the audit until after the IRS agent retires would be a violation of Section 10.23.

OBSERVATION: *The following two sections seek to ensure that all persons will be treated equally by the IRS and that none will receive preferential treatment.*

SECTION 10.24 Assistance from disbarred or suspended persons and former Internal Revenue Service employees.

A practitioner may not, knowingly and directly or indirectly:

(a) Accept assistance from or assist any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter or matters constituting practice before the Internal Revenue Service.

(b) Accept assistance from any former government employee where the provisions of §10.25 or any federal law would be violated.

SECTION 10.25 Practice by former government employees, their partners and their associates.

(a) Definitions.

For purposes of this section:

(1) Assist means to act in such a way as to advise, furnish information to, or otherwise aid another person, directly or indirectly.

(2) Government employee is an officer or employee of the United States or any agency of the United States, including a special government employee as defined in 18 U.S.C. 202(a), or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

(3) Member of a firm is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practitioners who represent nongovernmental parties.

(4) Particular matter involving specific parties is defined at 5 CFR 2637.201(c), or superseding post-employment regulations issued by the U.S. Office of Government Ethics.

(5) Rule includes Treasury regulations, whether issued or under preparation for issuance as notices of proposed rulemaking or as Treasury decisions, revenue rulings, and revenue procedures published in the Internal Revenue Bulletin (see 26 CFR 601.601(d)(2)(ii)(b)).

(b) General rules

(1) No former Government employee may, subsequent to Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate 18 U.S.C. 207 or any other laws of the United States.

(2) No former Government employee who personally and substantially participated in a particular matter involving specific parties may, subsequent to Government employment, represent or knowingly assist, in that particular matter, any person who is or was a specific party to that particular matter.

(3) A former Government employee who within a period of one year prior to the termination of Government employment had official responsibility for a particular matter involving specific parties may not, within two years after Government employment is ended, represent in that particular matter any person who is or was a specific party to that particular matter.

(4) No former Government employee may, within one year after Government employment is ended, communicate with or appear before, with the intent to influence, any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule the development of which the former Government employee participated in, or for which, within a period of one year prior to the termination of Government employment, the former government employee had official responsibility. This paragraph (b)(4) does not, however, preclude any former employee from appearing on one's own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a particular matter involving specific parties involving the application or interpretation of a rule with respect to that particular matter, provided that the representation is otherwise consistent with the other provisions of this section and the former employee does not utilize or disclose any confidential information acquired by the former employee in the development of the rule.

(c) Firm representation.

(1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any particular matter with respect to which the restrictions of paragraph (b)(2) of this section apply to the former Government employee, in that particular matter, unless the firm isolates the former Government employee in such a way to ensure that the former Government employee cannot assist in the representation.

(2) When isolation of a former Government employee is required under paragraph (c)(1) of this section, a statement affirming the fact of such isolation must be executed under oath by the former Government employee and by another member of the firm acting on behalf of the firm. The statement must clearly identify the firm, the former Government employee, and the particular matter(s) requiring isolation. The statement must be retained by the firm and, upon request, provided to the Director of the Office of Professional Responsibility.

(d) Pending representation. The provisions of this regulation will govern practice by former Government employees, their partners and associates with respect to representation in particular matters involving specific parties where actual representation commenced before the effective date of this regulation.

(e) Effective/applicability date. This section is applicable on September 26, 2007.

OBSERVATION: *This section reflects changes to federal statutes governing post-employment restrictions applicable to former government employees.*

OBSERVATION: *The section above may impose obligations on the firms of former government employees that exceed the obligations of other practitioners.*

SECTION 10.26 Notaries.

A practitioner may not take acknowledgments, administer oaths, certify papers, or perform any official act as a notary public with respect to any matter administered by the Internal Revenue Service and for which he or she is employed as counsel, attorney, or agent, or in which he or she may be in any way interested.

OBSERVATION: *Obviously, a notary may not be a party to the transaction, benefit from the transaction, or have a conflict of interest.*

SECTION 10.27 Fees.

(a) In general.

A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

OBSERVATION: *A practitioner may charge different rates depending upon the complexity of the issue.*

(b) Contingent fees.

(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to—

(i) An original tax return; or

(ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return

OBSERVATION: *Contrary to AICPA standards, a contingent fee may not be charged on an original return even when the practitioner reasonably anticipates that the return position will be substantively reviewed by the IRS prior to filing of the return.*

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.

(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

(c) Definitions. For purposes of this section—

(1) Contingent fee is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) Matter before the Internal Revenue Service includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.

(d) Effective/applicability date. This section is applicable for fee arrangements entered into after March 26, 2008.

SECTION 10.28 Return of client's records.

(a) In general, a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with his or her federal tax obligations. The practitioner may retain copies of the records returned to a client. The existence of a dispute over fees generally does not relieve the practitioner of his or her responsibility under this section. Nevertheless, if applicable state law allows or permits the retention of a client's records by a practitioner in the case of a dispute over fees for services rendered, the practitioner need only return those records that must be attached to the taxpayer's return. The practitioner, however, must provide the client with reasonable access to review and copy any additional records of the client retained by the practitioner under state law that are necessary for the client to comply with his or her federal tax obligations.

OBSERVATION: *The records that must be returned are limited to those records necessary for the client to comply with his or her federal tax obligations. This rule does not apply to other records the practitioner may have.*

(b) For purposes of this section – Records of the client include all documents or written or electronic materials provided to the practitioner, or obtained by the practitioner in the course of the practitioner's representation of the client, that preexisted the retention of the practitioner by the client. The term also includes materials that were prepared by the client or a third party (not including an employee or agent of the practitioner) at any time and provided to the practitioner with respect to the subject matter of the representation. The term also includes any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner, or his or her employee or agent, that was presented to the client with respect to a prior representation if such document is necessary for the taxpayer to comply with his or her current federal tax obligations. The term does not include any return, claim for refund, schedule, affidavit, appraisal or any other document prepared by the practitioner or the practitioner's firm, employees or agents if the practitioner is withholding such document pending the client's performance of its contractual obligation to pay fees with respect to such document.

OBSERVATION: *A practitioner may withhold the client's current year completed tax return pending payment of fees.*

AICPA AND STATE LAW COMPARISON: This section is more restrictive than AICPA rules. However, most state accountancy laws require the immediate return of all client records while the IRS rule pertains only to tax related records.

SECTION 10.29 Conflicting interests.

(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if:

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if:

(1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law;

(3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by each affected client, at the time the existence of the conflict of interest is known by the practitioner. The confirmation may be made within a reasonable period after the informed consent, but in no event later than 30 days.

(c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

(d) Effective/applicability date. This section is applicable on September 26, 2007.

Practice Pointer: Consents must be in writing and must be retained for at least 36 months after the conclusion of the engagement.

SECTION 10.30 Solicitation.

(a) Advertising and solicitation restrictions.

(1) A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim. Enrolled agents or enrolled retirement plan agents, in describing their professional designation, may not utilize the term of art "certified" or imply an employer/employee relationship with the Internal Revenue Service. Examples of acceptable descriptions for enrolled agents are "enrolled to represent taxpayers before the Internal Revenue Service," "enrolled to practice before the Internal Revenue Service," and "admitted to practice before the Internal Revenue Service." Similarly, examples of acceptable descriptions for enrolled retirement plan agents are "enrolled to represent taxpayers before the Internal Revenue Service as a retirement plan agent" and "enrolled to practice before the Internal Revenue Service as a retirement plan agent."

OBSERVATION: *Most Boards of Accountancy have similar laws banning false and misleading statements.*

(2) A practitioner may not make, directly or indirectly, an uninvited written or oral solicitation of employment in matters related to the Internal Revenue Service if the solicitation violates federal or state law or other applicable rule, e.g., attorneys are precluded from making a solicitation that is prohibited by conduct rules applicable to all attorneys in their State(s) of licensure. Any lawful solicitation made by or on behalf of a practitioner eligible to practice before the Internal Revenue Service must, nevertheless, clearly identify the solicitation as such and, if applicable, identify the source of the information used in choosing the recipient.

(b) Fee information.

(1)(i) A practitioner may publish the availability of a written schedule of fees and disseminate the following fee information:

(A) Fixed fees for specific routine services.

(B) Hourly rates.

(C) Range of fees for particular services.

(D) Fee charged for an initial consultation.

(ii) Any statement of fee information concerning matters in which costs may be incurred must include a statement disclosing whether clients will be responsible for such costs.

Practice Pointer: When practitioners send their clients annual income tax organizers, it is appropriate to include an engagement letter. The engagement letter should specify the responsibilities of both the practitioner and client as well as the responsibility for fees and costs.

(2) A practitioner may charge no more than the rate(s) published under paragraph (b)(1) of this section for at least 30 calendar days after the last date on which the schedule of fees was published.

(c) Communication of fee information.

Fee information may be communicated in professional lists, telephone directories, print media, mailings, electronic mail, facsimile, hand delivered flyers, radio, television, and any other method. The method chosen, however, must not cause the communication to become untruthful, deceptive, or otherwise in violation of this part. A practitioner may not persist in attempting to contact a prospective client if the prospective client has made it known to the practitioner that he or she does not desire to be solicited. In the case of radio and television broadcasting, the broadcast must be recorded and the practitioner must retain a recording of the actual transmission. In the case of direct mail and e-commerce communications, the practitioner must retain a copy of the actual communication, along with a list or other description of persons to whom the communication was mailed or otherwise distributed. The copy must be retained by the practitioner for a period of at least 36 months from the date of the last transmission or use.

Practice Pointer: Practitioners must keep a copy of all mailers for at least 36 months.

(d) Improper associations.

A practitioner may not, in matters related to the Internal Revenue Service, assist, or accept assistance from, any person or entity who, to the knowledge of the practitioner, obtains clients or otherwise practices in a manner forbidden under this section.

(e) Effective/applicability date. This section is applicable on September 26, 2007.

SECTION 10.31 Negotiation of taxpayer checks.

A practitioner who prepares tax returns may not endorse or otherwise negotiate any check issued to a client by the government in respect of a federal tax liability.

Practice Pointer: By completing Form 2848 “Power of Attorney and Declaration of Representative,” a taxpayer may authorize their CPA to receive refund checks. However, even the power of attorney specifically forbids the CPA from endorsing refund checks.

SECTION 10.32 Practice of law.

Nothing in the regulations in this part may be construed as authorizing persons not members of the bar to practice law.

SECTION 10.33 Best practices for tax advisors.

(a) Best practices. Tax advisors should provide clients with the highest quality representation concerning federal tax issues by adhering to best practices in providing advice and in preparing or assisting in the preparation of a submission to the Internal Revenue Service. In addition to compliance with the standards of practice provided elsewhere in this part, best practices include the following:

(1) Communicating clearly with the client regarding the terms of the engagement. For example, the advisor should determine the client's expected purpose for and use of the advice and should have a clear understanding with the client regarding the form and scope of the advice or assistance to be rendered.

(2) Establishing the facts, determining which facts are relevant, and evaluating the reasonableness of any assumptions or representations, relating the applicable law (including potentially applicable judicial doctrines) to the relevant facts, and arriving at a conclusion supported by the law and the facts.

(3) Advising the client regarding the import of the conclusions reached, including, for example, whether a taxpayer may avoid accuracy-related penalties under the Internal Revenue Code if a taxpayer acts in reliance on the advice.

(4) Acting fairly and with integrity in practice before the Internal Revenue Service.

(b) Procedures to ensure best practices for tax advisors. Tax advisors with responsibility for overseeing a firm's practice of providing advice concerning federal tax issues or of preparing or assisting in the preparation of submissions to the Internal Revenue Service should take reasonable steps to ensure that the firm's procedures for all members, associates, and employees are consistent with the best practices set forth in paragraph (a) of this section.

(c) Applicability date. This section is effective after June 20, 2005.

SECTION 10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) [Reserved].

(b) Documents, affidavits and other papers

(1) A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.

(2) A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service

(i) The purpose of which is to delay or impede the administration of the federal tax laws;
(ii) That is frivolous; or
(iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation unless the practitioner also advises the client to submit a document that evidences a good faith challenge to the rule or regulation.

(c) Advising clients on potential penalties.

(1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to

(i) A position taken on a tax return if—

(A) The practitioner advised the client with respect to the position; or
(B) The practitioner prepared or signed the tax return; and

(ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.

(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) Relying on information furnished by clients. A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) [Reserved].

(f) Effective/applicability date. Section 10.34 is applicable to tax returns, documents, affidavits and other papers filed on or after September 26, 2007.

SECTION 10.35 Requirements for covered opinions.

(a) A practitioner who provides a covered opinion shall comply with the standards of practice in this section.

(b) Definitions

For purposes of this subpart –

(1) A practitioner includes any individual described in Sec. 10.2(a)(5).

(2) Covered opinion –

(i) In general

A covered opinion is written advice (including electronic communications) by a practitioner concerning one or more federal tax issues arising from:

(A) A transaction that is the same as or substantially similar to a transaction that, at the time the advice is rendered, the Internal Revenue Service has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction under 26 CFR 1.6011-4(b)(2);

(B) Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, the principal purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code; or

(C) Any partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code if the written advice –

(1) Is a reliance opinion;
(2) Is a marketed opinion;
(3) Is subject to conditions of confidentiality; or
(4) Is subject to contractual protection.

(ii) Excluded advice

A covered opinion does not include –

(A) Written advice provided to a client during the course of an engagement if a practitioner is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of this section;

(B) Written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(ii)(B) of this section (concerning the principal purpose of avoidance or evasion) that –

(1) Concerns the qualification of a qualified plan;
(2) Is a state or local bond opinion; or
(3) Is included in documents required to be filed with the Securities and Exchange Commission;

(C) Written advice prepared for and provided to a taxpayer, solely for use by that taxpayer, after the taxpayer has filed a tax return with the Internal Revenue Service reflecting the tax benefits of the transaction. The preceding sentence does not apply if the practitioner knows or has reason to know that the written advice will be relied upon by the taxpayer to take a position on a tax return (including for these purposes an amended return that claims tax benefits not reported on previously filed return) filed after the date on which the advice is provided to the taxpayer;

(D) Written advice provided to an employer by a practitioner in that practitioner's capacity as an employee of that employer solely for purposes of determining the tax liability of the employer; or

(E) Written advice that does not resolve a federal tax issue in the taxpayer's favor, unless the advice reaches a conclusion favorable to the taxpayer at any confidence level (e.g., not frivolous, realistic possibility of success, reasonable basis or substantial authority) with respect to that issue. If written advice concerns more than one federal tax issue, the advice must comply with the requirements of paragraph (c) of this section with respect to any federal tax issue not described in the preceding sentence.

(3) A federal tax issue is a question concerning the federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property for federal tax purposes. For purposes of this subpart, a federal tax issue is significant if the Internal Revenue Service has a reasonable basis for a successful challenge and its resolution could have a significant impact, whether beneficial or adverse and under any reasonably foreseeable circumstances, on the overall federal tax treatment of the transaction(s) or matter(s) addressed in the opinion.

(4) Reliance opinion

Written advice is a reliance opinion if the advice concludes at a confidence level of at least more likely than not (a greater than 50 percent likelihood) that one or more significant federal tax issues would be resolved in the taxpayer's favor.

For purposes of this section, written advice, other than advice described in paragraph (b)(2)(1)(A) of this section (concerning listed transactions) or paragraph (b)(2)(1)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a reliance opinion if the practitioner prominently discloses in the written advice that it was not intended or written by the practitioner to be used, and that it cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(5) Marketed opinion

(i) Written advice is a marketed opinion if the practitioner knows or has reason to know that the written advice will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to one or more taxpayer(s).

(ii) For purposes of this section, written advice, other than advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions) or paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion), is not treated as a marketed opinion if the practitioner prominently discloses in the written advice that –

(A) The advice was not intended or written by the practitioner to be used, and that it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer;

(B) The advice was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the written advice; and

(C) The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

(6) Conditions of confidentiality

Written advice is subject to conditions of confidentiality if the practitioner imposes on one or more recipients of the written advice a limitation on disclosure of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that practitioner's tax strategies, regardless of whether the limitation on disclosure is legally binding. A claim that a transaction is proprietary or exclusive is not a limitation on disclosure if the practitioner confirms to all recipients of the written advice that there is no limitation on disclosure of the tax treatment or tax structure of the transaction that is the subject of the written advice.

(7) Contractual protection

Written advice is subject to contractual protection if the taxpayer has the right to a full or partial refund of fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) if all or a part of the intended tax consequences from the matters addressed in the written advice are not sustained, or if the fees paid to the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) are contingent on the taxpayer's realization of tax benefits from the transaction. All the facts and circumstances relating to the matters addressed in the written advice will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to a transaction have not designated as fees or any agreement to provide services without reasonable compensation.

(8) Prominently disclosed

An item is prominently disclosed if it is readily apparent to a reader of the written advice. Whether an item is readily apparent will depend on the facts and circumstances surrounding the written advice including, but not limited to, the sophistication of the taxpayer and the length of the written advice. At a minimum, to be prominently disclosed, an item must be set forth in a separate section (and not in a footnote) in a typeface that is the same size or larger than the typeface of any discussion of the facts or law in the written advice.

(9) State or local bond opinion

A state or local bond opinion is written advice with respect to a federal tax issue included in any materials delivered to a purchaser of a state or local bond in connection with the issuance of the bond in a public or private offering, including an official statement (if one is prepared), that concerns only the excludability of interest on a state or local bond from gross income under section 103 of the Internal Revenue Code, the application of section 55 of the Internal Revenue Code to a state or local bond, the status of a state or local bond as a qualified tax-exempt obligation under section 265(b)(3) of the Internal

Revenue Code, the status of a state or local bond as a qualified zone academy bond under section 1397E of the Internal Revenue Code, or any combination of the above.

(10) The principal purpose

For purposes of this section, the principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is the avoidance or evasion of any tax imposed by the Internal Revenue Code if that purpose exceeds any other purpose. The principal purpose of a partnership or other entity, investment plan or arrangement, or other plan or arrangement is not to avoid or evade federal tax if that partnership, entity, plan or arrangement has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose. A partnership, entity, plan or arrangement may have a significant purpose of avoidance or evasion even though it does not have the principal purpose of avoidance or evasion under this paragraph (b)(10).

(c) Requirements for covered opinions.

A practitioner providing a covered opinion must comply with each of the following requirements.

(1) Factual matters

(i) The practitioner must use reasonable efforts to identify and ascertain the facts, which may relate to future events if a transaction is prospective or proposed, and determine which facts are relevant. The opinion must identify and consider all facts that the practitioner determines to be relevant.

(ii) The practitioner must not base the opinion on any unreasonable factual assumptions (including assumptions as to future events). An unreasonable factual assumption includes a factual assumption that the practitioner knows or should know is incorrect or incomplete. For example, it is unreasonable to assume that a transaction has a business purpose or that a transaction is potentially profitable apart from tax benefits. A factual assumption includes reliance on a projection, financial forecast or appraisal. It is unreasonable for a practitioner to rely on a projection, financial forecast or appraisal if the practitioner knows or should know that the projection, financial forecast or appraisal is incorrect or incomplete or was prepared by a person lacking the skills or qualifications necessary to prepare such projection, financial forecast or appraisal. The opinion must identify in a separate section all factual assumptions relied upon by the practitioner.

(iii) The practitioner must not base the opinion on any unreasonable factual representations, statements or findings of the taxpayer or any other person. An unreasonable factual representation includes a factual representation that the practitioner knows or should know is incorrect or incomplete. For example, a practitioner may not rely on a taxpayer's factual representation that a transaction has a business purpose if the representation fails to include a specific description of the business purpose or the practitioner knows or should know that the representation is incorrect or incomplete. The opinion must identify in a separate section all factual representations, statements or findings of the taxpayer relied upon by the practitioner.

(2) Relate law to facts

(i) The opinion must relate the applicable law (including potentially applicable judicial doctrines) to the relevant facts.

(ii) The practitioner must not assume the favorable resolution of any significant federal tax issue except as provided in paragraphs (c)(3)(v) and (d) of this section, or otherwise base an opinion on any unreasonable legal assumptions, representations, or conclusions.

(iii) The opinion must not contain internally inconsistent legal analyses or conclusions.

(3) Evaluation of significant federal tax issues

(i) In general

The opinion must consider all significant federal tax issues except as provided in paragraphs (c)(3)(v) and (d) of this section.

(ii) Conclusion as to each significant federal tax issue

The opinion must provide the practitioner's conclusion as to the likelihood that the taxpayer will prevail on the merits with respect to each significant federal tax issue considered in the opinion. If the practitioner is unable to reach a conclusion with respect to one or more of those issues, the opinion must state that the practitioner is unable to reach a conclusion with respect to those issues. The opinion must describe the reasons for the conclusions, including the facts and analysis supporting the conclusions, or describe the reasons that the practitioner is unable to reach a conclusion as to one or more issues. If the practitioner fails to reach a conclusion at a confidence level of at least more likely than not with respect to one or more significant federal tax issues considered, the opinion must include the appropriate disclosure(s) required under paragraph (e) of this section.

(iii) Evaluation based on chances of success on the merits

In evaluating the significant federal tax issues addressed in the opinion, the practitioner must not take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised.

(iv) Marketed opinions

In the case of a marketed opinion, the opinion must provide the practitioner's conclusion that the taxpayer will prevail on the merits at a confidence level of at least more likely than not with respect to each significant federal tax issue. If the practitioner is unable to reach a more likely than not conclusion with respect to each significant federal tax issue, the practitioner must not provide the marketed opinion, but may provide written advice that satisfies the requirements in paragraph (b)(5)(ii) of this section.

(v) Limited scope opinions

(A) The practitioner may provide an opinion that considers less than all of the significant federal tax issues if –

(1) The practitioner and the taxpayer agree that the scope of the opinion and the taxpayer's potential reliance on the opinion for purposes of avoiding penalties that may be imposed on the taxpayer are limited to the federal tax issue(s) addressed in the opinion;

(2) The opinion is not advice described in paragraph (b)(2)(i)(A) of this section (concerning listed transactions), paragraph (b)(2)(i)(B) of this section (concerning the principal purpose of avoidance or evasion) or paragraph (b)(5) of this section (a marketed opinion); and

(3) The opinion includes the appropriate disclosure(s) required under paragraph (e) of this section.

(B) A practitioner may make reasonable assumptions regarding the favorable resolution of a federal tax issue (an assumed issue) for purposes of providing an opinion on less than all of the significant federal tax issues as provided in this paragraph (c)(3)(v). The opinion must identify in a separate section all issues for which the practitioner assumed a favorable resolution.

(4) Overall conclusion

(i) The opinion must provide the practitioner's overall conclusion as to the likelihood that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment and the reasons for that conclusion. If the practitioner is unable to reach an overall conclusion, the opinion must state that the practitioner is unable to reach an overall conclusion and describe the reasons for the practitioner's inability to reach a conclusion.

(ii) In the case of a marketed opinion, the opinion must provide the practitioner's overall conclusion that the federal tax treatment of the transaction or matter that is the subject of the opinion is the proper treatment at a confidence level of at least more likely than not.

(d) Competence to provide opinion; reliance on opinions of others

(1) The practitioner must be knowledgeable in all of the aspects of federal tax law relevant to the opinion being rendered, except that the practitioner may rely on the opinion of another practitioner with respect to one or more significant federal tax issues, unless the practitioner knows or should know that such opinion of the other practitioner should not be relied on. If a practitioner relies on the opinion of another practitioner, the relying practitioner must identify the other opinion and set forth the conclusions reached in the other opinion.

(2) The practitioner must be satisfied that the combined analysis of the opinions, taken as a whole, and the overall conclusion, if any, satisfy the requirements of this section.

(e) Required disclosures

A covered opinion must contain all of the following disclosures that apply -

(1) Relationship between promoter and practitioner. An opinion must prominently disclose the existence of -

(i) Any compensation arrangement, such as a referral fee or a fee-sharing arrangement, between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and any person (other than the client for whom the opinion is prepared) with respect to promoting, marketing or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion; or

(ii) Any referral agreement between the practitioner (or the practitioner's firm or any person who is a member of, associated with, or employed by the practitioner's firm) and a person (other than the client for whom the opinion is prepared) engaged in the promoting, marketing, or recommending the entity, plan, or arrangement (or a substantially similar arrangement) that is the subject of the opinion.

(2) Marketed opinions

A marketed opinion must prominently disclose that -

(i) The opinion was written to support the promotion or marketing of the transaction(s) or matter(s) addressed in the opinion; and

(ii) The taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

(3) Limited scope opinions

A limited scope opinion must prominently disclose that -

(i) The opinion is limited to the one or more federal tax issues addressed in the opinion;

(ii) Additional issues may exist that could affect the federal tax treatment of the transaction or matter that is the subject of the opinion and the opinion does not consider or provide a conclusion with respect to any additional issues; and

(iii) With respect to any significant federal tax issues outside the limited scope of the opinion, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(4) Opinions that fail to reach a more likely than not conclusion

An opinion that does not reach a conclusion at a confidence level of at least more likely than not with respect to a significant federal tax issue must prominently disclose that -

(i) The opinion does not reach a conclusion at a confidence level of at least more likely than not that with respect to one or more material federal tax issues addressed by the opinion; and

(ii) With respect to those significant federal tax issues, the opinion was not written, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

(5) Advice regarding required disclosures

In the case of any disclosure required under this section, the practitioner may not provide advice to any person that is contrary to or inconsistent with the required disclosure.

(f) Effect of opinion that meets these standards

(1) In general

An opinion that meets the requirements of this section satisfies the practitioner's responsibilities under this section, but the persuasiveness of the opinion with regard to the tax issues in question and the taxpayer's good faith reliance on the opinion will be separately determined under applicable provisions of the law and regulations.

(2) Standards for other written advice

A practitioner who provides written advice that is not a covered opinion for purposes of this section is subject to the requirements of Sec. 10.37.

(g) Effective date

This section applies to written advice that is rendered after June 20, 2005.

SECTION 10.36 Procedures to ensure compliance.

(a) Requirements for covered opinions

Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice of providing advice concerning federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with Sec. 10.35. Any such practitioner will be subject to discipline for failing to comply with the requirements of this paragraph if –

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with Sec. 10.35, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with Sec. 10.35; or

(2) The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with the firm, that does not comply with Sec. 10.35 and

the practitioner, through willfulness, recklessness, or gross incompetence, fails to take prompt action to correct the noncompliance.

(b) Effective date

This section is applicable after June 20, 2005.

SECTION 10.37 Requirements for other written advice.

(a) Requirements

A practitioner must not give written advice (including electronic communications) concerning one or more federal tax issues if the practitioner bases the written advice on unreasonable factual or legal assumptions (including assumptions as to future events), unreasonably relies upon representations, statements, findings or agreements of the taxpayer or any other person, does not consider all relevant facts that the practitioner knows or should know, or, in evaluating a federal tax issue, takes into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be resolved through settlement if raised. All facts and circumstances, including the scope of the engagement and the type and specificity of the advice sought by the client will be considered in determining whether a practitioner has failed to comply with this section. In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the determination of whether a practitioner has failed to comply with this section will be made on the basis of a heightened standard of care because of the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.

(b) Effective date.

This section applies to written advice that is rendered after June 20, 2005.

SECTION 10.38 Establishment of Advisory Committees.

(a) Advisory committees

To promote and maintain the public's confidence in tax advisors, the Director of the Office of Professional Responsibility is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the Internal Revenue Service. Under procedures prescribed by the Director, an advisory committee may review and make recommendations regarding professional standards or best practices for tax advisors, or more particularly, whether a practitioner may have violated Sec. 10.35 or 10.36.

(b) Effective date

This section applies after December 20, 2004.

SUBPART C -- SANCTIONS FOR VIOLATION OF THE REGULATIONS

SECTION 10.50 Sanctions.

(a) Authority to censure, suspend, or disbar.

The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may censure, suspend or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable (within the meaning of Sec. 10.51), fails to comply with any regulation in this part (under the prohibited conduct standards of Sec. 10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

OBSERVATION: *The new regulations add "censure" as a possible sanction.*

(b) Authority to disqualify.

The Secretary of the Treasury, or delegate, after due notice and opportunity for hearing, may disqualify any appraiser for a violation of these rules as applicable to appraisers.

(1) If any appraiser is disqualified pursuant to this subpart C, the appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Director of the Office of Professional Responsibility pursuant to §10.81, regardless of whether the evidence or testimony would pertain to an appraisal made prior to or after the effective date of disqualification.

(2) Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the taxpayer's reliance in good faith on such appraisal.

(c) Authority to impose monetary penalty

(1) In general.

(i) The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may impose a monetary penalty on any practitioner who engages in conduct subject to sanction under paragraph (a) of this section.

(ii) If the practitioner described in paragraph (c)(1)(i) of this section was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to the penalty, the Secretary of the Treasury, or delegate, may impose a monetary penalty on the employer, firm, or entity if it knew, or reasonably should have known, of such conduct.

(2) Amount of penalty. The amount of the penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty.

(3) Coordination with other sanctions. Subject to paragraph (c)(2) of this section

(i) Any monetary penalty imposed on a practitioner under this paragraph (c) may be in addition to or in lieu of any suspension, disbarment or censure and may be in addition to a penalty imposed on an employer, firm or other entity under paragraph (c)(1)(ii) of this section.

(ii) Any monetary penalty imposed on an employer, firm or other entity may be in addition to or in lieu of penalties imposed under paragraph (c)(1)(i) of this section.

(d) Sanctions to be imposed. The sanctions imposed by this section shall take into account all relevant facts and circumstances.

(e) Effective/applicability date. This section is applicable to conduct occurring on or after September 26, 2007, except paragraph (c) which applies to prohibited conduct that occurs after October 22, 2004.

SECTION 10.51 Incompetence and disreputable conduct.

(a) Incompetence and disreputable conduct. Incompetence and disreputable conduct for which a practitioner may be sanctioned under §10.50 includes, but is not limited to--

(1) Conviction of any criminal offense under the Federal tax laws.

(2) Conviction of any criminal offense involving dishonesty or breach of trust.

(3) Conviction of any felony under Federal or State law for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(4) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term “information.”

(5) Solicitation of employment as prohibited under §10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or any officer or employee thereof.

(6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.

(7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

(8) Misappropriation of, or failure properly or promptly to remit, funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(9) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage, or by the bestowing of any gift, favor or thing of value.

(10) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant or actuary by any duly constituted authority of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia, any Federal court of record or any Federal agency, body or board.

(11) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment or ineligibility of such other person.

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations or statements, knowing them to be false or circulating or publishing malicious or libelous matter.

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph (a)(13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

(14) Willfully failing to sign a tax return prepared by the practitioner when the practitioner's signature is required by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under §10.60.

(b) Effective/applicability date. This section is applicable to conduct occurring on or after September 26, 2007.

Disreputable Conduct

While employed by CPA firm, CPA prepared 17 income tax returns for clients who were not clients of the CPA firm. CPA used the employer's tax return preparation software and computer equipment to prepare these tax returns. CPA did not remove the employer's name from the paid preparer section of the tax returns prior to issuing these tax returns to clients. CPA billed the clients using invoices with CPA's name only and kept the fees received for these services.

CPA believed that these clients knew the CPA firm was not responsible for the tax returns even though the employer's name was displayed in the paid preparer section of the tax return.

Revised Regulations on Releasing Taxpayer Information

In early 2008, the IRS released revised regulations concerning taxpayer privacy and the release of taxpayer information with an effective date of January 1, 2009. Among the new rules:

- Generally, preparers must obtain taxpayer consent, either by paper or electronically depending on how the return is being filed, before tax return information can be disclosed to any third party or used for any purpose other than filing the return.
- If the taxpayer consents to the disclosure and use of his information, the consent must identify the intended purpose of the disclosure, identify the recipients, and describe the particular authorized disclosure or use of the information.
- Mandatory language informs individual taxpayers that they are not required to sign the consent. If they sign the consent, they can set a time period for the duration of that consent. If taxpayers fail to set a time period, the consent is valid for a maximum of one year.
- To prevent consent requests from individual taxpayers from being buried in fine print, the rules require the paper consent documents to be in 12-point type on 8½ by 11 inch paper and require electronic consent requests to be in the same type as the Web site's standard text.
- Mandatory consent from taxpayers also is required if the tax information is going to be disclosed to a tax preparer located outside the United States. This provision is intended to ensure taxpayers are informed if their tax information is being sent off-shore for return preparation. The individual taxpayer's Social Security Number also must be redacted.

Many of these provisions are similar to recently enacted state laws.

SECTION 10.52 Violation subject to sanction.

(a) A practitioner may be sanctioned under Sec. 10.50 if the practitioner

(1) Willfully violates any of the regulations (other than §10.33) contained in this part; or

(2) Recklessly or through gross incompetence (within the meaning of §10.51(a)(13)) violates §§10.34, 10.35, 10.36 or 10.37.

(b) Effective/applicability date. This section is applicable to conduct occurring on or after September 26, 2007.

SECTION 10.53 Receipt of information concerning practitioner.

(a) Officer or employee of the Internal Revenue Service.

If an officer or employee of the Internal Revenue Service has reason to believe that a practitioner has violated any provision of this part, the officer or employee will promptly make a written report to the Director of the Office of Professional Responsibility of the suspected violation. The report will explain the facts and reasons upon which the officer's or employee's belief rests.

Practice Pointer: Be very careful what you say and do when meeting with IRS personnel. As detailed above, IRS employees are required to report any violation by a practitioner.

(b) Other persons.

Any person other than an officer or employee of the Internal Revenue Service having information of a violation of any provision of this part may make an oral or written report of the alleged violation to the Director of the Office of Professional Responsibility or any officer or employee of the Internal Revenue Service. If the report is made to an officer or employee of the Internal Revenue Service, the officer or employee will make a written report of the suspected violation to the Director of the Office of Professional Responsibility.

(c) Destruction of report.

No report made under paragraph (a) or (b) of this section shall be maintained by the Director of the Office of Professional Responsibility unless retention of such record is permissible under the applicable records control schedule as approved by the National Archives and Records Administration and designated in the Internal Revenue Manual. The Director of the Office of Professional Responsibility must destroy such reports as soon as permissible under the applicable records control schedule.

(d) Effect on proceedings under subpart D.

The destruction of any report will not bar any proceeding under subpart D of this part, but precludes the Director of the Office of Professional Responsibility's use of a copy of such report in a proceeding under subpart D of this part.

(e) Effective/applicability date. This section is applicable on September 26, 2007.

New Registration Requirement for Paid Tax Return Preparers

In order to sign tax returns as a paid preparer after December 31, 2010, all preparers (including CPAs) must register with the IRS and obtain a preparer tax identification number (PTIN). Following are the answers to some questions courtesy of the IRS.

Tax Preparer Registration Questions & Answers

New PTIN Requirements

1. Who needs a Preparer Tax Identification Number (PTIN)?

All tax return preparers who are compensated for preparing, or assisting in the preparation of, all or substantially all of a U.S. federal tax return or claim for refund must obtain a PTIN. Refer to the Scenarios section for additional guidance.

2. I already have a PTIN. Do I need to take any action this year?

Yes. All federal tax return preparers, even those who already have a PTIN, will need to register in the new system now available. All preparers will need to be registered on the new system and have a PTIN prior to filing any return after Dec. 31, 2010. As long as the IRS can validate the ownership of the existing PTIN, the same number will be reassigned once the appropriate information is provided and the user fee is paid.

3. Can multiple individuals or one office share one PTIN?

No, a PTIN is an individual preparer's number. Each preparer must obtain his or her own PTIN.

4. Can one individual obtain multiple PTINS?

No, an individual may only obtain one PTIN.

5. If an employee of a business prepares the business' tax returns as part of their job responsibilities, do the regulations affect them?

No. An employee who prepares his employer's returns is not required to sign as a paid preparer. Accordingly, unless the employee prepares other federal tax returns for compensation, he or she is not required to register and obtain a PTIN.

6. Does the PTIN requirement apply to individuals who only prepare payroll or other non-1040 series returns?

Yes. All paid tax return preparers are required to obtain a PTIN.

7. If I don't obtain (or renew) a PTIN by January 1, 2011, can I still prepare returns?

Yes, but only after you sign up through the new online registration system, pay the fee, and obtain (or renew) a PTIN.

8. Is the IRS conducting fingerprint checks as part of the PTIN application process?

The IRS is not currently conducting fingerprint checks as part of the PTIN application process, but is considering them for certain applicants in the future. There is a current requirement for all applications to include an explanation of any felony convictions in the past 10 years.

<u>Scenarios</u>

1. I am a tax return preparer, and I have a PTIN. My firm employs a bookkeeper. She gathers client receipts and invoices, and organizes and records all information for me. Although I use the information that our bookkeeper has compiled, I prepare my clients' tax returns and make all substantive determinations that go into computing the tax liability. Does my bookkeeper need to have a PTIN?

No, she is not a tax return preparer, and is not required to have a PTIN.

2. I am a retired tax professional, and I volunteer during the tax filing season. I volunteer at a VITA site, where I prepare individual tax returns for lower-income individuals for no compensation. Do I need to have a PTIN?

No, you are not a tax return preparer and you are not required to have a PTIN.

3. I run a small tax return preparation business that is heavily software-based. I employ four associates who sit with taxpayers and walk through a step-by-step software program that uses an "interview" process that results in a draft tax return. I check and sign the returns, and I have a PTIN. Do my four associates need to have a PTIN?

You will need to perform additional analysis to determine whether your four associates must have a PTIN. The answer depends on the specific circumstances of your firm. In general, if individuals prepare all or substantially all of a tax return, including making determinations that affect tax liability, they must have a PTIN.

Testing

1. What is the testing proposal?

The IRS has proposed that individuals who are not an attorney, certified public accountant, or enrolled agent will have to pass a competency test to officially become a Registered Tax Return Preparer. The IRS expects testing to begin in mid-2011.

Tax return preparers who have PTINs before testing becomes available will have until Dec. 31, 2013, to pass the competency test. After testing becomes available, new tax return preparers will be required to pass the competency test before they can obtain a PTIN.

2. Will a CPA who keeps his or her license current but is considered inactive be subject to testing?

Yes. Only attorneys, certified public accountants, or enrolled agents who are active and in good standing with their respective licensing agencies are exempt from competency testing.

CPE Requirements

1. What is the continuing education proposal?

The IRS has proposed that Registered Tax Return Preparers will be required to complete continuing education annually. The annual continuing education requirement is expected to include 3 hours of federal tax law updates, 2 hours of ethics, and 10 hours of other federal tax law.

This will not apply to attorneys, CPAs, enrolled agents, enrolled actuaries, or enrolled retirement plan agents due to their existing education requirements.

Public Database

1. Who will be included in the public database of return preparers?

At a minimum, it will include the preparers who have passed the competency exam. Other information about who would be included is not yet available. Stay tuned to the IRS.gov Tax Professionals page for information on this issue.

CHAPTER 5 – REVIEW QUESTIONS

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

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Under Circular 230 Section 10.27, a practitioner is prohibited from charging certain fees. Which of the following fees is prohibited:

   a) fees in excess of $300 per hour
   b) contingent fees
   c) an unconscionable fee
   d) fees based on the number of forms and schedules contained in a tax return

2. Circular 230 provides rules regulating the conduct of tax practitioners when clients of a practitioner have conflicting interests. However, a practitioner may represent clients with conflicting interests in certain instances. Which of the following conditions must be met in order for a Circular 230 practitioner to represent clients with conflicting interests: (Section 10.29)

   a) the clients must have been clients of the practitioner prior to the conflict arising
   b) the practitioner reasonably believes that he will be able to provide competent and diligent representation to each affected client
   c) the clients are aware of the conflict
   d) the practitioner is charging each client for only one half of the time spent on the matter

3. Circular 230 Section 10.30 imposes numerous restrictions on solicitation and advertising. Which of the following is true:

   a) hourly fee information must be included in all ads
   b) although ads may include a fee schedule, rates can be changed at any time
   c) a copy of all direct mail advertisements must be retained for at least 36 months
   d) when accepting a new client, the practitioner must give the client a good faith estimate of the cost of the services contemplated

4. Section 10.33 outlines best practices for tax advisors. Which of the following is a "best practice" under Section 10.33:

   a) communicating in a way that might confuse the client in order to show how important the advisor is to the client
   b) determining which facts are relevant
   c) doing anything possible to place the client's interests above those of the tax authorities
   d) finding creative ways to hide deductions that would otherwise be hard to support when the client has indicated that they want to take the deduction

5. In preparing the tax return for Nash Plumbing, Inc., you notice a large deduction for "consulting services." You ask your client to explain this deduction and he explains it represents gifts he purchased for his wife to make up for him being on call and having to work at odd hours. You know that no 1099 or W-2 is issued for these "services" nor is any of this income reflected on your client's personal tax return. Your client states that "everyone" in this industry does this. The deduction is equivalent to 20% of net income. Which of the following is correct regarding your ability to sign the tax return for Nash Plumbing, Inc. per Circular 230:

    a) you may sign the return since everything on the return is the representation of the client
    b) you may sign the return since the return meets the "realistic possibility standard"
    c) the client's assertion that the deduction in industry practice is frivolous. Accordingly, the position does not meet the "realistic possibility standard" and you may not sign the return
    d) you may sign the return only if the deduction is clearly identified on the return as "consulting expense paid to spouse" or some similar disclosure

6. Circular 230 Section 10.51 outlines items that may constitute incompetence or disreputable conduct. Which of the following would <u>not</u> be considered disreputable conduct:

    a) using abusive language with an IRS auditor in order to get the auditor to delete an item from the audit report
    b) having one's CPA license revoked for cause
    c) being subject to a preparer penalty for negligence in the preparation of a state tax return by that state's tax authority
    d) conviction of a crime relating to the filing of a state tax return

CHAPTER 5 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. There is no limit on the hourly rate charged as long as the fee is not unconscionably high.

   B: Incorrect. There are significant restrictions on contingent fees, but they are not prohibited in all circumstances.

   C: Correct. Although subject to interpretation, an unconscionably high fee is prohibited.

   D: Incorrect. Generally, the more schedules required in a tax return, the more time and effort required by the practitioner. Accordingly, charging a greater fee for a more detailed return is not prohibited.

   (See Section 10.27 of Circular 230 in the course material.)

2. A: Incorrect. In certain circumstances, new clients with conflicting interests may be accepted. A common example is couples going through divorce. While this may prove difficult for the practitioner and possibly be ill-advised, it is not prohibited.

   B: Correct. Furthermore, two additional conditions must be met. The representation must not be prohibited by law and each affected client must give informed consent. Such consent must be in writing.

   C: Incorrect. The clients are likely already aware of their conflict.

   D: Incorrect. The issue at hand is, "can the practitioner serve each client without neglecting the other." Furthermore, are the clients fully aware of the conflict and how it impacts the services they may receive from the practitioner?

   (See Section 10.29 of Circular 230 in the course material.)

3. A: Incorrect. Ads may include a schedule of fees, but publishing the fee schedule is not mandatory.

   B: Incorrect. Rates may not be increased for at least 30 days after the last date the fee schedule was published.

   C: Correct. In addition, a list or description of the intended recipients must also be retained for 36 months. This also applies to e-mail solicitations.

   D: Incorrect. Although sound business practices suggest the use of an engagement letter that includes fee information, Circular 230 does not require giving the client a fee estimate.

   (See Section 10.30 of Circular 230 in the course material.)

4. A: Incorrect. In order to best serve one's client, an advisor should have specialized knowledge that can be used to benefit the client. However, there is no need to confuse the client to boost one's own ego.

   B: Correct. By eliminating irrelevant facts, the practitioner can better serve the client.

   C: Incorrect. A tax practitioner has a dual role. While the client's interests are paramount, the practitioner has an obligation to the tax authorities to help the client submit an accurate return.

   D: Incorrect. Pleasing the client is important, and clients have different comfort levels when it comes to documenting legitimate deductions. However, trying to hide deductions is not included in the "best practices for tax advisors."

   (See Section 10.33 of Circular 230 in the course material.)

5. A: Incorrect. A practitioner signs the return based on all his knowledge, not just what is reported on the return.

   B: Incorrect. The deduction is patently improper. Therefore, it does not meet the reasonable possibility standard.

   C: Correct. You may not sign the return.

   D: Incorrect. Hiding an improper deduction does not qualify as disclosure.

   (See Section 10.34 of Circular 230 in the text material.)

6. A: Incorrect. Using abusive language with an IRS agent is unprofessional and may subject you to disciplinary action.

   B: Incorrect. Having one's CPA license revoked is considered disreputable conduct.

   C: Correct. Section 10.51 is primarily concerned with the preparation of federal tax forms. However, conviction of a state tax crime would be disreputable.

   D: Incorrect. Section 10.51 is primarily concerned with the preparation of federal tax forms. However, conviction of a state tax crime would be disreputable.

   (See Section 10.51 of Circular 230 in the course material.)

CHAPTER 6: ETHICS FOR INDUSTRY CPAs

Objectives: After completing this chapter, you will be able to:

- Identify the AICPA guidance for industry CPAs.

AICPA GUIDANCE

Rule 102 – Integrity and objectivity has particular importance to CPAs in industry. Rule 102 is very broad in its dictate that "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."

Following are summaries and discussion of the AICPA Rule 102 Interpretations relating to Management Accountants.

Interpretation 102-2 (Conflicts of Interest) A conflict of interest may arise when a member performs a professional service for a client or employer and has a "significant relationship" with another party. For example, the firm may provide investment advice for a client but may have a relationship with a financial product that is sold to the client. This situation is not prohibited if the client is informed of the relationship. In making the disclosure to the client the member should make sure that Rule 301 (Confidential Client Information) is not violated. The disclosure and consent option is available only for conflicts of interest. Impairments of *independence* cannot be so eliminated.

Interpretation 102-3 (Obligations of a Member to His or Her Employer's External Accountant) When a member who is not in public practice communicates with his or her employer's external accountant, the member "must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts." This guidance applies, for example, to written representations requested by the employer's external accountant.

Interpretation 102-4 (Subordination of Judgment by a Member) During the performance of a professional service (all services performed by a member while holding out as a CPA), a member should not subordinate his or her judgment to the position taken by a supervisor. Specifically, if there is a disagreement about the preparation of financial statements or the recording of a transaction, the member should observe the following guidelines.

- Determine whether the position taken by the supervisor is consistent with an acceptable alternative accounting principle. If the principle is generally acceptable, the member does not need to take additional action.

- If the member determines that the alternative accounting principle is not acceptable, the member should communicate the disagreement to an "appropriate higher level(s) of management with the organization." This higher level could include the supervisor's supervisor, members of senior management, or the audit committee.

- If, after the appropriate higher level(s) of management was informed of the disagreement, appropriate action was not taken, the member should consider whether to continue as an employee and whether there is any responsibility to notify appropriate regulatory agencies or the employer's current or former external accountant. Consultation with legal counsel may be appropriate before communicating with external parties.

Example

Cindy Steffen is a CPA and the controller of Company X Inc. In preparing the financial statements for the quarter ended September 30, 2006, Steffen proposes to reduce obsolete inventory to net realizable value. The obsolete items represent a significant amount of total inventory. The CFO concurs with Steffen's position. However, he decides not to go against the CEO whose position is that reducing the inventory this quarter is a discretionary decision and the CEO would prefer to record any such reduction at year end, after Company X completes its anticipated public offering of stock later this year. What are the ethical obligations of Steffen's in this situation?

Answer: To avoid subordinating her judgment, Steffen should first determine whether the inventory writedown is material. If so, she should restate her concerns to the CFO and CEO and, if the latter persists in not supporting the writedown, Steffen should bring the matter to the attention of the audit committee of the board of directors. She should document the understanding of the facts, the accounting principles involved, the application of the principles to the facts, and the parties with whom discussions were held. Steffen should consider any responsibility that may exist to go outside the company, although legal counsel should be sought on this matter.

The member should be aware of obligations established under Interpretation 102-3.

The AICPA has also issued one ruling of interest to CPAs in industry. When may an industry CPA use the CPA designation? The AICPA believes it is proper for the CPA to use the CPA designation provided it is not done in a manner that implies the CPA is independent of the employer.

Following are questions asked by AICPA members. The answers are from the AICPA Professional Ethics division:

1. A member is hired by a company as the chief financial officer. The member later discovers that, prior to his or her employment, material false and misleading entries were recorded in the books and records of the company. If he or she fails to record a correcting entry, is the member in violation of the AICPA Code of Professional Conduct?

Yes. Rule 102 requires that in the performance of any professional service, a member shall not knowingly misrepresent facts. Interpretation 102-1 states that a member shall have knowingly misrepresented facts if he or she knowingly fails to correct an entity's financial statements or records that are materially false and misleading when the member has the authority to record such an entry.

2. A member is the controller of a company. The company's external auditors request, and the member provides them with, copies of documents relating to the company's revenue-recognition policy. However, the member does not disclose the existence of other documents that would reveal the company is improperly and prematurely recording revenue which has a material impact on the company's financial statements. Is the member in violation of the AICPA code?

Yes. Under Interpretation 102-3, when dealing with his or her employer's external accountant, a member must be candid and not knowingly misrepresent facts or fail to disclose material facts.

3. A supervisor instructs a member to record a transaction that would result in a material misstatement of the financial statements. If, after appropriate research and consultation, the member determines that the transaction cannot be recorded using an acceptable alternative, should he or she comply with the supervisor's instructions?

No. Interpretation 102-4 prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. If the member concludes that the financial statements could be materially misstated, he or she should discuss the concerns with the appropriate higher level(s) of management and consider documenting his or her understanding of the facts, the accounting principles involved, the application of the accounting principles to the facts and the parties with whom the matters were discussed. If the member then concludes that appropriate action was not taken, that member may wish to consider his or her continuing relationship with the employer and any responsibility to communicate the matter to third parties, including the employer's external accountants. The member also may wish to consult with legal counsel.

4. A member in industry is assigned by his or her employer to facilitate a transaction between two entities. During this process, the member creates false and misleading documents that are presented to one of the entities. Is the member in violation of the AICPA code?

Yes. Rule 102 requires that, in the performance of any professional service, a member shall not knowingly misrepresent facts.

5. A member employed as the controller of a company is directed by its president to record a sale material to the company's financial statements. The member records the sale without obtaining the necessary documents to determine whether the transaction is in compliance with GAAP. It is later discovered that the sale occurred after the reporting period and resulted in materially overstated earnings in the financial statements. Is the member in violation of the AICPA code?

Yes. Under Interpretation 501-4, if the member, by virtue of his or her negligence, makes, or permits or directs another to make, materially false or misleading entries in the financial statements or records of an entity, he or she shall be considered to have committed an act discreditable to the profession.

6. A member who is a CFO has been asked to sign a management representation letter stating that the company's financial statements are in conformity with GAAP when he or she is aware of a material departure from an established accounting principle. Should the member sign the letter?

No. Rule 203 provides that a member shall not state affirmatively that the financial statements are in conformity with GAAP if such financial statements contain any departure from an established accounting principle that has a material effect on them. In addition, Rule 102 requires that in the performance of any professional service a member shall not knowingly misrepresent facts.

Case Study

Integrity & Objectivity

CPA, Director of Finance for a publicly owned company, made journal entries to adjust second and third quarter 2007 financial statements according to a model developed and used by the company. When CPA made the adjustments to the second and third quarter financial statements, CPA did not report to senior management or to the external auditors that the adjustments could result in a misstatement of the financial statements. CPA reported the unsupported journal entries on the fourth quarter financial statements.

CPA made journal entries that were not in compliance with Generally Accepted Accounting Principals. CPA did not discharge the duty owed to the general public when CPA allowed incorrect second and third quarter financial statements to be issued.

HOT TOPIC: STOCK OPTION BACKDATING

In 2006, there was a flurry of controversy over stock option backdating. This controversy is the direct result of an ethical breakdown in corporate America. While it may take years to sort out the full impact of this dubious practice, here are a few of the possible impacts excerpted from articles written by the experts in employee ownership at the National Center for Employee Ownership (www.NCEO.org):

1. **Shareholder Litigation:** Backdating will be a field day for securities lawyers for a number of reasons. If a company said it was issuing options at fair market value, but really didn't, shareholders could sue because they never approved such a plan. Furthermore, IRS rules make shareholder approval a condition of tax-qualified incentive stock option plans.

2. **SEC Enforcement:** Lawyers still haven't quite sorted out all the violations that could be involved with backdating. If an executive got options timed just before the release of data that would affect the stock price, that's potentially insider trading. If the options were granted in a way not in accordance with the plan, that could mean that proper disclosures from the executive to the SEC had not been made. If the two-day rule for reporting grants was effectively violated (because the grant date was pushed back more than two days over what the company actually claimed it was), then the securities laws are violated again.

3. **Corporate Taxes:** It's not entirely clear how the new rules on the taxation of deferred compensation will apply to backdated options issued before the effective date of the new deferred compensation rules under Internal Revenue Code Section 409A, which says that certain kinds of deferred compensation will be heavily taxed unless the recipient specified well in advance when the award would be paid.

Options generally do not require such an advance election (you can exercise whenever you like once they are vested until they expire; that's why they are so appealing). Option grants at fair market value are not covered by Section 409A, but discounted options are. More clear is that if the options were incentive stock options, then the backdating would disqualify the option as an incentive option, and the executive would owe big-time back taxes on the exercised award, even if the stock had not yet been sold. If the exercise date is bogus, that means the company has underwithheld taxes on the exercise, and that means it owes the government, with penalties and interest. Failure to withhold payroll taxes on non-qualified options can result in the denial of the corporate tax deduction for the compensation element of the stock option award. This alone could result in hundreds of millions of dollars in unpaid corporate income taxes.

4. **Financial Statements and Restatements:** Rules for recording the impact of options expenses have changed, but under both the old rules and the new rules, pretending the awards were granted at a price they were not requires companies to go back and restate earnings.

5. **Excess Compensation:** Companies can take tax deductions for compensation to top executives over $1 million only if it is performance-based. Backdated options are not, so there may well be tax penalties.

6. **The Alternative Minimum Tax:** Employees who have incentive stock options do not have to pay any tax when they exercise the option, only when they sell the stock (provided they hold the shares for one year after exercise and two years after grant). At sale, they only would pay capital gains taxes, but they may be subject to the alternative minimum tax (AMT) requiring them to count the spread on the option at exercise as a "preference" item. Many employees (especially executives) would have held on to the stock after exercise for at least a year and paid the AMT. But backdated options cannot be incentive options because incentive options must be issued at fair market value. So, that means they now owe regular tax on the exercise of the option from years ago.

7. **Changes to Option Programs:** This scandal could force companies to reduce or eliminate the granting of options. Why risk the hassle? Just cancel the plan.

OBSERVATION: GREED

Excessive executive compensation seems to be an issue that just won't go away. The theory seems to be that a good CEO is worth any price a company will pay. Any gain a company makes is assumed to be the sole result of the extraordinary wisdom of this one very special person, not the collective efforts of hundreds or thousands of employees. Despite all the editorials, all the accounting rule changes, and all the new laws, nothing much seems to change except the particular manner in which so many executives get overpaid. Chances are this particular practice will now go away, but another one will surface all too soon. The question is – How will you react to the next scandal? Will you have the courage to question and stop the practice? Check out the latest at www.NCEO.org.

CHAPTER 6 – REVIEW QUESTIONS

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

We recommend that you answer each review question and then compare your response to the suggested solution before answering the final exam questions related to this chapter.

1. Smith is a member of the AICPA and is the controller for a large wholesale distribution company. In the current year, sales were down 10% from the prior year. The Vice President of Finance has instructed Smith to "keep the books open" for a few days in January so that some anticipated large orders could be booked in the prior year. What should Smith do:

   a) determine if "leaving the books open" for a few days is an acceptable alternative accounting principle
   b) communicate the disagreement to the appropriate higher level of management
   c) if higher level management fails to take action, Smith should consider quitting employment
   d) all of the above

2. Which of the following is a potential consequence of stock option backdating:

   a) less opportunity for shareholder litigation
   b) reduced corporate taxes
   c) mandatory jail time for stock option recipients
   d) an increased number of financial statement restatements

CHAPTER 6 – SOLUTIONS AND SUGGESTED RESPONSES

1. A: Incorrect. He must do more than simply analyze the circumstances.

   B: Incorrect. While a proper second step, claiming, "I was only following orders" is not acceptable.

   C: Incorrect. Quitting may be required, but it is not the only requirement.

   D: Correct. A CPA should take all of the above steps.

   (See Interpretation 102-4 in the course material.)

2. A: Incorrect. Since options were issued at less than fair value, shareholders were harmed. This could lead to more litigation, not less.

   B: Incorrect. Corporate taxes could be increased if the backdated options were deemed to be deferred compensation under section 409A.

   C: Incorrect. The SEC is investigating those persons who are responsible for backdating options. However, most recipients of the stock options are not under criminal investigation.

   D: Correct. Financial statements will need to be restated to reflect the actual financial impact of the stock option award.

   (See Stock Option Backdating in the course material.)

GLOSSARY OF ETHICS TERMS

The terms included in this glossary are related to the ethics area in general, but may not be specifically used in this material. They are provided for greater clarification and educational purpose.

TERM	DEFINITION
Alternative Practice Structures (APS)	A nontraditional structure for the practice of public accounting in which a traditional CPA firm engaged in auditing and other attestation services might be closely aligned with another organization, public or private, that performs other professional services (e.g., tax and consulting).
American Institute of Certified Public Accountants (AICPA)	The national professional organization for all certified public accountants (CPAs).
Client's records	Any accounting or other records belonging to the client that were given to the member by, or on behalf of, the client.
Close relative	Close relatives are the member's nondependent children (including grandchildren and stepchildren), brothers and sisters, grandparents, parents, and parents-in-law. Spouses of any of the above are also close relatives. The SEC definition of close relatives expands the above to include a spouse's brothers and sisters and their spouses.
Code of Professional Conduct (the Code)	The Code was adopted by the membership of the AICPA to provide guidance and rules to all members on various ethics requirements. The Code consists of: 1) Principles, 2) Rules, 3) Interpretations, and 4) Ethics Rulings.
Conflict of interest	A conflict of interest may occur if a member performs a professional service for a client or employer, and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity.
Consulting process	The analytical approach applied in performing a consulting service. The process typically involved some combination of the following: • Determining the client's objective • Fact-finding • Defining problems or opportunities • Evaluating alternatives • Formulating proposed actions • Communicating results • Implementing • Following up

Consulting services	Professional services that use the practitioner's technical skills, education, observations, experiences, and knowledge of the consulting process.
Contingent fee	A fee for performing any service in which the amount of the fee (or whether a fee will be paid) depends on the results of the service.
Direct financial interest	A direct financial interest is created when a member invests in a client entity.
Disqualifying services	Term used to refer to the following services, which when performed for a client prohibit the member from accepting a contingent fee or commission: a. An audit or a review of a financial statement. b. An examination of prospective financial information. c. A compilation of a financial statement expected to be used by third parties except when the compilation report discloses a lack of independence.
Ethics Rulings	Part of the Code of Professional Conduct. Rulings summarize the application of rules and interpretations to a particular set of factual circumstances.
Firm	A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.
Former practitioner	A proprietor, partner, shareholder or equivalent of a firm, who leaves by resignation, termination, retirement, or sale of all or part of the practice.
Holding out as a CPA	Includes any action initiated by a member, whether or not in public practice, that informs others of his or her status as a CPA.
Independence in appearance	If there are circumstances that a reasonable person might believe are likely to impair independence, the CPA is not independent in appearance. To be recognized as independent, the auditor must be free from any obligation to or interest in the client, its management, or its owners.
Independence in fact	To be independent in fact (mental independence), the CPA must have integrity and objectivity. If there is evidence that independence is actually lacking, the auditor is not independent in fact.
Indirect financial interest	An indirect financial interest is created when a member invests in a nonclient entity that has a financial interest in a client.
Integrity	An element of character fundamental to professional recognition. It is the quality from which public trust derives and the benchmark against which a member must ultimately test all decisions.

Internal audit outsourcing	Internal audit outsourcing involves performing audit procedures that are generally of the type considered to be extensions of audit scope applied in the audit of financial statements. Examples of such procedures might include confirming receivables, analyzing fluctuations in account balances, and testing and evaluating the effectiveness of controls.
Interpretations of rules of conduct	Part of the Code of Professional Conduct. Interpretations are pronouncements issued by the AICPA's Division of Professional Ethics to provide guidelines concerning the scope and application of the rules of conduct.
Joint closely held business investment	An investment that is subject to control by the member, or the member's firm, client or its officers, directors, or principal stockholders, or any combination of the above.
Joint Ethics Enforcement Program (JEEP)	The AICPA and most state societies cooperate in the Joint Ethics Enforcement Program (JEEP) in bringing enforcement actions against their members.
Member	In its broadest sense, "member" is a term used to describe a member, associate member, or international associate of the AICPA. All members must adhere to the AICPA's Code of Professional Conduct. For the purposes of applying the independence rules, the term "member" identifies the people in a CPA firm and their spouses, dependents, and cohabitants who are subject to the independence requirements.
Multidisciplinary practices (MDP)	Arrangements in which CPAs share fees with attorneys or other professionals.
National Association of State Boards of Accountancy (NASBA)	A voluntary organization composed of the state boards of accountancy. It promotes communication, coordination, and uniformity among state boards.
Objectivity	The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Objectivity is a state of mind, a quality that lends value to a member's services.
Period of professional engagement	The period of engagement starts when the member begins the service requiring independence and ends upon termination of the relationship (by the member or the client) or, if later, when the report is issued. The period does not stop when the report is issued and restart with the beginning of the next engagement. The period of engagement typically covers many periods.

Practice of public accounting	According to the Code of Professional Conduct, the practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as CPAs, of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements on Standards for Tax Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements. However, a member or member's firm, while holding out as CPAs, is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.
Principles	Positive statements of responsibility in the Code of Professional Conduct that provide the framework for the rules, which govern performance.
Professional services	Includes all services performed by a member while holding out as a CPA.
Rules	Broad but specific descriptions of conduct that would violate the responsibilities stated in the principles in the Code of Professional Conduct.
Securities and Exchange Commission (SEC)	A federal government regulatory agency with responsibility for administering the federal securities laws.
State boards of accountancy	State government regulatory organizations. Each state government issues a license to practice within the particular state under that state's accountancy statute.
State societies of CPAs	Voluntary organizations of CPAs within each individual state.
Statements on Standards for Tax Services (SSTS)	SSTS superseded and replaced the AICPA's Statements on Responsibilities in Tax Practice (SRTP). They are enforceable standards of conduct for tax practice under the Code of Professional Conduct.
Unpaid fees	Fees for: 1) audit, and 2) other professional services that relate to certain prior periods that are delinquent as of the date the current year's audit engagement begins, if the client is an SEC registrant, or the date the audit report is issued for non-SEC clients (i.e., AICPA rule).
Yellow Book	Governmental Auditing Standards issued by the Government Accountability Office.

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