PacificCPE

Ethics for Michigan CPAs

Course #5002

Accounting

3 Credit Hours

Support@PacificCPE.com | (800) 787-5313

GENERAL ETHICS FOR MICHIGAN CPAS (COURSE #5002A)

COURSE DESCRIPTION

This course is designed to meet the general ethics requirements for the state of Michigan. It covers the AICPA Code of Professional Conduct and IRS Circular 230.

Note: Beginning June 17, 2018, of the 4 hours of CE in the area of professional ethics that are required in a 2-year license cycle, at least 1 hour must cover the laws and rules of Michigan that apply to public accountancy. The content for this hour of CE is required to be created by a statewide professional CPA association approved by LARA. This one-hour requirement will count towards the 4 hour ethics requirement and will first need to be reported for the 2019 renewal. This course qualifies for 3 hours of general ethics but does not fulfill the specific 1 hour requirement. For more information, please consult the Board's website at http://www.www.michigan.gov/lara.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

ASSIGNMENT **SUBJECT**

1 **Chapter 1: The AICPA Code of Professional Conduct**

Study the course materials from pages 1 to 42

Complete the review questions at the end of the chapter

Answer the exam questions 1 to 8

Objectives:

- To recognize the rules of the Code of Professional Conduct

ASSIGNMENT **SUBJECT**

2 **Chapter 2: IRS Circular 230**

Study the course materials from pages 43 to 78

Complete the review questions at the end of the chapter

Answer the exam questions 9 to 15

Objectives:

- To identify the Internal Revenue Service Requirements as outlined in Circular 230

ASSIGNMENT **SUBJECT**

3 **Complete the Online Exam**

Program publication date **7/24/18**

EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 15 multiple-choice questions and is based specifically on the information covered in the course materials.

- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.

- **LICENSE RENEWAL INFORMATION:** This course (#5002A) qualifies for **3** CPE hours.

- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.

- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

ENJOY YOUR COURSE

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INTRODUCTION

LAW CHANGE IMPACTING REQUIREMENTS FOR CERTIFIED PUBLIC ACCOUNTANTS AND FIRMS

House Bill 5236 (now Public Act 81 of 2018) amends Article 7 of the Occupational Code, 1980 PA 299, by revising the continuing education requirements for licensed CPAs, as well as revising the requirements for out of state firms. These requirements took effect on June 17, 2018.

Highlights of PA 81 of 2018 include the following:

- Requires that the CPA examination used by the state be the Uniform CPA Examination developed and scored by the American Institute of Certified Public Accountants, or its successor organization, and the bill would authorize Licensing and Regulatory Affairs (LARA) to promulgate rules governing the educational requirements that qualify an applicant to sit for the exam.
- Allows an out-of-state firm to perform attest services without a license if it meets certain conditions, which include being authorized to perform the services in the jurisdiction where it is licensed and meeting Michigan requirements regarding peer review and firm ownership.
- Provides that a licensee is not required to meet the CE requirements for the 12-month period beginning on the date of his or her original license.
- Requires at least 8 of the 40 hours of CE required annually to be in the areas of auditing and accounting, while also stipulating that the board cannot require more than 8 hours of CE in auditing and accounting in any 1 year.
- Requires at least 2 of the 40 hours of CE required annually to be in the area of professional ethics, while also stipulating that the board cannot require more than 2 hours of CE in professional ethics in any 1 year.
- Requires that, of the 4 hours of CE in the area of professional ethics that are required in a 2-year license cycle, at least 1 hour must cover the laws and rules of this state that apply to public accountancy. The content for this hour of CE is required to be created by a statewide professional CPA association approved by LARA.
- Allows a licensee who has earned more than 40 hours of CE in a year to carry over the excess hours to the next year, as long as the hours carried over to the next year do not exceed 40 hours in total and do not exceed 8 hours of CE in auditing and accounting, 2 hours of CE in professional ethics, or 1 hour of CE in public accountancy laws and regulations.

- Requires a nonresident licensee to certify in his or her renewal application that he or she has met the state's CE requirements, but stipulate that a nonresident licensee is considered to have met this state's CE requirements if the state where his or her business is located also has CE requirements for renewal of a licensee and the nonresident licensee has met the CE requirements of that state.
- Requires a licensee to provide, upon request of LARA, proof acceptable to LARA that the licensee meets applicable CE requirements. For a licensee with a principal place of business in this state, the proof would show that the licensee meets the CE requirements for license renewal in this state. For a nonresident licensee, the proof would show that the licensee meets the CE requirements for license renewal in the licensing jurisdiction where his or her principal place of business is located.

ACCOUNTANCY FAQS

When can I renew my license? How do I renew my license?

Licensees can begin to renew their licenses approximately 90 days prior to the renewal due date of their current license.

Licensees will be mailed a renewal notification to their address on record approximately 90 days prior to the renewal due date of the license. Remember to notify the Department in writing of any address change. It is a licensee's responsibility to renew his or her license on time. Failure to receive the renewal notification, or to notify the Department of an address change, does not exempt a licensee from renewing their license on time.

Licensees are required to renew their license(s) by using the online renewal system at www.michigan.gov/elicense using a debit or credit card containing a MasterCard, Visa or Discover logo or by electronic check.

What are my continuing education requirements?

A licensed CPA is required to earn 40 hours annually within the continuing education period including a minimum of 8 hours in auditing and accounting and 2 hours in ethics. The content of 1 hour of the 4 hours of ethics required in a 2-year license cycle must cover the laws and rules of this state. A licensee is not required to meet the CE requirements for the 12-month period beginning on the date of his or her original license.

CE requirements for relicensure applicants are prorated from the month following the date of licensure for the continuing education period in which the license is granted. Once a relicensure application has been approved, the Department notifies the licensee of their CE requirements for the next renewal by mail.

"Continuing education period" means all or part of a year beginning July 1 and ending June 30.

What is the difference between a CPA license and a CPA registration?

If an individual only seeks to use the CPA title, the individual shall apply for a registration.

If an individual seeks to use the CPA title and engage in the practice of public accounting, the individual shall apply for a license.

Can I use the CPA designation while in registered status?

If an individual only seeks to use the CPA title, the individual shall apply for a registration.

How do I change my status from licensed to registered? Can I do this online?

You must submit a completed Application for CPA License, Relicensure, Registration, or Reregistration, along with the appropriate fee, to the Department. The Application for CPA License, Relicensure, Registration, or Reregistration can be downloaded from www.michigan.gov/accountancy.

An application for a CPA registration is for current Michigan CPA certificate holders who have never held a CPA registration in Michigan, who hold a current or lapsed license, and who wish to obtain a CPA registration.

An application for a CPA reregistration is for current Michigan certificate holders whose CPA registration has lapsed for 61 days or more and who wish to reactivate their expired CPA registration.

The Application for CPA License, Relicensure, Registration, or Reregistration cannot be submitted online at this time.

My license is expired. How do I become relicensed?

You must submit a completed Application for CPA License, Relicensure, Registration, or Reregistration, along with the appropriate fee and proof of having completed 40 hours of continuing education including 8 hours of accounting/auditing and 2 hours of ethics within the 12 months immediately preceding the date of application, to the Department. The Application for CPA License, Relicensure, Registration, or Reregistration can be downloaded from www.michigan.gov/accountancy.

A person may be relicensed or reregistered subsequent to 3 or more years after the expiration date of the last license or registration if the person shows that the person meets the requirements for licensure or registration as established by the Department in rules or procedures, which may require a person to pass all or part of a required examination, to complete continuing education requirements, or to meet current education or training requirements.

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CHAPTER 1: THE AICPA CODE OF PROFESSIONAL CONDUCT

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the rules of the Code of Professional Conduct.

INTRODUCTION

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.

RULES

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

Practice of public accounting - The practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as a 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 a 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 with very few exceptions.

CODIFIED CODE OF PROFESSIONAL CONDUCT

The AICPA has codified the Code of Professional Conduct to be more logical and user friendly. The code, rules, interpretations and rulings are essentially the same but have been grouped into functional areas based on the member's area of practice plus a preface that is applicable to all members. (Note: throughout the AICPA Code of Professional Conduct you will see the term "Member." This term relates to you, the CPA, whether or not you are a member of the AICPA.) The three functional areas are:

Part 1: Members in Public Practice

Part 2: Members in Business

Part 3: Other Members (retired, unemployed, etc.)

The part number is followed by two sets of three digit numbers to identify the topic and, when applicable, the subtopic. For example, 1.100.001 relates to Part 1 (members in Public Practice); topic 100 Integrity and Objectivity; and subtopic 001 the Integrity and Objectivity rule.

By grouping all guidance for a particular type of member in one place, the CPA will save much time in researching a situation, as well as (hopefully) reach a more accurate conclusion. However, bear in mind that a member may be covered by more than one category. For example, one could work full time for an employer in industry and work part time during busy season preparing tax returns.

This chapter will focus on Part 1 of the Code of Professional Conduct: Members in Public Practice. Below is a listing of the topics covered in Part 1 followed by a discussion of each topic and selected corresponding interpretations, rulings, and other guidance by topic.

1.000 Conceptual Framework for Members in Public Practice

1.100 Integrity and Objectivity

1.200 Independence

1.300 General Standards

1.400 Acts Discreditable

1.500 Fees and Other Types of Remuneration

1.600 Advertising and Other Forms of Solicitation

1.700 Confidential Information

1.800 Form of Organization and Name

Throughout this course, we will attempt to use the actual AICPA code section references whenever possible. This will allow you to conduct further research on topics of interest to you. However, the source material is very voluminous and in many instances we have omitted entire sections of the code. In other instances we have summarized the material. We believe this approach is both appropriate and beneficial for the CPA seeking an overview or refresher course.

MEMBERS IN PUBLIC PRACTICE

1.000 INTRODUCTION

.01 Part 1 of the Code of Professional Conduct (the code) applies to members in public practice. Accordingly, when the term member is used in part 1 of the code, the requirements apply only to members in public practice. When a member in public practice is also a member in business (for example, serves as a member of an entity's board of directors), the member should also consult part 2 of the code, which applies to a member in business.

.02 Government auditors within a government audit organization who audit federal, state, or local governments or component units thereof, that are structurally located within the government audit organization, are considered in public practice with respect to those entities provided the head of the government audit organization meets at least one of the following criteria:

a. Is directly elected by voters of the government entity with respect to which attest engagements are performed

b. Is appointed by a legislative body and is subject to removal by a legislative body

c. Is appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

1.000.010 CONCEPTUAL FRAMEWORK FOR MEMBERS IN PUBLIC PRACTICE

Introduction

.01 Members may encounter various relationships or circumstances that create threats to the member's compliance with the rules. The rules and interpretations seek to address many situations; however, they cannot address all relationships or circumstances that may arise. Thus, in the absence of an interpretation that addresses a particular relationship or circumstance, a member should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a threat to the member's compliance with the rules that is not at an acceptable level. When making that evaluation, the member should apply the conceptual framework approach as outlined in this interpretation.

.02 The code specifies that in some circumstances no safeguards can reduce a threat to an acceptable level. For example, the code specifies that a member may not subordinate the member's professional judgment to others without violating the "Integrity and Objectivity Rule" [1.100.001]. A member may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in the code.

.03 The "Conceptual Framework for Independence" interpretation [1.210.010] of the "Independence Rule" [1.200.001] provides authoritative guidance that members should use when making decisions on independence matters that are not explicitly addressed by the "Independence Rule" and its interpretations.

Definitions Used in Applying the Conceptual Framework

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

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

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

Conceptual Framework Approach

.07 Under the conceptual framework approach, members should identify threats to compliance with the rules and evaluate the significance of those threats. Members should evaluate identified threats both individually and in the aggregate because threats can have a cumulative effect on a member's compliance with the rules. Members should perform three main steps in applying the conceptual framework approach:

a. Identify threats. The relationships or circumstances that a member encounters in various engagements and work assignments will often create different threats to complying with the rules. When a member encounters a relationship or circumstance that is not specifically addressed by a rule or an interpretation, under this approach, the member should determine whether the relationship or circumstance creates one or more threats, such as those identified in paragraphs .10–.16 that follow. The existence of a threat does not mean that the member is in violation of the rules; however, the member should evaluate the significance of the threat.

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

c. Identify and apply safeguards. If, in evaluating the significance of an identified threat, the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. The member

should apply judgment in determining the nature of the safeguards to be applied because the effectiveness of safeguards will vary, depending on the circumstances. When identifying appropriate safeguards to apply, one safeguard may eliminate or reduce multiple threats. In some cases, the member should apply multiple safeguards to eliminate or reduce one threat to an acceptable level. In other cases, an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member will be unable to implement effective safeguards. Under such circumstances, providing the specific professional services would compromise the member's compliance with the rules, and the member should determine whether to decline or discontinue the professional services or resign from the engagement.

Threats

.08 Many threats fall into one or more of the following seven broad categories: adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.

.09 Examples of threats associated with a specific relationship or circumstance are identified in the interpretations of the code. Paragraphs .10–.16 of this section define and provide examples, which are not all inclusive, of each of these threat categories.

.10 Adverse interest threat. The threat that a member will not act with objectivity because the member's interests are opposed to the client's interests. Examples of adverse interest threats include the following:

a. The client has expressed an intention to commence litigation against the member.

b. A client or officer, director, or significant shareholder of the client participates in litigation against the firm.

c. A subrogee asserts a claim against the firm for recovery of insurance payments made to the client.

d. A class action lawsuit is filed against the client and its officers and directors and the firm and its professional accountants.

.11 Advocacy threat. The threat that a member will promote a client's interests or position to the point that his or her objectivity or independence is compromised. Examples of advocacy threats include the following:

a. A member provides forensic accounting services to a client in litigation or a dispute with third parties.

b. A firm acts as an investment adviser for an officer, a director, or a 10 percent shareholder of a client.

c. A firm underwrites or promotes a client's shares.

d. A firm acts as a registered agent for a client.

e. A member endorses a client's services or products.

.12 Familiarity threat. The threat that, due to a long or close relationship with a client, a member will become too sympathetic to the client's interests or too accepting of the client's work or product. Examples of familiarity threats include the following:

a. A member's immediate family or close relative is employed by the client.

b. A member's close friend is employed by the client.

c. A former partner or professional employee joins the client in a key position and has knowledge of the firm's policies and practices for the professional services engagement.

d. Senior personnel have a long association with a client.

e. A member has a significant close business relationship with an officer, a director, or a 10 percent shareholder of a client.

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

.14 Self-interest threat. The threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client. Examples of self-interest threats include the following:

a. The member has a financial interest in a client, and the outcome of a professional services engagement may affect the fair value of that financial interest.

b. The member's spouse enters into employment negotiations with the client.

c. A firm enters into a contingent fee arrangement for a tax refund claim that is not a predetermined fee.

d. Excessive reliance exists on revenue from a single client.

.15 Self-review threat. The threat that a member will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the member or an individual in the member's firm and that the member will rely on that service in forming a judgment as part of another service. Examples of self-review threats include the following:

a. The member relies on the work product of the member's firm.

b. The member performs bookkeeping services for a client.

c. A partner in the member's office was associated with the client as an employee, an officer, a director, or a contractor.

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

Examples of undue influence threats include the following:

a. The firm is threatened with dismissal from a client engagement.

b. The client indicates that it will not award additional engagements to the firm if the firm continues to disagree with the client on an accounting or tax matter.

c. An individual associated with a client or any relevant third party threatens to withdraw or terminate a professional service unless the member reaches certain judgments or conclusions.

Safeguards

.17 Safeguards may partially or completely eliminate a threat or diminish the potential influence of a threat. The nature and extent of the safeguards applied will depend on many factors. To be effective, safeguards should eliminate the threat or reduce it to an acceptable level.

.18 Safeguards that may eliminate a threat or reduce it to an acceptable level fall into three broad categories:

a. Safeguards created by the profession, legislation, or regulation.

b. Safeguards implemented by the client. It is not possible to rely solely on safeguards implemented by the client to eliminate or reduce significant threats to an acceptable level.

c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements.

.19 The effectiveness of a safeguard depends on many factors, including those listed here:

a. The facts and circumstances specific to a particular situation

b. The proper identification of threats

c. Whether the safeguard is suitably designed to meet its objectives

d. The party(ies) who will be subject to the safeguard

e. How the safeguard is applied

f. The consistency with which the safeguard is applied

g. Who applies the safeguard

h. How the safeguard interacts with a safeguard from another category

i. Whether the client is a public interest entity

.20 Examples of safeguards within each category are presented in the following paragraphs. Because these are only examples and are not intended to be all inclusive, it is possible that threats may be sufficiently mitigated through the application of other safeguards not specifically identified herein.

.21 The following are examples of safeguards created by the profession, legislation, or regulation:

a. Education and training requirements on independence and ethics rules

b. Continuing education requirements on independence and ethics

c. Professional standards and the threat of discipline

d. External review of a firm's quality control system

e. Legislation establishing prohibitions and requirements for a firm or a firm's professional employees

f. Competency and experience requirements for professional licensure

g. Professional resources, such as hotlines, for consultation on ethical issues

.22 Examples of safeguards implemented by the client that would operate in combination with other safeguards are as follows:

a. The client has personnel with suitable skill, knowledge, or experience who make managerial decisions about the delivery of professional services and makes use of third-party resources for consultation as needed.

b. The tone at the top emphasizes the client's commitment to fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.

c. Policies and procedures are in place to achieve fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.

d. Policies and procedures are in place to address ethical conduct.

e. A governance structure, such as an active audit committee, is in place to ensure appropriate decision making, oversight, and communications regarding a firm's services.

f. Policies are in place that bar the entity from hiring a firm to provide services that do not serve the public interest or that would cause the firm's independence or objectivity to be considered impaired.

.23 The following are examples of safeguards implemented by the firm:

a. Firm leadership that stresses the importance of complying with the rules and the expectation that engagement teams will act in the public interest.

b. Policies and procedures that are designed to implement and monitor engagement quality control.

c. Documented policies regarding the identification of threats to compliance with the rules, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate identified threats or reduce them to an acceptable level.

d. Internal policies and procedures that are designed to monitor compliance with the firm's policies and procedures.

e. Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and the firm's clients.

f. The use of different partners, partner equivalents, and engagement teams from different offices or that report to different supervisors.

g. Training on, and timely communication of, a firm's policies and procedures and any changes to them for all partners and professional staff.

h. Policies and procedures that are designed to monitor the firm's, partner's, or partner equivalent's reliance on revenue from a single client and that, if necessary, trigger action to address excessive reliance.

i. Designation of someone from senior management as the person responsible for overseeing the adequate functioning of the firm's quality control system.

j. A means for informing partners and professional staff of attest clients and related entities from which they must be independent.

k. A disciplinary mechanism that is designed to promote compliance with policies and procedures.

l. Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution.

m. Policies and procedures relating to independence and ethics communications with audit committees or others charged with client governance.

n. Discussion of independence and ethics issues with the audit committee or others responsible for the client's governance.

o. Disclosures to the audit committee or others responsible for the client's governance regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged.

p. The involvement of another professional accountant who (a) reviews the work that is done for a client or (b) otherwise advises the engagement team. This individual could be someone from outside the firm or someone from within the firm who is not otherwise associated with the engagement.

q. Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant.

r. Rotation of senior personnel who are part of the engagement team.

s. Policies and procedures that are designed to ensure that members of the engagement team do not make or assume responsibility for management decisions for the client.

t. The involvement of another firm to perform part of the engagement.

u. Having another firm to reperform a nonattest service to the extent necessary for it to take responsibility for that service.

v. The removal of an individual from an attest engagement team when that individual's financial interests or relationships pose a threat to independence or objectivity.

w. A consultation function that is staffed with experts in accounting, auditing, independence, ethics, and reporting matters who can help engagement teams

i. assess issues when guidance is unclear or when the issues are highly technical or require a great deal of judgment; and

ii. resist undue pressure from a client when the engagement team disagrees with the client about such issues.

x. Client acceptance and continuation policies that are designed to prevent association with clients that pose a threat that is not at an acceptable level to the member's compliance with the rules.

y. Policies that preclude audit partners or partner equivalents from being directly compensated for selling nonattest services to the attest client.

z. Policies and procedures addressing ethical conduct and compliance with laws and regulations.

1.000.020 ETHICAL CONFLICTS

.01 An ethical conflict arises when a member encounters one or both of the following:

a. Obstacles to following an appropriate course of action due to internal or external pressures

b. Conflicts in applying relevant professional standards or legal standards

For example, a member suspects a fraud may have occurred, but reporting the suspected fraud would violate the member's responsibility to maintain client confidentiality.

.02 Once an ethical conflict is encountered, a member may be required to take steps to best achieve compliance with the rules and law. In weighing alternative courses of action, the member should consider factors such as the following:

a. Relevant facts and circumstances, including applicable rules, laws, or regulations

b. Ethical issues involved

c. Established internal procedures

.03 The member should also be prepared to justify any departures that the member believes were appropriate in applying the relevant rules and law. If the member was unable to resolve the conflict in a way that permitted compliance with the applicable rules and law, the member may have to address the consequences of any violations.

.04 Before pursuing a course of action, the member should consider consulting with appropriate persons within the firm or the organization that employs the member.

.05 If a member decides not to consult with appropriate persons within the firm or the organization that employs the member and the conflict remains unresolved after pursuing the selected course of action, the member should consider either consulting with other individuals for help in reaching a resolution or obtaining advice from an appropriate professional body or legal counsel. The member also should consider documenting the substance of the issue, the parties with whom the issue was discussed, details of any discussions held, and any decisions made concerning the issue.

.06 If the ethical conflict remains unresolved, the member will in all likelihood be in violation of one or more rules if he or she remains associated with the matter creating the conflict. Accordingly, the member should consider his or her continuing relationship with the engagement team, specific assignment, client, firm, or employer.

1.100 INTEGRITY AND OBJECTIVITY

1.100.001 INTEGRITY AND OBJECTIVITY RULE

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

Interpretations Under the Integrity and Objectivity Rule

1.100.005 APPLICATION OF THE CONCEPTUAL FRAMEWORK FOR MEMBERS IN PUBLIC PRACTICE AND ETHICAL CONFLICTS

.01 In the absence of an interpretation of the “Integrity and Objectivity Rule” [1.100.001] that addresses a particular relationship or circumstance, a member should apply the “Conceptual Framework for Members in Public Practice” [1.000.010].

.02 A member would be considered in violation of the “Integrity and Objectivity Rule” [1.100.001] if the member cannot demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

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

1.110 CONFLICTS OF INTEREST

1.110.010 CONFLICTS OF INTEREST FOR MEMBERS IN PUBLIC PRACTICE

.01 A member or his or her firm may be faced with a conflict of interest when performing a professional service. In determining whether a professional service, relationship or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

.02 A conflict of interest creates adverse interest and self-interest threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001]. For example, threats may be created when

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

b. the interests of the member or the member's firm with respect to a particular matter and the interests of the client for whom the member or the member's firm provides a professional service related to that matter are in conflict.

.03 Certain professional engagements, such as audits, reviews and other attest services require independence. Independence impairments under the "Independence Rule" [1.200.001], its interpretations, and rulings cannot be eliminated by the safeguards provided in this interpretation or by disclosure and consent.

.04 The following are examples of situations in which conflicts of interest may arise:

a. Providing corporate finance services to a client seeking to acquire an audit client of the firm, when the firm has obtained confidential information during the course of the audit that may be relevant to the transaction

b. Advising two clients at the same time who are competing to acquire the same company when the advice might be relevant to the parties' competitive positions

c. Providing services to both a vendor and a purchaser who are clients of the firm in relation to the same transaction

d. Preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets

e. Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership

f. Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement

g. Advising a client to invest in a business in which, for example, the immediate family member of the member has a financial interest in the business

h. Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client

i. Advising a client on the acquisition of a business which the firm is also interested in acquiring

j. Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service

k. Providing forensic investigation services to a client for the purpose of evaluating or supporting contemplated litigation against another client of the firm

l. Providing tax or personal financial planning services for several members of a family whom the member knows to have opposing interests

m. Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement

n. A client asks the member to provide tax or personal financial planning services to its executives, and the services could result in the member recommending to the executives actions that may be adverse to the company

o. A member serves as a director or an officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities receive funds. Some of those charities are clients of the member's firm

p. A member who is an officer, a director, or a shareholder of an entity has significant influence over the entity, and that entity has a loan to or from a client of the firm

Identification of a Conflict of Interest

.05 Before accepting a new client relationship, engagement, or business relationship, a member should take reasonable steps to identify circumstances that might create a conflict of interest including identification of

a. the nature of the relevant interests and relationships between the parties involved, and

b. the nature of the service and its implication for relevant parties.

.06 The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a member is asked to conduct an engagement for a client in a situation that may become adversarial with respect to another client or the member or member's firm, even though the parties who engage the member may not initially be involved in a dispute. A member should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

.07 For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a member in identifying actual or potential conflicts of interest that may create significant threats to compliance with the "Integrity and Objectivity Rule" [1.100.001] prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example clients or potential clients. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a member being able to apply safeguards to eliminate or reduce significant threats to an acceptable level. The process to identify actual or potential conflicts of interest will depend on such factors as

a. the nature of the professional services provided,

b. the size of the firm,

c. the size and nature of the client base, and

d. the structure of the firm, for example the number and geographic location of offices.

.08 If the firm is a member of a network, the member is not required to take specific steps to identify conflicts of interest of other network firms; however, if the member knows or has reason to believe that such conflicts of interest may exist or might arise due to interests and relationships of a network firm, the member should evaluate the significance of the threat created by such conflicts of interest as described below.

Evaluation of a Conflict of Interest

.09 When an actual conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. Members should consider both qualitative and quantitative factors when evaluating the significance of the threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. In evaluating the significance of an identified threat, members should consider both of the following:

a. The significance of relevant interests or relationships.

b. The significance of the threats created by performing the professional service or services. In general, the more direct the connection between the professional service and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

.10 If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of safeguards include the following:

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

i. using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;

ii. creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm;

iii. establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and the physical and electronic separation of confidential information.

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

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

d. Consulting with third parties, such as a professional body, legal counsel, or another professional accountant.

.11 In cases where an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

Disclosure of a Conflict of Interest and Consent

.12 When a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional services. The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.

.13 Disclosure and consent may take different forms. The following are examples:

a. General disclosure to clients of circumstances in which the member, in keeping with common commercial practice, does not provide services exclusively for any one client (for example, in a particular service in a particular market sector) in order for the client to provide general consent accordingly. Such disclosure might be made in a member's standard terms and conditions for the engagement.

b. Specific disclosure to affected clients of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the client to make an informed decision with respect to the matter and to provide specific consent.

.14 The member should determine whether the nature and significance of the conflict of interest is such that specific disclosure and specific consent are necessary, as opposed to general disclosure and general consent. For this purpose, the member should exercise professional judgment in evaluating the circumstances that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

.15 When a member has requested specific consent from a client and that consent has been refused by the client, the member should (a) decline to perform or discontinue professional services that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level, such that consent can be obtained, after applying any additional safeguards, if necessary.

.16 The member is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

.17 When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a member should remain alert to the requirements of the "Confidential Client Information Rule" [1.700.001 and the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] of the "Acts Discreditable Rule" [1.400.001]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of client information may be more restrictive than the requirements contained in the Code of Professional Conduct.

.18 When practicing before the IRS or other taxing authorities, members should ensure compliance with any requirements that are more restrictive. For example, Treasury Department Circular No. 230, Regulations Governing Practice before the Internal Revenue Service, provides more restrictive requirements concerning written consent by the client when a conflict of interest exists.

Independent Contractors: Q&A

Question: Would independence be impaired if a CPA firm retained an independent contractor (as defined by IRS regulations and other federal regulatory guidance such as case law and revenue rulings) on a part-time basis that is employed by or associated with an attest client in a key position?

Answer: Yes. Independence would be impaired if an independent contractor retained by the firm was simultaneously employed by or associated with an attest client in a key position. However, if the independent contractor is employed by or associated with the attest client in a non-key position, a member should consider the following criteria when determining if independence (in fact and appearance) is impaired:

a. Location of the firm office where the independent contractor will work in relation to the location of the office providing services to the attest client.

b. Whether the independent contractor performs services for other firms or entities or solely to the member's firm. Factors to consider include but are not limited to:

1. The percentage of income the individual derives from the member's firm in relation to the individual's total "self-employed" or earned income.

2. The percentage of income the individual derives from the client entity in relation to the individual's total earned income.

3. The amount of time the individual devotes to the member's firm versus time devoted to the attest client.

4. The amount of time the individual devotes to the member's firm versus time devoted to other firms or entities.

In situations in which the threats to independence (in fact or appearance) are deemed not significant, the member or the member's firm should consider the potential conflict of interest arising from such a relationship as set forth in the "Conflicts of Interest for Members in Public Practice" interpretation (ET sec. 1.110.010) under "Integrity and Objectivity Rule". If threats are deemed significant, the member should consider whether safeguards are available to eliminate or reduce them to an acceptable level. If no safeguards could eliminate or reduce threats to an acceptable level, independence would be considered impaired.

1.120 GIFTS AND ENTERTAINMENT

1.120.010 OFFERING OR ACCEPTING GIFTS OR ENTERTAINMENT

.01 For purposes of this interpretation, a client includes the client, an individual in a key position with the client, or an individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

.02 When a member offers to a client or accepts gifts or entertainment from a client, self-interest, familiarity, or undue influence threatsto the member's compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist.

.03 Threats to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards and the member would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

a. The member offers to a client or accepts gifts or entertainment from a client that violate the member's or client's policies or applicable laws, rules, and regulations; and

b. The member knows of the violation or demonstrates recklessness in not knowing.

.04 A member should evaluate the significance of any threats to determine if they are at an acceptable level. Threats are at an acceptable level when gifts or entertainment are reasonable in the circumstances. The member should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:

a. The nature of the gift or entertainment

b. The occasion giving rise to the gift or entertainment

c. The cost or value of the gift or entertainment

d. The nature, frequency, and value of other gifts and entertainment offered or accepted

e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment

f. Whether other clients also participated in the entertainment

g. The individuals from the client and member's firm who participated in the entertainment

.05 Threats to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an acceptable level and could not be reduced to an acceptable level through the application of safeguards if a member offers to a client or accepts gifts or entertainment from a client that is not reasonable in the circumstances. The member would be presumed to lack objectivity in violation of the "Integrity and Objectivity Rule" under these circumstances.

.06 Refer to the "Offering or Accepting Gifts or Entertainment" interpretation [1.285.010] of the "Independence Rule" [1.200.001] for additional guidance.

Campaign Contributions: Q&A

Question: May a member make a political contribution to the campaign of an individual that is associated with an attest client in a key position or holds a financial interest in the attest client that is material and/or enables the individual to exercise significant influence over the attest client without impairing independence or violating any other rule of conduct?

Answer: Yes. A member would not impair independence or be in violation of any other rule of conduct provided the political contribution is not made with the intention of influencing the procurement of professional services or in contravention of federal or state laws or regulations. Related Guidance: "Offering or Accepting Gifts or Entertainment" interpretation (ET sec. 1.285.010) under the "Independence Rule" and "Offering or Accepting Gifts or Entertainment" interpretation (ET sec. 1.120.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001) [August 2012]

1.130 PREPARING AND REPORTING INFORMATION

1.130.010 KNOWING MISREPRESENTATIONS IN THE PREPARATION OF FINANCIAL STATEMENTS OR RECORDS

.01 Threats to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards and the member would be considered to have knowingly misrepresented facts in violation of the "Integrity and Objectivity Rule," if the member

a. makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records;

b. fails to correct an entity's financial statements or records that are materially false and misleading when the member has the authority to record the entries; or

c. signs, or permits or directs another to sign, a document containing materially false and misleading information.

1.130.020 SUBORDINATION OF JUDGMENT

.01 The "Integrity and Objectivity Rule" [1.100.001] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services for a client , for an employer, or on a volunteer basis. This interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the member's organization.

.02 Self-interest, familiarity, and undue influence threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist when a member and his or her supervisor or any other person within the member's organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.

.03 A member should evaluate the significance of any threats to determine if they are at an acceptable level. Threats are at an acceptable level if the member concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If threats are not at an acceptable level, the member should apply the safeguards in paragraphs .06–.08 to eliminate or reduce the threat(s) to an acceptable level so that the member does not subordinate his or her judgment.

.04 In evaluating the significance of any identified threats, the member should determine, after appropriate research or consultation, whether the result of the position taken by the supervisor or other person

a. fails to comply with professional standards, when applicable;

b. creates a material misrepresentation of fact; or

c. may violate applicable laws or regulations.

.05 If the member concludes that threats are at an acceptable level the member should discuss his or her conclusions with the person taking the position. No further action would be needed under this interpretation.

.06 If the member concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then threats would not be at an acceptable level. In such circumstances, the member should discuss his or her concerns with the supervisor.

.07 If the difference of opinion is not resolved after discussing the concerns with the supervisor, the member should discuss his or her concerns with the appropriate higher level(s) of management within the member's organization (for example, the supervisor's immediate superior, senior management, and those charged with governance).

.08 If after discussing the concerns with the supervisor and appropriate higher level(s) of management within the member's organization, the member concludes that appropriate action was not taken, then the member should consider, in no specific order, the following safeguards to ensure that threats to the member's compliance with the "Integrity and Objectivity Rule" [1.100.001] are eliminated or reduced to an acceptable level:

a. Determine whether the organization's internal policies and procedures have any additional requirements for reporting differences of opinion.

b. Determine whether he or she is responsible for communicating to third parties, such as regulatory authorities or the organization's (former organization's) external accountant. In considering such communications, the member should be cognizant of his or her obligations under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] of the "Acts Discreditable Rule" [1.400.001].

c. Consult with his or her legal counsel regarding his or her responsibilities.

d. Document his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

.09 If the member concludes that no safeguards can eliminate or reduce the threats to an acceptable level or if the member concludes that appropriate action was not taken, then he or she should consider the continuing relationship with the member's organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

.10 Nothing in this interpretation precludes a member from resigning from the organization at any time. However, resignation may not relieve the member of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

.11 A member should use professional judgment and apply similar safeguards, as appropriate, to other situations involving a difference of opinion as described in this interpretation so that the member does not subordinate his or her judgment.

Question and Answer

Q: Cindy Steffen is a CPA and the controller of Company X Inc. In preparing the financial statements for the quarter ended March 31, 2017, 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?

A: 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.

1.200 INDEPENDENCE

1.200.001 INDEPENDENCE RULE

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

Interpretations Under the Independence Rule

1.200.005 APPLICATION OF THE CONCEPTUAL FRAMEWORK FOR INDEPENDENCE AND ETHICAL CONFLICTS

.01 In the absence of an interpretation of the "Independence Rule" [1.200.001] that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation [1.210.010].

.02 A member would be considered in violation of the "Independence Rule" [1.200.001] if the member cannot demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

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

Observation

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.

1.210 CONCEPTUAL FRAMEWORK APPROACH

1.210.010 CONCEPTUAL FRAMEWORK FOR INDEPENDENCE

Introduction

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

also wish to consider the conceptual framework approach described in this interpretation to gain a better understanding of the conclusions reached in other interpretations in ET section 1.200, "Independence."

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

Definitions Used in Applying the Conceptual Framework for Independence

.03 Acceptable level. A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a member's independence is not impaired.

.04 Impair(ed). In connection with independence, to effectively extinguish independence. When a member's independence is impaired, the member is not independent.

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

.06 Threats. Relationships or circumstances that could impair independence.

Conceptual Framework Approach

.07 The conceptual framework approach entails identifying threats and evaluating the threat that the member would not be independent or would be perceived by a reasonable and informed third party who is aware of the relevant information as not being independent. The member must eliminate or reduce that threat to an acceptable level to conclude that the member is independent. Threats are at an acceptable level either because of the types of threats and their potential effect or because safeguards have eliminated or reduced the threat, so that a reasonable and informed third party who is aware of the relevant information would perceive that the member's professional judgment is not compromised.

.08 Refer to paragraph .07 of the "Conceptual Framework for Members in Public Practice" [1.000.010.07] for a detailed description of the conceptual framework approach.

Documentation

.09 When the member applies safeguards to eliminate or reduce significant threats to an acceptable level, as described in paragraph .07c of the "Conceptual Framework for Members in Public Practice" [1.000.010.07], the member should document the identified threats and safeguards applied. Failure to prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001] rather than the "Independence Rule" [1.200.001] if the member can demonstrate that safeguards were applied that eliminated or reduced significant threats to an acceptable level.

Threats

.10 Many different relationships or circumstances (or combinations of relationships or circumstances) can

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

.11 Examples of threats associated with a specific relationship or circumstance are identified in the interpretations of the code. Paragraphs .12–.18 in this section define and provide examples, which are not all inclusive, of each of these threat categories. In certain circumstances, the code specifies that because of the type of threat and its potential effect, either no safeguards can eliminate or reduce the threat to an acceptable level, or a member would need to apply specific safeguards to eliminate or reduce an independence threat to an acceptable level. When independence interpretations in the code address one of these examples, a specific reference to the independence interpretation is provided in brackets after that example. If an example does not contain a specific reference to an independence interpretation, a member should use this "Conceptual Framework for Independence" interpretation to evaluate whether a threat is significant.

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

.13 Advocacy threat. The threat that a member will promote an attest client's interests or position to the point that his or her independence is compromised. Examples of advocacy threats include the following:

a. A member promotes the attest client's securities as part of an initial public offering. [1.295.130]

b. A member provides expert witness services to an attest client. [1.295.140]

c. A member represents an attest client in U.S. tax court or other public forum. [1.295.160]

.14 Familiarity threat. The threat that, because of a long or close relationship with an attest client, a member will become too sympathetic to the attest client's interests or too accepting of the attest client's work or product. Examples of familiarity threats include the following:

a. A member of the attest engagement team has an immediate family member or close relative in a key position at the attest client, such as the attest client's CEO. [1.270.020 and 1.270.100]

b. A partner or partner equivalent of the firm has been a member of the attest engagement team for a prolonged period.

c. A member of the firm has recently been a director or an officer of the attest client. [1.277.010]

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

.15 Management participation threat. The threat that a member will take on the role of attest client management or otherwise assume management responsibilities for an attest client. Examples of management participation threats include the following:

a. A member serves as an officer or a director of the attest client. [1.275.005]

b. A member accepts responsibility for designing, implementing, or maintaining internal controls for the attest client. [1.295.030]

c. A member hires, supervises, or terminates the attest client's employees. [1.295.135]

.16 Self-interest threat. The threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, an attest client or persons associated with the attest client. Examples of self-interest threats include the following:

a. A member has a direct financial interest or material indirect financial interest in the attest client. [1.240.010]

b. A member has a loan from the attest client, an officer or a director of the attest client, or an individual who owns 10 percent or more of the attest client's outstanding equity securities. [1.260.010]

c. A member or his or her firm relies excessively on revenue from a single attest client.

d. A member or member's firm has a material joint venture or other material joint business arrangement with the attest client. [1.265]

.17 Self-review threat. The threat that a member will not appropriately evaluate the results of a previous judgment made, or service performed or supervised by the member or an individual in the member's firm and that the member will rely on that service in forming a judgment as part of an attest engagement. Certain self-review threats, such as preparing source documents used to generate the attest client's financial statements [1.295.120], pose such a significant self-review threat that no safeguards can eliminate or reduce the threats to an acceptable level.

.18 Undue influence threat. The threat that a member will subordinate his or her judgment to that of an individual associated with an attest client or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. Examples of undue influence threats include the following:

a. Management threatens to replace the member or member's firm over a disagreement on the application of an accounting principle.

b. Management pressures the member to reduce necessary audit procedures in order to reduce audit fees.

c. The member receives a gift from the attest client, its management, or its significant shareholders. [1.285.010]

Safeguards

.19 Safeguards may partially or completely eliminate a threat or diminish the potential influence of a threat. The nature and extent of the safeguards applied will depend on many factors, including the size of the firm and whether the attest client is a public interest entity. To be effective, safeguards should eliminate the threat or reduce it to an acceptable level.

.20 The following are three broad categories of safeguards:

a. Safeguards created by the profession, legislation, or regulation.

b. Safeguards implemented by the attest client. It is not possible to rely solely on safeguards implemented by the attest client to eliminate or reduce significant threats to an acceptable level.

c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements.

.21 The effectiveness of a safeguard depends on many factors, including those listed here:

a. The facts and circumstances specific to a particular situation

b. The proper identification of threats

c. Whether the safeguard is suitably designed to meet its objectives

d. The party(ies) that will be subject to the safeguard

e. How the safeguard is applied

f. The consistency with which the safeguard is applied

g. Who applies the safeguard

h. How the safeguard interacts with a safeguard from another category

i. Whether the attest client is a public interest entity

.22 Examples of various safeguards within each category are presented in paragraphs .21–.23 of the "Conceptual Framework for Members in Public Practice" [1.000.010]. The examples presented in these paragraphs are not intended to be all inclusive. In addition, threats may be sufficiently mitigated through the application of other safeguards not specifically identified in these paragraphs.

1.230 FEES

1.230.010 UNPAID FEES

.01 The existence of unpaid fees to a covered member for professional services previously rendered to an attest client may create self-interest, undue influence, or advocacy threats to the covered member's compliance with the "Independence Rule" [1.200.001].

.02 Threats to the covered member's compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards if a covered member has unpaid fees from an attest client for any previously rendered professional service provided more than one year prior to the date of the current-year report. Accordingly, independence would be impaired. Unpaid fees include fees that are unbilled or a note receivable arising from such fees.

.03 This interpretation does not apply to fees outstanding from an attest client in bankruptcy.

1.240 FINANCIAL INTERESTS

1.240.010 OVERVIEW OF FINANCIAL INTERESTS

.01 If a covered member had or was committed to acquire any direct financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member's compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

.02 If a covered member had or was committed to acquire any material indirect financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member's compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

.03 If a partner or professional employee of the firm, his or her immediate family, or any group of such persons acting together owned more than 5 percent of an attest client's outstanding equity securities or other ownership interests during the period of the professional engagement, the self-interest threat to compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired.

Close Relatives and the Independence Rule: Q&A

Question: A potential audit client is owned by the CPA's stepbrother. Would the CPA be independent with regard to the potential client? What if the CPA is closer to the stepbrother than to his own brother?

Answer: A stepbrother is not considered a close relative under the independence rules and normally would not impair independence. However, if the relationship between the CPA and stepbrother was close enough to lead a reasonable person, aware of all the facts, to conclude that the situation poses an unacceptable threat to the appearance of independence and the CPA's objectivity, then the relationship would impair independence.

1.300 GENERAL STANDARDS

1.300.001 GENERAL STANDARDS RULE

.01 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.

Pro Bono / Below Cost Fees: Q&A

Question: May a member perform professional services for a client for no fee or for a fee that is below cost without impairing independence or violating any other rule of conduct?

Answer: Yes. However, regardless of what fee is charged, members are required to comply with all professional standards that are applicable to the services performed. For example, a member must comply with the "General Standards Rule" (ET sec. 1.300.001), which requires members to

- only undertake those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.
- exercise due professional care in the performance of professional services.
- adequately plan and supervise the performance of professional services.
- obtain relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

The member's state board(s) of accountancy may have rules that are more restrictive than provided in the above guidance. Accordingly, members should consult with their state board(s) of accountancy for guidance.

Professional services performed for a client for no fee or a fee below cost would not be considered a gift for purposes of applying the "Gifts and Entertainment" subtopic (ET sec. 1.120.010) of the "Integrity and Objectivity Rule" and the "Gifts and Entertainment" subtopic (ET sec. 1.285.010) of the "Independence Rule."

1.300.010 COMPETENCE

.01 Competence, in this context, means that the member or member's staff possess the appropriate technical qualifications to perform professional services and that the member, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession's standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of professional services.

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

.03 The member may have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing professional services involves performing additional research or consulting with others to gain sufficient competence.

.04 If a member is unable to gain sufficient competence, the member should suggest, in fairness to the client and public, the engagement of a competent person to perform the needed professional service, either independently or as an associate.

1.310 COMPLIANCE WITH STANDARDS

1.310.001 COMPLIANCE WITH STANDARDS RULE

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

Use of Standards That Have Not Been Established by a Body Designated by AICPA Council: Q&A

Question: May a member perform a professional service using standards that have not been established by a body designated by AICPA Council, as set forth in appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards" (Council resolution) (ET appendix A) of the AICPA Code of Professional Conduct (hereinafter referred to as "alternative standards")?

Answer: Yes, there are circumstances in which a member is permitted to perform a professional service using alternative standards. However, the member must consider whether the professional service can be covered by technical standards established by a body designated by AICPA Council (hereinafter referred to as "established standards"). Examples of such standards are the Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs), Statements on Standards for Accounting and Review Services (SSARSs) and Statement on Standards for Consulting Services (SSCS). The "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) states the following:

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

The Council resolution sets forth those bodies designated by Council to promulgate technical standards and includes AICPA standard-setting bodies, such as the Accounting and Review Services Committee (ARSC), Auditing Standards Board (ASB), and Management Consulting Services Executive Committee.

When a member is engaged to perform a professional service that can be covered by established standards, the member must perform the service using such established standards. The member is permitted to also apply any relevant alternative standards.

When a member is engaged to perform a professional service that, based on his or her professional judgment, cannot be covered by established standards, the member will not be considered to be in violation of the "Compliance With Standards Rule" if only the alternative standards are applied.

Irrespective of the professional service performed by the member and whether he or she applies established or alternative standards, or both, the member must always comply with the "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) when performing any professional service. This rule requires that a member comply with the following standards:

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.

Members should also be aware that laws or regulations, including state boards of accountancy rules and regulations, may require the professional service to be performed under established standards.

1.320 ACCOUNTING PRINCIPLES

1.320.001 ACCOUNTING PRINCIPLES RULE

.01 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 has 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.

1.400 ACTS DISCREDITABLE

1.400.001 ACTS DISCREDITABLE RULE

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

NOTE: 1.400.001 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.

In addition, interpretations under the Acts Discreditable Rule identify the following discreditable acts:

- Discrimination or harassment in employment practices.
- Solicitation or disclosure of CPA examination questions or answers.
- Failure to file a tax return or pay a tax liability.
- Negligence in the preparation of financial statements or records.
- Negligence in the preparation of reports to governmental bodies, commissions, or other regulatory agencies.
- Failure to follow applicable standards in conducting governmental audits.
- Use of prohibited indemnification agreements.

- Disclosure or use of confidential information obtained from employment or volunteer activities.
- Using the CPA credential in violation of state law.
- Failure to comply with the request to return client records.
- Removing client files or proprietary information from a former employer.
- Use of confidential information from nonclient services.

1.400.090 FALSE, MISLEADING, OR DECEPTIVE ACTS IN PROMOTING OR MARKETING PROFESSIONAL SERVICES

.01 A member would be in violation of the "Acts Discreditable Rule" [1.400.001] if the member promotes or markets the member's abilities to provide professional services or makes claims about the member's experience or qualifications in a manner that is false, misleading, or deceptive.

.02 Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body.

1.500 FEES AND OTHER TYPES OF REMUNERATION

1.510 CONTINGENT FEES

1.510.001 CONTINGENT FEES RULE

.01 A member in public practice shall not

a. 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,

i. an audit or review of a financial statement; or

ii. 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

iii. an examination of prospective financial information; or

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

.02 The prohibition in a. above applies during the period in which the member or 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.

.03 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 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.

Contingent Fees: Q&A

Question: A CPA offers a new client a free one-hour consultation or a 10 percent discount on tax return preparation. Is this acceptable?

Answer: Yes. These are not prohibited transactions.

.04 A member's fees may vary depending, for example, 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.

Observation

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.

Observation (continued)

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, 2017, and the date of the auditor's report is March 12, 2018, no services could be performed on a contingent fee basis by the auditor for the period from January 1, 2017, through March 12, 2018.

1.510.001 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.

1.520 COMMISSIONS AND REFERRAL FEES

1.520.001 COMMISSIONS AND REFERRAL FEES RULE

.01 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 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.

.02 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.

.03 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.

.04 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. [Prior reference: paragraph .01 of ET section 503]

Disclosure of Commissions: Q&A

Question: When is a member required to disclose to a client that a commission will be received under the "Commissions and Referral Fees Rule" ET sec. 1.520.001)?

Answer: A member should disclose that a commission would be received at the time the referral is being made so that the client can decide whether to act on the recommendation.

1.600 ADVERTISING AND OTHER FORMS OF SOLICITATION

1.600.001 ADVERTISING AND OTHER FORMS OF SOLICITATION RULE

.01 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, over-reaching, or harassing conduct is prohibited.

1.700 CONFIDENTIAL INFORMATION

1.700.001 CONFIDENTIAL CLIENT INFORMATION RULE

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

.02 This rule shall not be construed (1) to relieve a member of his or her professional obligations of the "Compliance With Standards Rule" [1.310.001] or the "Accounting Principles Rule" [1.320.001], (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy. Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

Confidential Client Information: Q&A

Question: The IRS requested that a CPA provide copies of documents relating to a prior client of the CPA. The CPA is not able to locate the client to obtain permission to release the documents. Should the CPA turn the information over to the IRS?

Answer: No. A CPA cannot release confidential client information without the specific consent of the client unless the CPA receives a validly issued and enforceable subpoena or summons. Information obtained by a licensee can be disclosed in response to an official inquiry from a federal or state government regulatory agency. However, the IRS is considered to be a taxing agency and not a government regulatory agency.

1.800 FORM OF ORGANIZATION AND NAME

1.800.001 FORM OF ORGANIZATION AND NAME RULE

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

.02 A member shall not practice public accounting under a firm name that is misleading.

.03 Names of one or more past owners may be included in the firm name of a successor organization.

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

Organization Name: Q&A

Question: Three CPA firms wish to form an association – not a partnership – to be known as "Smith, Jones, Nash and Assoc." Is there any impropriety in this?

Answer: The use of such a title is not permitted since it might mislead the public into thinking a true partnership exists. Instead, each firm is advised to use its own name on its letterhead, indicating the other two as correspondents.

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.

Practice Pointer: 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.

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CHAPTER 1: TEST YOUR KNOWLEDGE

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

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1.	**Which of the following is the topic of Part 1 of the AICPA Code of Professional Conduct:** **A.** Members in Business **B.** Members in Private Practice **C.** Other Members **D.** Members in Public Practice
2.	**Which of the following is <u>not</u> a broad category of potential threats when applying the conceptual framework approach:** **A.** undue influence **B.** self-proclaimed **C.** familiarity **D.** adverse interest
3.	**Which of the following is an example of a safeguard created by a profession, legislation, or regulation:** **A.** professional standards and the threat of discipline **B.** well-trained personnel to make managerial decisions about professional services **C.** strong firm leadership **D.** an active audit committee to ensure appropriate decision making regarding a firm's services

4.	**According to 1.230.010, independence would be impaired if a covered member has unpaid fees from an attest client for any previously rendered professional service provided more than what period of time prior to the date of the current-year report:** **A.** 3 months **B.** 6 months **C.** 9 months **D.** 12 months
5.	**Which of the following is true regarding a CPA accepting an engagement under 1.300.010:** **A.** a CPA must accept any engagement in which the CPA can meet the expectations of the client **B.** a CPA may accept an engagement only if, at the time of acceptance, the CPA possesses sufficient professional competence to complete the engagement **C.** 1.300.010 allows a CPA to accept an engagement in which the CPA lacks professional competence provided the CPA can obtain the necessary competence prior to completing the engagement **D.** 1.300.010 generally prohibits CPAs from representing taxpayers before the Internal Revenue Service unless the CPA has also earned the Enrolled Agent designation
6.	**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 certain guidelines are observed. Which of the following guidelines <u>must</u> be met:** **A.** 51% of the ownership must be held by CPAs **B.** a non-CPA owner must be actively engaged in providing services to the firm's clients **C.** a non-CPA owner may not hold him or herself out as a CPA **D.** all of the above

CHAPTER 1: SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.	**A.** Incorrect. Members in business are the topic of Part 2 of the AICPA Code of Professional Conduct. **B.** Incorrect. There is no part of the code that is dedicated to members in private practice. **C.** Incorrect. Other members is the focus of Part 3 of the Code of Professional Conduct. **D.** **CORRECT**. The topic of Part 1 of the AICPA Code of Professional Conduct is Members in Public Practice. *(See page 2 of the course material.)*
2.	**A.** Incorrect. Undue influence threats are a general category of threat that exists when applying the conceptual framework approach. **B.** **CORRECT**. Self-interest threats and self-review threats exist, but self-proclaimed threats are not a category of threat when applying the conceptual framework approach. **C.** Incorrect. Familiarity threats may exist when applying the conceptual framework approach. **D.** Incorrect. Adverse interest threats are a broad category of threat to be aware of when applying the conceptual framework approach. *(See pages 5 to 6 of the course material.)*
3.	**A.** **CORRECT**. A potential safeguard to minimize a threat that is created by the profession, legislation, or regulation, is the establishment of professional standards and the threat of discipline. **B.** Incorrect. Well trained personnel to make managerial decisions about professional services is a safeguard implemented by the client. **C.** Incorrect. A safeguard implemented by the firm would include strong firm leadership that stresses the importance of complying with the rules. **D.** Incorrect. An active audit committee, put in place to ensure appropriate decision making, would be a safeguard established by the client. *(See page 8 of the course material.)*

4.	**A.** Incorrect. The upper limit of the time period is more than three months. **B.** Incorrect. The time frame is longer than six months. **C.** Incorrect. Nine months is not the upper limit to test for independence. **D.** **CORRECT**. According to 1.230.010, independence is impaired if a covered member has unpaid fees from an attest client for any previously rendered service provided more than one year prior to the date of the current-year report. *(See pages 26 to 27 of the course material.)*
5.	**A.** Incorrect. A CPA is not required to accept an engagement simply because they can meet the client's expectations. **B.** Incorrect. A CPA may accept an engagement, even if at the time of acceptance they do not have the required professional competence, as long as they seek out the requisite knowledge by performing additional research or consulting with others. **C.** **CORRECT**. 1.300.010 allows a CPA to accept an engagement that he or she lacks professional competence in, as long as the CPA can obtain the necessary competence prior to completing the engagement. **D.** Incorrect. 1.300.010 does not require that only Enrolled Agents represent taxpayers before the Internal Revenue Service. *(See page 29 of the course material.)*
6.	**A.** Incorrect. The AICPA allows for non-CPA ownership of CPA firms as long as 51% of the ownership (as measured by financial interest and voting rights) is held by CPAs. However, this is not the only correct selection. **B.** Incorrect. One of the prerequisites for non-CPA ownership of a CPA firm is that non-CPA owners must be actively engaged in providing services to the firm's clients, but this is not the only selection that is correct. **C.** Incorrect. The AICPA allows for non-CPA ownership of a CPA firm assuming that the non-CPA owner does not hold him or herself out as a CPA. However, this is not the only selection that is correct. **D.** **CORRECT**. The AICPA allows for non-CPA ownership of a CPA firm as long as CPAs own a minimum of 51%, the non-CPA owner is actively engaged in providing services to the clients, and non-CPAs do not hold themselves out as CPAs. *(See page 37 of the course material.)*

CHAPTER 2: IRS CIRCULAR 230

Chapter Objectives

After completing this chapter, you should be able to:

- Identify the Internal Revenue Service Requirements as outlined in Circular 230.

Introduction

The tax preparation and tax consulting industry has historically enjoyed less government regulation than the practice of accountancy. 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 issued regulations requiring the registration of tax preparers. Since January 1, 2011, all paid tax return preparers have been required to have a Preparer Tax Identification Number (PTIN).

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 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.

I. 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.

A. 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.

B. WHAT IS NOT CONSIDERED "PRACTICE BEFORE THE IRS"

Section 10.7 of Circular 230 provides a long list of exceptions and exclusions to Circular 230. The following persons and situations are not 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 appear on their own behalf before the IRS, provided they present satisfactory identification.

(b) Participating in rulemaking – individuals may participate in rulemaking.

(c) Limited practice –

(1) In general. Subject to the limitations in paragraph (c)(2) of this section, an individual who is not a practitioner may represent a taxpayer before the Internal Revenue Service in the circumstances described in this paragraph (c)(1), even if the taxpayer is not present, provided the individual presents satisfactory identification and proof of his or her authority to represent the taxpayer. The circumstances described in this paragraph (c)(1) are as follows:

(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, association, or organized group may represent the corporation, association, or organized group

(v) A regular full-time employee of a trust, receivership, guardianship, or estate may represent the trust, receivership, guardianship, or estate

(vi) An officer or a regular employee of a governmental unit, agency, or authority may represent the governmental unit, agency, or authority in the course of his or her official duties.

(vii) An individual may represent any individual or entity, who is outside the United States, before personnel of the Internal Revenue Service when such representation takes place outside the United States.

(2) Limitations.

(i) An individual who is under suspension or disbarment from practice before the Internal Revenue Service may not engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section.

(ii) The Commissioner, or delegate, may, after notice and opportunity for a conference, deny eligibility to engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section to any individual who has engaged in conduct that would justify a sanction under §10.50.

(iii) An individual who represents a taxpayer under the authority of paragraph (c)(1) of this section is subject, to the extent of his or her authority, to such rules of general applicability regarding standards of conduct and other matters as prescribed by the Internal Revenue Service.

(d) Special appearances. The Commissioner, or delegate, may, subject to conditions deemed appropriate, authorize an individual who is not otherwise eligible to practice before the Internal Revenue Service to represent another person in a particular matter.

(e) Fiduciaries. For purposes of this part, a fiduciary (for example, a trustee, receiver, guardian, personal representative, administrator, or executor) is considered to be the taxpayer and not a representative of the taxpayer.

(f) Effective/applicability date. This section is applicable beginning August 2, 2011.

Observation

None of the items above in (a)-(e) are considered to be practicing before the IRS.

Section 10.8 of Circular 230 discusses the application of Circular 230 on those that prepare tax returns and the application of the rules to other individuals as follows:

(a) Preparing all or substantially all of a tax return. Any individual who for compensation prepares or assists with the preparation of all or substantially all of a tax return or claim for refund must have a preparer tax identification number. Except as otherwise prescribed in forms, instructions, or other appropriate guidance, an individual must be an attorney, certified public accountant, enrolled agent, or registered tax return preparer to obtain a preparer tax identification number. Any individual who for compensation prepares or assists with the preparation of all or substantially all of a tax return or claim for refund is subject to the duties and restrictions relating to practice in subpart B, as well as subject to the sanctions for violation of the regulations in subpart C.

(b) Preparing a tax return and furnishing information. Any individual may for compensation prepare or assist with the preparation of a tax return or claim for refund (provided the individual prepares less than substantially all of the tax return or claim for refund), appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Internal Revenue Service or any of its officers or employees.

(c) Application of rules to other individuals. Any individual who for compensation prepares, or assists in the preparation of, all or a substantial portion of a document pertaining to any taxpayer's tax liability for submission to the Internal Revenue Service is subject to the duties and restrictions relating to practice in subpart B, as well as subject to the sanctions for violation of the regulations in subpart C. Unless otherwise a practitioner, however, an individual may not for compensation prepare, or assist in the

preparation of, all or substantially all of a tax return or claim for refund, or sign tax returns and claims for refund. For purposes of this paragraph, an individual described in 26 CFR 301.7701-15(f) is not treated as having prepared all or a substantial portion of the document by reason of such assistance.

(d) Effective/applicability date. This section is applicable beginning August 2, 2011.

An EA 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.

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

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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.

When a proper and lawful request is made by a duly authorized officer or employee of the Internal Revenue Service, concerning an inquiry into an alleged violation of the regulations in this part, a practitioner must provide any information the practitioner has concerning the alleged violation and 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.

(b) 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, 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
Errors and Omissions

If you know that a client has not complied with the U.S. revenue laws or has made an error in, or omission from, any return, affidavit, or other document which the client submitted or executed under U.S. revenue laws, you must promptly inform the client of that noncompliance, error, or omission and advise the client regarding the consequences under the Code and regulations of that noncompliance, error, or omission. Depending on the particular facts and circumstances, the consequences of an error or omission could include (among other things) additional tax liability, civil penalties, interest, criminal penalties, and an extension of the statute of limitations.

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 modified in §§10.34 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.

Observation
Professional Responsibility and the Report of Foreign Bank and Financial Accounts

Practitioners who prepare Form 1040 must inquire of their clients with sufficient detail to prepare correct responses for the two questions at the bottom of Schedule B. Penalties of up to $10,000 can apply for a simple failure to file the required forms.

(c) Effective/applicability date. Paragraph (a) of this section is applicable on September 26, 2007. Paragraph (b) of this section is applicable June 12, 2014.

Observation
Due Diligence

You must exercise due diligence in preparing and filing tax returns and other documents/submissions, and in determining the correctness of representations made by you to your client or to the IRS. You can rely on the work product of another person if you use reasonable care in engaging, supervising, training, and evaluating that person, taking into account the nature of the relationship between you and that person. You generally may rely in good faith and without verification on information furnished by your client, but you cannot ignore other information that has been furnished to you or which is actually known by you. You must make reasonable inquiries if any information furnished to you appears to be incorrect, incomplete or inconsistent with other facts or assumptions.

Enrolled Agent Disbarred for Stealing a Client's Tax Payments and Preparing Returns with False Deductions

The Internal Revenue Service announced that its Office of Professional Responsibility obtained the disbarment of enrolled agent LMW for stealing a client's tax payments and for preparing tax returns with false deductions for multiple clients. LMW's enrolled agent status and her ability to prepare federal tax returns were revoked for at least five years.

"Practitioners who disregard their responsibilities to the tax system and their clients can expect to hear from OPR," said Karen L. Hawkins, director of OPR. "Any tax professional who steals from a client or causes them undue tax problems is unfit to practice before this agency."

In a Final Agency Decision, the Administrative Law Judge (ALJ) disbarred LMW for misappropriating client payments intended for the IRS in furtherance of an offer in compromise, and for preparing multiple returns containing Schedule C deductions for which she could not produce substantiation on audit.

LMW was engaged to represent a taxpayer in a collection matter. The client gave LMW two money orders totaling $1,500 to forward to the IRS along with an offer in compromise for delinquent taxes. It was found by the ALJ that LMW altered, endorsed and cashed the money orders for her own personal use, which are acts of willful incompetent and disreputable conduct under Circular 230.

The ALJ also found that LMW prepared Forms 1040 for seven clients claiming Schedule C deductions that were unsubstantiated and unsupportable. It was found that LMW failed to exercise due diligence in preparing the Schedule C's, thereby violating multiple due diligence provisions contained in Circular 230.

LMW also failed to respond to the administrative complaint and the motion for default judgment. The ALJ determined that because LMW failed to respond either to the complaint or to the motion for default judgment, she was deemed to admit all the allegations in the complaint, and to not oppose the default motion.

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.

Observation
Handling Matters Promptly

You cannot unreasonably delay the prompt disposition of any matter before the Internal Revenue Service. This applies with respect to responding to your client as well as to IRS personnel. You cannot advise a client to submit any document to the IRS for the purpose of delaying or impeding the administration of the Federal tax laws.

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.

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 office(s) of the Internal Revenue Service administering or enforcing this part.

(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 beginning August 2, 2011.

Observation

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

It 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.

(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 withold the client's current year completed tax return pending payment of fees.

Observation
Client Records

On request of a client, you must promptly return any client records necessary for the client to comply with his or her Federal tax obligations, even if there is a dispute over fees. You may keep copies of these records. If state law allows you to retain a client's records in the case of a fee dispute, you need only return the records that must be attached to the client's return but you must provide the client with reasonable access to review and copy any additional client records retained by you that are necessary for the client to comply with his or her Federal tax obligations. The term "client records" includes all written or electronic materials provided to you by the client or a third party. "Client records" also include any tax return or other document that you prepared and previously delivered to the client, if that return or document is necessary for the client to comply with his or her current Federal tax obligations. You are not required to provide a client with any of your work product- i.e., any return, refund claim, or other document that you have prepared but not yet delivered to the client if (i) you are withholding the document pending the client's payment of fees related to the document and (ii) your contract with the client requires the payment of those fees prior to delivery.

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.

Observation
Conflicts of Interest

A conflict of interest exists if representing one of your clients will be directly adverse to another client. A conflict of interest also exists if there is a significant risk that representing a client will be materially limited by your responsibilities to another client, a former client or a third person, or by your personal interests. When a conflict of interest exists, you may not represent a client in an IRS matter unless (i) you reasonably believe that you can provide competent and diligent representation to all affected clients, (ii) your representation is not prohibited by law, and (iii) all affected clients give informed, written consent to your representation. You must retain these consents for 36 months following the termination of the engagement and make them available to the IRS/OPR upon request.

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." An example of an acceptance description for registered tax return preparers is "designated as a registered tax return preparer by the Internal Revenue Service."

(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.

(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.

(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 beginning August 2, 2011.

Observation
Solicitation

With respect to any Internal Revenue Service matter, you may not use 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. You also may not assist, or accept assistance from, any person or entity who obtains clients or otherwise practices in violation of the solicitation provisions.

SECTION 10.31 Negotiation of taxpayer checks.

(a) A practitioner may not endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated) issued to a client by the government in respect of a Federal tax liability.

(b) Effective/applicability date. This section is applicable beginning June 12, 2014.

Observation
Negotiating Checks

You may not endorse, negotiate, electronically transfer, or direct the deposit of any government check relating to a Federal tax liability issued to a client. This prohibits any person subject to Treasury Circular No. 230 from directing or accepting payment from the government to the taxpayer into an account owned or controlled by that person. This provision does not apply to whistleblower payments.

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) Tax returns.

(1) A practitioner may not willfully, recklessly, or through gross incompetence —

(i) Sign a tax return or claim for refund that the practitioner knows or reasonably should know contains a position that —

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in Section 6694(a)(2) of the Internal Revenue Code (Code) (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in Section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(ii) Advise a client to take a position on a tax return or claim for refund, or prepare a portion of a tax return or claim for refund containing a position, that—

(A) Lacks a reasonable basis;

(B) Is an unreasonable position as described in Section 6694(a)(2) of the Code (including the related regulations and other published guidance); or

(C) Is a willful attempt by the practitioner to understate the liability for tax or a reckless or intentional disregard of rules or regulations by the practitioner as described in Section 6694(b)(2) of the Code (including the related regulations and other published guidance).

(2) A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted willfully, recklessly, or through gross incompetence.

(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) Effective/applicability date. Paragraph (a) of this section is applicable for returns or claims for refund filed or advice provided beginning August 2, 2011. Paragraphs (b) through (d) of this section are applicable to tax returns, documents, affidavits and other papers filed on or after September 26, 2007.

Observation
Tax Return Positions

You cannot sign a tax return or refund claim or advise a client to take a position on a tax return or refund claim that you know or should know contains a position (i) for which there is no reasonable basis; (ii) which is an unreasonable position as defined in Internal Revenue Code §6694(a)(2); or, (iii) which is a willful attempt to understate tax liability, or a reckless or intentional disregard of rules or regulations. An unreasonable position is one which lacks substantial authority as defined in IRC §6662 but has a reasonable basis, and is disclosed. For purposes of Circular 230 disclosure, if you advised the client regarding the position, or you prepared or signed the tax return, you must inform a client of any penalties that are reasonably likely to apply to the client with respect to the tax return position and how to avoid the penalties through disclosure (or, by not taking the position).

SECTION 10.35 Competence.

(a) A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged. A practitioner may become competent for the matter for which the practitioner has been engaged through various methods, such as consulting with experts in the relevant area or studying the relevant law.

(b) Effective/applicability date. This section is applicable beginning June 12, 2014.

Certified Public Accountant Disbarred for Multiple Circular 230 Violations

The Internal Revenue Service announced that its Office of Professional Responsibility (OPR) obtained the disbarment of Certified Public Accountant ATT for charging unconscionable fees, giving irresponsible advice to clients and making false statements to federal and state authorities, among other things. ATT is prohibited from preparing tax returns or representing taxpayers before the Internal Revenue Service for a minimum of five years.

"Practitioners who abuse the trust of their clients by charging unconscionable fees for taking frivolous positions on their tax returns can expect to hear from my office in the IRS," said Karen L. Hawkins, director of OPR.

In a Final Agency Decision, the Administrative Law Judge (ALJ) disbarred ATT on March 1. The ALJ found that ATT's advice to clients to use Form 2555 to treat California earned income as foreign source income on at least fifty-two tax returns, constituted disreputable conduct under Circular 230, and his failure to research the legitimacy of the filing position specifically violated the Circular's due diligence standards.

The ALJ also found Circular 230 violations in ATT's use of a contingent fee structure and in the false statement to IRS Criminal Investigation regarding his fee structure. He was also found to have made false claims to the California Board of Accountancy that he ceased advising use of Form 2555 after becoming aware of the first IRS examination of his clients' returns.

The ALJ also found that ATT violated Circular 230 by engaging in a pattern of delaying IRS examination and collection actions by repeatedly raising numerous frivolous arguments, long-rejected by the IRS and by case law. ATT's litigation threats against IRS employees, as part of client settlement proposals, were also determined to be violations.

"The mere possession of a professional license does not give a practitioner the right to make his or her own rules, or to threaten IRS personnel doing their jobs," Hawkins said.

The ALJ found other violations of Circular 230 including: ATT did not respond to OPR requests for information and he submitted a Form 2848, Power of Attorney, naming an unlicensed individual as a second "authorized" representative in a collection matter thereby aiding an ineligible person to practice before the IRS.

SECTION 10.36 Procedures to ensure compliance.

(a) Any individual subject to the provisions of this part who has (or individuals who have or share) principal authority and responsibility for overseeing a firm's practice governed by this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the Internal Revenue Service, 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 subparts A, B, and C of this part, as applicable. In the absence of a person or persons identified by the firm as having the principal authority and responsibility described in this paragraph,

the Internal Revenue Service may identify one or more individuals subject to the provisions of this part responsible for compliance with the requirements of this section.

(b) Any such individual who has (or such individuals who have or share) principal authority as described in paragraph (a) of this section will be subject to discipline for failing to comply with the requirements of this section if--

(1) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with this part, as applicable, 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 this part, as applicable;

(2) The individual through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that firm procedures in effect are properly followed, 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 this part, as applicable; or

(3) The individual 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 their practice with the firm, that does not comply with this part, as applicable, and the individual, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.

(c) Effective/applicability date. This section is applicable beginning June 12, 2014.

Observation

This provision is important for a number of reasons. First, it places the first layer of responsibility on the firm as part of a "self-regulatory" environment. Second, it puts certain individuals on notice that they could be subject to individual disciplinary actions based on the actions of others in the firm. The individual will be responsible to ensure:

1. The firm has procedures in place to ensure compliance with Circular 230;
2. The firm follows the requisite procedures; and
3. Individuals in the firm do not engage in a pattern and practice of disregarding the provisions of Circular 230.

In essence, the IRS is making certain individuals at the firm into enforcers.

Observation
Supervisor Responsibilities

If you have or share principal authority and responsibility for overseeing your firm's tax practice, you must take reasonable steps to ensure that your firm has adequate procedures in place to raise awareness and to promote compliance with Circular 230 by your firm's members, associates, and employees and that all such employees are complying with the regulations governing practice before the IRS.

SECTION 10.37 Requirements for written advice.

(a) Requirements. (1) A practitioner may give written advice (including by means of electronic communication) concerning one or more Federal tax matters subject to the requirements in paragraph (a)(2) of this section. Government submissions on matters of general policy are not considered written advice on a Federal tax matter for purposes of this section. Continuing education presentations provided to an audience solely for the purpose of enhancing practitioners' professional knowledge on Federal tax matters are not considered written advice on a Federal tax matter for purposes of this section. The preceding sentence does not apply to presentations marketing or promoting transactions.

(2) The practitioner must--

(i) Base the written advice on reasonable factual and legal assumptions (including assumptions as to future events);

(ii) Reasonably consider all relevant facts and circumstances that the practitioner knows or reasonably should know;

(iii) Use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;

(iv) Not rely upon representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable;

(v) Relate applicable law and authorities to facts; and

(vi) Not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.

(3) Reliance on representations, statements, findings, or agreements is unreasonable if the practitioner knows or reasonably should know that one or more representations or assumptions on which any representation is based are incorrect, incomplete, or inconsistent.

(b) Reliance on advice of others. A practitioner may only rely on the advice of another person if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances.

Reliance is not reasonable when--

(1) The practitioner knows or reasonably should know that the opinion of the other person should not be relied on;

(2) The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice; or

(3) The practitioner knows or reasonably should know that the other person has a conflict of interest in violation of the rules described in this part.

(c) Standard of review. (1) In evaluating whether a practitioner giving written advice concerning one or more Federal tax matters complied with the requirements of this section, the Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, including, but not limited to, the scope of the engagement and the type and specificity of the advice sought by the client.

(2) 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 Commissioner, or delegate, will apply a reasonable practitioner standard, considering all facts and circumstances, with emphasis given to the additional risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances, when determining whether a practitioner has failed to comply with this section.

(d) Federal tax matter. A Federal tax matter, as used in this section, is any matter concerning the application or interpretation of---

(1) A revenue provision as defined in Section 6110(i)(1)(B) of the Internal Revenue Code;

(2) Any provision of law impacting a person's obligations under the internal revenue laws and regulations, including but not limited to the person's liability to pay tax or obligation to file returns; or

(3) Any other law or regulation administered by the Internal Revenue Service.

(e) Effective/applicability date. This section is applicable to written advice rendered after June 12, 2014.

Observation
Written Tax Advice

In providing written advice concerning any Federal tax matter, you must (i) base your advice on reasonable assumptions, (ii) reasonably consider all relevant facts that you know or should know, and (iii) use reasonable efforts to identify and ascertain the relevant facts. You cannot rely upon representations, statements, findings, or agreements that are unreasonable or that you know to be incorrect, inconsistent, or incomplete. You must not take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit in evaluating a Federal tax matter (audit lottery). In providing your written advice, you may rely in good faith on the advice of another practitioner only if that advice is reasonable considering all facts and circumstances. You cannot rely on the advice of a person whom you know or should know is not competent to provide the advice or who has an unresolved conflict of interest as defined in §10.29.

SECTION 10.38 Establishment of Advisory Committees.

(a) Advisory committees.

To promote and maintain the public's confidence in tax advisors, the Internal Revenue Service is authorized to establish one or more advisory committees composed of at least five individuals authorized to practice before the Internal Revenue Service. Membership of an advisory committee must be balanced among those who practice as attorneys, accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and registered tax return preparers. Under procedures prescribed by the Internal Revenue Service, an advisory committee may review and make general recommendations regarding the practices, procedures, and policies of the offices described in §10.1.

(b) Effective date.

This section is applicable beginning August 2, 2011.

D. CIRCULAR 230: SUBPART C – SANCTIONS FOR VIOLATION OF THE REGULATIONS

Table of Contents (this subpart)

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.

(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 Internal Revenue Service 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) Authority to accept a practitioner's consent to sanction. The Internal Revenue Service may accept a practitioner's office of consent to be sanctioned under §10.50 in lieu of instituting or continuing a proceeding under §10.60(a).

(e) Sanctions to be imposed. The sanctions imposed by this section shall take into account all relevant facts and circumstances.

(f) Effective/applicability date. This section is applicable to conduct occurring on or after August 2, 2011, except that paragraphs (a), (b)(2), and (e) apply to conduct occurring on or after September 26, 2007, and paragraph (c) 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.

Observation
Personal Tax Compliance Responsibilities

You are responsible for insuring the timely filing and payment of your personal income tax returns and the tax returns for any entity over which you have, or share, control. Failing to file 4 of the last 5 years income tax returns, or 5 of the last 7 quarters of employment/excise tax returns is per se disreputable and incompetent conduct for which a practitioner may be summarily suspended, indefinitely. The willful evasion of the assessment or payment of tax is also conduct which violates Circular 230.

(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.

(16) Willfully failing to file on magnetic or other electronic media a tax return prepared by the practitioner when the practitioner is required to do so by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(17) Willfully preparing all or substantially all of, or signing, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid preparer tax identification number or other prescribed identifying number.

(18) Willfully representing a taxpayer before an officer or employee of the Internal Revenue Service unless the practitioner is authorized to do so pursuant to this part.

(b) Effective/applicability date. This section is applicable beginning August 2, 2011.

Case Study: Disreputable Conduct

While employed by a 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.

Practice Pointer: Revised Regulations on Releasing Taxpayer Information

In 2008, the IRS released revised regulations concerning taxpayer privacy and the release of taxpayer information with an effective date of January 1, 2009. In 2013, Revenue Procedure 2013-14 was released, supplementing the regulations and providing additional guidance to tax return preparers regarding the form and content of taxpayer consents to disclose and consents to use tax return information, effective as of January 14, 2013. The effective date was extended to January 1, 2014 by Revenue Procedure 2013-19.

In general terms, a taxpayer's consent to each separate disclosure or separate use of tax return information must be contained on a separate written document, which can be furnished on paper or electronically. The consent may be included as an attachment to an engagement letter.

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 of the suspected violation. The report will explain the facts and reasons upon which the officer's or employee's belief rests, and must be submitted to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part.

(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 office(s) of the Internal Revenue Service responsible for administering or enforcing this part 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, and submit the report to the office(s) of the Internal Revenue Service responsible for administering or enforcing this part.

(c) Destruction of report.

No report made under paragraph (a) or (b) of this section shall be maintained 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. Reports must be destroyed 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 beginning August 2, 2011.

THE TAXPAYER BILL OF RIGHTS

In 2014, the IRS took administrative action to issue a Taxpayer Bill of Rights. While impressive looking on its face, the new Bill of Rights is simply a restatement of previously existing rights into a single document. The IRS has issued Publication 1 that is summarized as follows.

- The right to be informed.
- The right to quality service.
- The right to pay no more than the correct amount of tax.
- The right to challenge the IRS's position and be heard.
- The right to appeal an IRS decision in an independent forum.
- The right to finality.
- The right to privacy.
- The right to confidentiality.
- The right to retain representation.
- The right to a fair and just tax system.

Although, these rights are not new, they merit attention here since taxpayers may perceive them as new rights.

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CHAPTER 2: TEST YOUR KNOWLEDGE

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

We recommend that you answer each question and then compare your response to the suggested solutions on the following page(s) before answering the final exam questions related to this chapter (assignment).

1.	**Which of the following would be considered "practicing before the IRS" and subject to Circular 230:** **A.** an individual that participates in rulemaking **B.** a fiduciary **C.** a CPA representing a taxpayer **D.** an individual appearing on their own behalf
2.	**Under Circular 230 Section 10.27, a practitioner is prohibited from charging certain fees. Which of the following fees is prohibited:** **A.** fixed fees for specific routine services (e.g., $300 for a Form 1040A) **B.** a flat percentage fee based on the amount of refund on a Form 1040 **C.** hourly rates **D.** a range of fees for particular services with a higher fee charged for more complex situations
3.	**Circular 230 Section 10.30 places numerous restrictions on solicitation and advertising. Which of the following is correct:** **A.** a copy of all direct mail advertisements must be retained for at least 36 months **B.** hourly fee information must be included in all advertisements **C.** although ads may include a fee schedule, rates can be changed at any time **D.** when accepting a new client, the practitioner must give the client a good faith estimate of the cost of the services contemplated

4.	**Circular 230 Section 10.50 authorizes the Secretary of the Treasury to do which of the following:** **A.** to impose monetary penalties on practitioners **B.** to censure, suspend, or disbar practitioners **C.** to disqualify appraisers **D.** all of the above

CHAPTER 2: SOLUTIONS AND SUGGESTED RESPONSES

Below are the solutions and suggested responses for the questions on the previous page(s). If you choose an incorrect answer, you should review the pages as indicated for each question to ensure comprehension of the material.

1.	**A.** Incorrect. Section 10.7 of Circular 230 states that individuals participating in rulemaking are not considered "practicing before the IRS." **B.** Incorrect. A fiduciary is considered to be the taxpayer and not a representative of the taxpayer. Therefore, they are not "practicing before the IRS." **C.** **CORRECT**. A CPA representing a taxpayer would be considered "practicing before the IRS." **D.** Incorrect. Provided an individual can present satisfactory identification, individuals may appear on their own behalf before the IRS and not have it considered "practicing before the IRS." *(See pages 44 to 46 of the course material.)*
2.	**A.** Incorrect. Circular 230 Section 10.27 does not limit a practitioner's ability to charge fixed fees for specific routine services. **B.** **CORRECT**. A practitioner charging a flat percentage fee based on the amount of refund on a Form 1040 is an example of the type of contingent fee prohibited in Circular 230 Section 10.27. **C.** Incorrect. Hourly rates are not limited by Circular 230 Section 10.27. **D.** Incorrect. Practitioners are not prohibited from charging different rates depending on the complexity of the issue. *(See pages 53 to 54 of the course material.)*
3.	**A.** **CORRECT**. Circular 230 Section 10.30 requires the practitioner to retain a copy of the actual communication from a direct mail advertisement for a period of at least 36 months from the date of the last use. **B.** Incorrect. Hourly fees may be, but are not required to be, included in all advertisements. **C.** Incorrect. Circular 230 Section 10.30 restricts a practitioner from changing the schedule of fees within 30 calendar days of the last date on which the schedule was published. **D.** Incorrect. Circular 230 Section 10.30 does not mandate the use of good faith estimates when practitioners meet prospective clients. *(See pages 57 to 58 of the course material.)*

4.	**A.** Incorrect. Circular 230 Section 10.50 authorizes the Secretary of the Treasury to impose monetary penalties on practitioners that have been sanctioned. However, this is not the only correct selection. **B.** Incorrect. The Secretary of the Treasury may censure, suspend or disbar any practitioner from practice before the IRS if the practitioner is shown to be incompetent or disreputable, but this is not the only selection that is correct. **C.** Incorrect. Circular 230 Section 10.50 gives the Secretary of the Treasury the authority to disqualify appraisers, but this is not the only correct selection listed. **D.** **CORRECT**. Circular 230 Section 10.50 gives the Secretary of the Treasury the authorization to censure, suspend or disbar practitioners, to disqualify appraisers, and to impose monetary penalties. *(See page 68 of the course material.)*

GLOSSARY

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 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.

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.

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.

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.

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.

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.

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).

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GENERAL ETHICS FOR MICHIGAN CPAS
(COURSE #5002A) – FINAL EXAM

The following exam will not be graded. It is attached only for your convenience while you read the course text. To access the exam to be submitted for grading, go to your account and select Take Exam.

1. **Which of the following is <u>not</u> one of the main steps that a member should perform in applying the conceptual framework approach:**

   A. identify and apply safeguards
   B. eliminate all threats, and if unable to do so, decline the engagement
   C. identify threats
   D. evaluate the significance of a threat

2. **Which of the following types of threats is exemplified by senior personnel having a long association with a client:**

   A. self-review threat
   B. self-interest threat
   C. undue influence threat
   D. familiarity threat

3. **Which of the following is an example of a safeguard implemented by a client that would operate in conjunction with other safeguards:**

   A. implementing professional standards and the threat of discipline
   B. creating a system of education and training requirements on independence and ethics rules
   C. creating an active audit committee to ensure appropriate decision making, oversight, and communications regarding a firm's services
   D. creating competency and experience requirements for professional licensing

4. **According to 1.110.010, which of the following situations may be a potential conflict of interest:**

   A. preparing valuations of assets for two clients who are in an adversarial position with respect to the same assets
   B. advising two clients at the same time who are competing to acquire the same company when the advice may be relevant to the parties' competitive positions
   C. representing two clients at the same time regarding the same matter who are in a legal dispute with each other
   D. all of the above

5. **The General Standards covered in 1.300.001 include all of the following <u>except</u>:**

   A. contingent fees
   B. professional competence
   C. sufficient relevant data
   D. due professional care

6. **Which of the following would most likely be a violation of 1.400.001 "Acts Discreditable":**

   A. a CPA is convicted of a traffic offense and is fined $400
   B. a CPA cuts his professional services fee by 80% for a client who is near bankruptcy and prepays the estimated fee
   C. a CPA files a false personal tax return but is not convicted of any crime due to the suppression of evidence that is inadmissible in court
   D. a CPA mistakenly fails to sign his personal tax return but does sign it when requested by the tax authorities

7. **Which of the following is correct regarding a member's fees under 1.510:**

   A. a member is prohibited from offering a free one-hour consultation

   B. a member is prohibited from charging a contingent fee to prepare an amended tax return

   C. a member is prohibited from offering a 10 percent discount on tax return preparation

   D. a member is prohibited from charging varying fees depending on the complexity of the services rendered

8. **Which of the following AICPA members can accept a commission from a client during the period the services identified are performed:**

   A. if the member performed a compilation of the financial statements of the client, but disclosed the lack of independence

   B. if the member did not personally participate in the audit of the client associated with the member's firm

   C. if the member performed an examination of prospective financial information, but disclosed the lack of independence

   D. if the member performed a review of the financial statements of the client, but disclosed the lack of independence

9. **Which of the following is correct regarding the Confidential Client Information Rule (1.700.001):**

   A. the confidential client information rule relieves a member of his or her professional obligations of the Accounting Principles Rule (1.320.001)

   B. a member in public practice shall never disclose confidential client information under any circumstances

   C. a member is required to provide confidential client information without the specific consent of the client if the CPA receives a validly issued and enforceable subpoena or summons

   D. this rule prohibits the review of a member's professional practice under AICPA or state CPA society authorization without a client's consent

10. **Bob Jones, Inc. is a new small business client that has asked you to prepare its current year tax return. Upon interviewing the client, you determine that the client has not filed several prior year tax returns. According to Circular 230, what should you do:**

    A. advise the client promptly of the fact of noncompliance

    B. notify the IRS of this failure

    C. advise the client promptly of the fact of noncompliance and notify the IRS if the client refuses to file

    D. ignore the fact of non-filing provided the current year return is filed timely

11. **Which of the following is true regarding when a contingent fee is permitted by the IRS:**

    A. contingent fees are permitted as long as AICPA standards are followed

    B. contingent fees are allowed on original tax returns

    C. contingent fees are allowed when representing a client under audit

    D. contingent fees are never allowed

12. 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 tuition paid for his son to attend college. You know that no 1099 or W-2 was issued for these services nor is any of this income reflected on your client's personal tax return or his son's. Your client states that "everyone" in this industry does this. This deduction is equivalent to 20% of the net income. Which of the following is correct regarding your ability to sign the tax return for Nash Plumbing, Inc. per Circular 230 Section 10.34:

A. you may sign the return since the return meets the "nonfrivolous standard"

B. the client's assertion that the deduction is industry practice is frivolous. Accordingly, the position does not meet Section 10.34 and you may not sign the return

C. you may sign the return only if the deduction is clearly identified on the return as "consulting expense paid to son" or some similar disclosure

D. you may sign the return since everything on the return is the representation of the client

13. According to Circular 230, Section 10.36, which of the following is correct regarding procedures to ensure compliance:

A. it places the first layer of responsibility on the individual as part of a "self-regulatory" environment

B. it provides that only firms, and not individuals of a firm, can be subject to disciplinary action for failing to comply with Circular 230

C. the provision is ineffective

D. it makes an individual of a firm into an enforcer of Circular 230

14. A practitioner may give written advice concerning one or more federal tax matters. All of the following are requirements of such practitioners <u>except</u>:

A. the practitioner must base the written advice on reasonable factual and legal assumptions

B. the practitioner must reasonably consider all relevant facts and circumstances that the practitioner knows or reasonably should know

C. the practitioner must use reasonable efforts to identify and ascertain the facts relevant to written advice on each federal tax matter

D. the practitioner must provide a reasonable estimate of the cost of the written advice prior to performing any such work

15. Which of the following is <u>not</u> a component of the Taxpayer Bill of Rights:

A. the right to have a refund issued within 10 days

B. the right to privacy

C. the right to pay no more than the correct amount of tax

D. the right to appeal an IRS decision in an independent forum