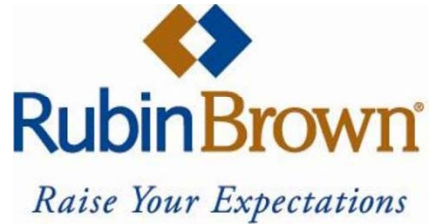


# Professional Ethics



# AICPA Ethics and Independence Update

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Partner-In-Charge: Colleges & Universities Services  
Group

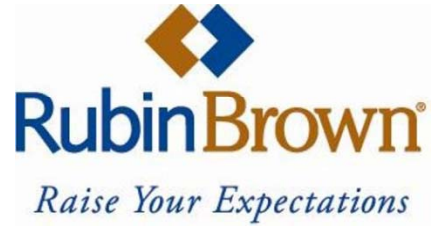
- ◆ Overview of the AICPA's Professional Ethics Division
- ◆ Ethics Standard Setting Process
- ◆ New Ethics Standards Relevant to Members in Business
- ◆ Tools and Resources

The views expressed in this presentation are our own and not those of the AICPA, the Professional Ethics Division, or the Professional Ethics Executive Committee.

# Overview of the AICPA's Professional Ethics Division

# AICPA's Professional Ethics Division

- ❖ Establish independence and ethics standards for the CPA profession
  - ▶ AICPA Code of Professional Conduct
  - ▶ Non-authoritative guidance (e.g., FAQ's)
- ❖ Enforcement – investigate potential violations of the code
- ❖ Educate members on ethics standards
  - ▶ Hotline, Presentations, etc.



# AICPA Ethics Hotline

- ◆ Open from 9 a.m. to 5 p.m. ET on weekdays
- ◆ 888-777-7077
- ◆ [ethics@aicpa.org](mailto:ethics@aicpa.org)



# Other U.S. Ethics Standard-Setters / Regulators

- ❖ **State boards of accountancy**
- ❖ Public Company Accounting Oversight Board (PCAOB)
- ❖ Securities and Exchange Commission (SEC)
- ❖ **Government Accountability Office (GAO)**
- ❖ **Department of Labor (DOL)**
- ❖ Banking regulators

# Ethics Division Structure

Professional Ethics Division  
staffs the following committees:



# Professional Ethics Executive Committee (PEEC)

- ❖ AICPA senior technical committee
- ❖ Comprised of 20 members
  - ❖ 14 public practice members
    - Big 4, 5 Medium and 5 Small Firms
  - ❖ 2 state board members
  - ❖ 3 public members (including academia and government)
  - ❖ 1 business and industry member

# Ethics Standard Setting Process

# AICPA Ethics Standards

- ❖ The Code of Conduct
  - ❖ Principles
  - ❖ Rules
  - ❖ Interpretations
  - ❖ Ethics Rulings
  - ❖ Definitions

# Principles

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_

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

# AICPA Ethics Standards

- ◆ Non-authoritative Guidance
  - ◆ Basis for conclusions documents
  - ◆ Staff Q&As
  - ◆ Staff informal policy decisions
  - ◆ Practice aids

# Standard Setting Process

- ◆ Available on AICPA website:
  - ◆ Committee Meeting Dates\*
  - ◆ Open Meeting Agendas\*\*
  - ◆ Open Meeting Minutes
  - ◆ Exposure Drafts
  - ◆ New Rules and supporting documentation

\*Also published in *The CPA Letter*

\*\*Also mailed to SEC, PCAOB, state boards

# **New Ethics Standards Relevant to Members in Business**

# Confidential Client Information

- ◆ Revised Ethics Ruling
- ◆ Rule 301 – Confidential Client Information
- ◆ Revised Ethics Ruling No. 2, Disclosure of Client Information to Third Parties
- ◆ Effective November 30, 2011

# Confidential Client Information



## New definition of “Confidential Client Information”:

“Confidential client information is any information obtained from the client that is not available to the public.”

# Confidential Client Information

- ❖ Disclosure of client information to third parties is allowable if:
  - ❖ The information is available to the public, or
  - ❖ Specific consent, preferably in writing
- ❖ Disclosure of other information in the member's possession does not require client consent if sufficiently de-identified

# Confidential Client Information

- ◆ Specific consent should include:
  - ◆ Nature of information to be disclosed or used
  - ◆ Type of third party
  - ◆ Intended use

# Confidential Employer Information

- ❖ New Interpretation
- ❖ Rule 501 – Acts Discreditable
- ❖ New Interpretation 501-9, Confidential information obtained from employment or volunteer activities
- ❖ Effective November 30, 2011

# Confidential Employer Information

- ❖ Confidential employer information is any proprietary information pertaining to an employer or any volunteer organization
- ❖ A member must not disclose or use confidential employer information
- ❖ Always be alert to the possibility of inadvertent disclosure

# Confidential Employer Information

- ❖ Take reasonable steps to ensure others are aware of the confidential nature of such information
- ❖ The requirement to maintain confidentiality continues post employment
- ❖ Post employment, a member is entitled to use experience and expertise gained through prior employment relationships

# Member in Business

## ◆ Revised definition approved

- ◆ Effective November 30, 2011
- ◆ Now a “member in business” and not a “member in business and industry”

*“Member in business. A member employed or engaged on a contractual basis or volunteer basis in an executive, staff, governance, advisory or administrative capacity in such areas as industry, the public sector, education, the not-for-profit sector, regulatory bodies, or professional bodies. This does not include members while engaged in the practice of public accounting.”*

# Promotion and Marketing of Services

- ❖ New Interpretation
- ❖ Rule 501 – Acts Discreditable
- ❖ New Interpretation 501-10, False, misleading, or deceptive acts in promoting or marketing professional services
- ❖ Effective November 30, 2011

# Promotion and Marketing of Services

- ❖ Cannot promote or market abilities or make claims about experience or qualifications in a manner that is false, misleading, or deceptive
- ❖ Reasonable person standard
- ❖ Includes misrepresentations about CPA licensure or any other professional certification or accreditation

# Adjunct Faculty Member

- ◆ New Interpretation
- ◆ Rule 101 – Independence
- ◆ New Interpretation 101-19, Permitted employment with client educational institution
- ◆ Effective November 30, 2011

# Adjunct Faculty Member

- ❖ Partners or professional employees are permitted to serve as an adjunct faculty member if they:
  - ❖ Do not hold a key position
  - ❖ Do not participate on the attest engagement
  - ❖ Cannot influence the attest engagement
  - ❖ Employed on a part-time, nontenure basis
  - ❖ Don't participate in any client benefit plans, unless required
  - ❖ Do not assume management responsibilities

# International Convergence

- ❖ As a member of IFAC, the AICPA must have ethics standards that are at least as stringent as the IESBA ethics standards
- ❖ This convergence effort began in 2001 and is on-going
- ❖ Substantive changes to AICPA's rules not anticipated

# Ethics Tools and Resources

# State Accountancy Boards



- ❖ Boards may reference other (e.g., AICPA) or have their own ethics rules
- ❖ [www.aicpa.org/ADVOCACY/STATE/STATECONTACTINFO/Pages/StateContactInformation.aspx](http://www.aicpa.org/ADVOCACY/STATE/STATECONTACTINFO/Pages/StateContactInformation.aspx)

**Ethics / Code of Professional Conduct:**

[www.aicpa.org/InterestAreas/ProfessionalEthics/Pages/ProfessionalEthics.aspx](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Pages/ProfessionalEthics.aspx)

**Ethics Tools and Aids:**

[www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/Pages/default.aspx](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/Pages/default.aspx)

**Tax / SSTs:**

[www.aicpa.org/RESEARCH/STANDARDS/TAX/Pages/default.aspx](http://www.aicpa.org/RESEARCH/STANDARDS/TAX/Pages/default.aspx)



**Current and proposed ethics and  
independence rules under the Yellow Book**

[www.gao.gov/yellowbook](http://www.gao.gov/yellowbook)

**Also see the AICPA  
Government Audit Quality Center:**

[www.aicpa.org/InterestAreas/Governmental  
AuditQuality/Pages/GAQC.aspx](http://www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Pages/GAQC.aspx)



## SEC Independence Resources:

[www.sec.gov/info/accountants/independref.shtml](http://www.sec.gov/info/accountants/independref.shtml)

## PCAOB Ethics / Independence Standards:

[www.irs.gov/pub/irs-utl/pcir230.pdf](http://www.irs.gov/pub/irs-utl/pcir230.pdf)

## Information for tax professionals:

[www.irs.gov/taxpros/content/0,,id=175435,00.html](http://www.irs.gov/taxpros/content/0,,id=175435,00.html)

### **Circular No. 230:**

[www.irs.gov/pub/irs-utl/pcir230.pdf](http://www.irs.gov/pub/irs-utl/pcir230.pdf)

### **AICPA Tax Center:**

<http://www.aicpa.org/INTERESTAREAS/TAX/RESOURCES/STANDARDSETHICS/Pages/default.aspx>



**Questions?**



- ◆ Two Types of Decisions
  - ◀ Right vs. Wrong
  - ◀ Right vs. Right

# Right vs. Wrong Decisions

- ◆ Usually pretty clear.. what is right and what is wrong
- ◆ Make or break an organization
- ◆ High profile --Infamous
- ◆ Long life

# Right vs. Wrong Decisions

- ❖ When you confront these situations, they are defining moments
- ❖ You will be relying on years of experience and influences to guide you
- ❖ Could be applicable laws and industry regulations that guide you
- ❖ Rely on your personal Core Values

# What is a “Right vs. Right” Decision?

- ◆ Certainly the more interesting discussion is the “Right vs. Right” decisions
- ◆ Not a clearly better answer
- ◆ Depends on perspective of the parties impacted

# Why are these decisions important?

- ❖ Frequently present themselves
- ❖ Fabric of an organization
- ❖ We can improve our performance with practice and effort

# Right vs. Right

- ◆ Early in your career –
  - Personal Stakes
- ◆ Later in your career –
  - Organizational Stakes



## Right vs. Right

- ❖ No formula or guaranteed process
- ❖ Each individual has to develop their own approach
- ❖ Core Values, Mission Statements, and Ethics Policies are helpful, but not the answer

## The Good News –

- ◀ Generally a poor decision doesn't doom the Organization
- ◀ Can learn from previous mistakes
- ◀ All future choices can still be influenced

## The Bad News –

-  All these decisions matter and their sum is your organization's culture
-  The more responsibility you have, the more complicated the decisions become...and the more impact they can have on your organization!

# Test Your Ethical Judgment

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

## Question #1

A number of employees are compensated well in excess of the guidelines of the Institution's approved salary and bonus schedules allowable for their positions. The Institution's pay schedule is appropriate, up-to-date, and represents current market conditions (i.e. commensurate with similar positions).

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

Financial information within the Organization is very closely guarded. Even some individuals with a need to know are denied full access to organizational information.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

## Question #3

Each year, Internal Audit presents its final report for completed projects for the year just ended along with its plan for proposed audit projects for the upcoming year to the Audit Committee of the Board of Directors. The rest of the year, Internal Audit reports to the CFO/VP of Finance, who controls and directs their ongoing efforts and approves their promotions, salary increases, bonuses, stock options, and more.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

The President assigns Internal Audit the responsibility for generating an important operational reporting package that has no audit purpose or use. Its production is time-intensive, consuming most of the time of Internal Audit's staff for at least the first six months of its inception. This effort drained already limited departmental resources and delayed scheduled audits.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

At the end of each month, the organization estimates and books a particular operating expense as an adjusting entry because it is subject to delayed billings. Until the organization pays the bills, the accrued amounts remain in a liability account on its balance sheet.

## Question #5 - Continued

Because these accruals are estimates, the organization reevaluates them periodically to see if they are at appropriate levels. Accordingly, the organization routinely adjusts its accruals as it learns more about applicable charges.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

## Question #6

In an effort to reduce these accrued expenses (Q#5) to meet budget, the CFO/VP of Finance directs accounting to reduce a particular department's specific expense by \$150 million.

When accounting calls the VP of Finance of this division and asks her to reduce these expenses, she refuses because there is no support for the entry. Consequently, the requested journal entry is prepared in General Accounting.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

In an attempt to reduce operating expenses, the organization capitalizes “rent” on underutilized assets (excess capacity) as prepaid capacity.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

## Question #8

An accountant in General Accounting feels uncomfortable with this accounting treatment (Q#7), believing that even considering preparing a journal entry to meet budget is “wrong and beyond aggressive accounting.” He brought his concerns to the CFO, who explained the business rationale behind the entries, saying that these things were occurring to “bring the cost structure down.”

## Question #8 - Continued

As the meeting ended, the CFO assures this accountant that everything would be okay. Nevertheless, the accountant wanted to resign but didn't have another job available. Despite his concern, he did nothing to communicate the issue to either internal or external auditors because he was concerned for his job security and had a family to support.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

The Controller also did nothing to stop the questionable capitalization, despite the fact that he, too, felt uncomfortable with the entries. To the contrary, he encouraged the questionable accounting treatment.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting

## Question #10

The organization has a long-term minimum purchase contract with a major customer. Under the terms of the contract, the customer agrees to refund \$100 million if they fail to meet these required minimums on an annual basis, cumulatively measured at the end of five-year periods.

## Question #10 - Continued

By the end of the second year, forecasts show that this particular customer would again fall short of its annual purchase commitment. Thus, the organization begins to accrue revenue on this contract ratably at \$5 million per quarter.

## Possible Answers

- a) Good business practice
- b) Perfectly ethical, but raises a red flag
- c) Improper, but not fraudulent
- d) Improper and a possible indicator of fraud
- e) Fraudulent accounting