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AICPA Professional Standards: Ethics, Bylaws, Quality control as of July 1, 1979

American Institute of Certified Public Accountants

AICPA PROFESSIONAL STANDARDS

VOLUME 2

ETHICS
BYLAWS
QUALITY CONTROL

AS OF JULY 1, 1979

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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HOW TO USE THIS VOLUME

Scope of This Volume . . .

This volume, which is a reprint of volume 2, the looseleaf edition of *AICPA Professional Standards,* contains Concepts of Professional Ethics, Rules of Conduct, Interpretations of Rules of Conduct, Ethics Rulings, the Bylaws of the American Institute of Certified Public Accountants, and Quality Control.

How This Volume Is Arranged . . .

The contents of this volume are arranged as follows:

How to Use This Volume . . .

The arrangement of material in this volume is indicated in the general table of contents at the front of the volume. There is a detailed table of contents covering the material within each major division.

The major divisions are divided into sections, each with its own section number. Each paragraph within a section is decimally numbered. For example, ET section 101.04 refers to the fourth paragraph of section 101, *Independence.*

The Rules of Conduct, Interpretations of Rules of Conduct, and Ethics Rulings related to the same subjects have been assembled within the major divisions of the Ethics part of the volume. Related Interpretations of Rules of Conduct have section numbers which are the same as the numbers of the Rules of Conduct to which they relate.

A separate topical index is provided for the Ethics part of the volume.

The Bylaws of the AICPA and related Implementing Resolutions of Council are assembled within the major divisions by section number. For example, BL section 250, *International Associates,* is followed by BL section 250R, *Implementing Resolution under Section 2.5, International Associates.*

In BL section 900, *General,* the following sections are included:

Objectives of the American Institute of Certified Public Accountants

A Description of the Professional Practice of Certified Public Accountants

The Bylaws division is also provided with a separate topical index.

The topical indexes use the key word method to facilitate reference to the pronouncements. The indexes are arranged alphabetically by subject with references to section and paragraph numbers. Each index is identified as either the ET Index or the BL Index to indicate the major division.

Quality Control is located in the third division of the volume.

CODE OF PROFESSIONAL ETHICS

Introduction

There are four categories of ethical standards. They are described in the following paragraphs.

The first, *Concepts of Professional Ethics,* is a philosophical essay approved by the professional ethics division. The essay suggests behavior which CPAs should strive for beyond the minimum level of acceptable conduct set forth in the Rules of Conduct and is not intended to establish enforceable standards.

The second category, *Rules of Conduct,* consists of enforceable ethical standards and required the approval of the membership before the Rules became effective. The same is true of the Bylaws of the Institute.

The third category, *Interpretations of Rules of Conduct,* consists of interpretations which have been adopted, after exposure to state societies and state boards, by the professional ethics division's executive committee to provide guidelines as to the scope and application of the Rules but are not intended to limit such scope or application. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary hearing.

The fourth category, *Ethics Rulings,* consists of formal rulings made by the professional ethics division's executive committee after exposure to state societies and state boards. These rulings summarize the application of Rules of Conduct and Interpretations to a particular set of factual circumstances. Members who depart from such rulings in similar circumstances will be requested to justify such departures.

Publication of an Interpretation or Ethics Ruling in *The Journal of Accountancy* constitutes notice to members. Hence the publication date of the notice, unless a later date is specifically indicated, constitutes the effective date of the pronouncement. The professional ethics division will take into consideration the time that would have been reasonable for the member to comply with the pronouncement.

A member should also consult, if applicable, the ethical standards of his state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental agency which may regulate his client's business or use his report to evaluate the client's compliance with applicable laws and related regulations.

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Introduction

A man should *be* upright; not be *kept* upright.

MARCUS AURELIUS

.01 A distinguishing mark of a professional is his acceptance of responsibility to the public. All true professions have therefore deemed it essential to promulgate codes of ethics and to establish means for ensuring their observance.

.02 The reliance of the public, the government and the business community on sound financial reporting and advice on business affairs, and the importance of these matters to the economic and social aspects of life impose particular obligations on certified public accountants.

.03 Ordinarily those who depend upon a certified public accountant find it difficult to assess the quality of his services; they have a right to expect, however, that he is a person of competence and integrity. A man or woman who enters the profession of accountancy is assumed to accept an obligation to uphold its principles, to work for the increase of knowledge in the art and for the improvement of methods, and to abide by the profession's ethical and technical standards.

.04 The ethical Code of the American Institute emphasizes the profession's responsibility to the public, a responsibility that has grown as the number of investors has grown, as the relationship between corporate managers and stockholders has become more impersonal and as government increasingly relies on accounting information.

.05 The Code also stresses the CPA's responsibility to clients and colleagues, since his behavior in these relationships cannot fail to affect the responsibilities of the profession as a whole to the public.

.06 The Institute's Rules of Conduct set forth minimum levels of acceptable conduct and are mandatory and enforceable. However, it is in the best interests of the profession that CPAs strive for conduct beyond that indicated merely by prohibitions. Ethical conduct, in the true sense, is more than merely abiding by the letter of explicit prohibitions. Rather it requires unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

.07 The conduct toward which CPAs should strive is embodied in five broad concepts stated as affirmative Ethical Principles:

Independence, integrity and objectivity. A certified public accountant should maintain his integrity and objectivity and, when engaged in the practice of public accounting, be independent of those he serves.

General and technical standards. A certified public accountant should observe the profession's general and technical standards and strive continually to improve his competence and the quality of his services.

Responsibilities to clients. A certified public accountant should be fair and candid with his clients and serve them to the best of his ability, with professional concern for their best interests, consistent with his responsibilities to the public.

Responsibilities to colleagues. A certified public accountant should conduct himself in a manner which will promote cooperation and good relations among members of the profession.

Other responsibilities and practices. A certified public accountant should conduct himself in a manner which will enhance the stature of the profession and its ability to serve the public.

.08 The foregoing Ethical Principles are intended as broad guidelines as distinguished from enforceable Rules of Conduct. Even though they do not provide a basis for disciplinary action, they constitute the philosophical foundation upon which the Rules of Conduct are based.

.09 The following discussion is intended to elaborate on each of the Ethical Principles and provide rationale for their support.

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Independence, Integrity and Objectivity

A certified public accountant should maintain his integrity and objectivity and, when engaged in the practice of public accounting, be independent of those he serves.

.01 The public expects a number of character traits in a certified public accountant but primarily integrity and objectivity and, in the practice of public accounting, independence.

Independence has always been a concept fundamental to the accounting profession, the cornerstone of its philosophical structure. For no matter how competent any CPA may be, his opinion on financial statements will be of little value to those who rely on him—whether they be clients or any of his unseen audience of credit grantors, investors, governmental agencies and the like—unless he maintains his independence.

.02 Independence has traditionally been defined by the profession as the ability to act with integrity and objectivity.

.03 Integrity is an element of character which is fundamental to reliance on the CPA. This quality may be difficult to judge, however, since a particular fault of omission or commission may be the result either of honest error or a lack of integrity.

.04 Objectivity refers to a CPA's ability to maintain an impartial attitude on all matters which come under his review. Since this attitude involves an individual's mental processes, the evaluation of objectivity must be based largely on actions and relationships viewed in the context of ascertainable circumstances.

.05 While recognizing that the qualities of integrity and objectivity are not precisely measurable, the profession nevertheless constantly holds them up to members as an imperative. This is done essentially by education and by the Rules of Conduct which the profession adopts and enforces.

.06 CPAs cannot practice their calling and participate in the world's affairs without being exposed to situations that involve the possibility of pressures upon their integrity and objectivity. To define and proscribe all such situations would be impracticable. To ignore the problem for that reason, however, and to set no limits at all would be irresponsible.

.07 It follows that the concept of independence should not be interpreted so loosely as to permit relationships likely to impair the CPA's integrity or the impartiality of his judgment, nor so strictly as to inhibit the rendering of useful services when the likelihood of such impairment is relatively remote.

.08 While it may be difficult for a CPA always to appear completely independent even in normal relationships with clients, pressures upon his integrity or objectivity are offset by powerful countervailing forces and restraints. These include the possibility of legal liability, professional discipline ranging up to revocation of the right to practice as a CPA, loss of reputation and, by no means least, the inculcated resistance of a disciplined professional to any infringement upon his basic integrity and objectivity. Accordingly, in deciding which types of relationships should be specifically prohibited, both the magnitude of the threat posed by a relationship and the force of countervailing pressures have to be weighed.

.09 In establishing rules relating to independence, the profession uses the criterion of whether reasonable men, having knowledge of all the facts and taking into consideration normal strength of character and normal behavior under the circumstances, would conclude that a specified relationship between a CPA and a client poses an unacceptable threat to the CPA's integrity or objectivity.

.10 When a CPA expresses an opinion on financial statements, not only the fact but also the appearance of integrity and objectivity is of particular importance. For this reason, the profession has adopted rules to prohibit the expression of such an opinion when relationships exist which might pose such a threat to integrity and objectivity as to exceed the strength of countervailing forces and restraints. These relationships fall into two general categories: (1) certain financial relationships with clients and (2) relationships in which a CPA is virtually part of management or an employee under management's control.

.11 Although the appearance of independence is not required in the case of management advisory services and tax practice, a CPA is encouraged to avoid the proscribed relationships with clients regardless of the type of services being rendered. In any event, the CPA, in all types of engagements, should refuse to subordinate his professional judgment to others and should express his conclusions honestly and objectively.

.12 The financial relationships proscribed when an opinion is expressed on financial statements make no reference to fees paid to a CPA by a client. Remuneration to providers of services is necessary for the continued provision of those services. Indeed, a principal reason for the development and persistence in the professions of the client-practitioner relationship and of remuneration by fee (as contrasted with an employer-employee relationship and remuneration by salary) is that these arrangements are seen as a safeguard of independence.

.13 The above reference to an employer-employee relationship is pertinent to a question sometimes raised as to whether a CPA's objectivity in expressing an opinion on financial statements will be impaired by his being involved with his client in the decision-making process.

.14 CPAs continually provide advice to their clients, and they expect that this advice will usually be followed. Decisions based on such advice may have a significant effect on a client's financial condition or operating results. This is the case not only in tax engagements and management advisory services but in the audit function as well.

.15 If a CPA disagrees with a client on a significant matter during the course of an audit, the client has three choices—he can modify the financial statements (which is usually the case), he can accept a qualified report or he can discharge the CPA. While the ultimate decision and the resulting financial statements clearly are those of the client, the CPA has obviously been a significant factor in the decision-making process. Indeed, no responsible user of financial statements would want it otherwise.

.16 It must be noted that when a CPA expresses an opinion on financial statements, the judgments involved pertain to whether the results of operating decisions of the client are fairly presented in the statements and not on the underlying wisdom of such decisions. It is highly unlikely therefore that being a factor in the client's decision-making process would impair the CPA's objectivity in judging the fairness of presentation.

.17 The more important question is whether a CPA would deliberately compromise his integrity by expressing an unqualified opinion on financial statements which were prepared in such a way as to cover up a poor business decision by the client and on which the CPA has rendered advice. The basic character traits of the CPA as well as the risks arising from such a compromise of integrity, including liability to third parties, disciplinary action and loss of right to practice, should preclude such action.

.18 Providing advice or recommendations which may or may not involve skills logically related to a client's information and control system, and which may affect the client's decision-making, does not in itself indicate lack of independence. However, the CPA must be alert to the possibility that undue identification with the management of the client or involvement with a client's affairs to such a degree as to place him virtually in the position of being an employee, may impair the appearance of independence.

.19 To sum up, CPAs cannot avoid external pressures on their integrity and objectivity in the course of their professional work, but they are expected to resist these pressures. They must, in fact, retain their integrity and objectivity in all phases of their practice and, when expressing opinions on financial statements, avoid involvement in situations that would impair the credibility of their independence in the minds of reasonable men familiar with the facts.

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General and Technical Standards

A certified public accountant should observe the profession's general and technical standards and strive continually to improve his competence and the quality of his services.

.01 Since accounting information is of great importance to all segments of the public, all CPAs, whether in public practice, government service, private employment or academic pursuits, should perform their work at a high level of professionalism.

.02 A CPA should maintain and seek always to improve his competence in all areas of accountancy in which he engages. Satisfaction of the requirements for the CPA certificate is evidence of basic competence at the time the certificate is granted, but it does not justify an assumption that this competence is maintained without continuing effort. Further, it does not necessarily justify undertaking complex engagements without additional study and experience.

.03 A CPA should not render professional services without being aware of, and complying with, the applicable general or technical standards as interpreted by bodies designated by Council. Moreover, since published general and technical standards can never cover the whole field of accountancy, he must keep broadly informed.

.04 Observance of the rule on general and technical standards calls for a determination by a CPA with respect to each engagement undertaken that there is a reasonable expectation it can be completed with the exercise of due professional care, with adequate planning and supervision and with the gathering of sufficient relevant data to afford a reasonable basis for conclusions and recommendations. If a CPA is unable to bring such professional competence to the engagement he should suggest, in fairness to his client and the public, the engagement of someone competent to perform the needed service, either independently or as an associate.

.05 The standards referred to in the rules are elaborated and refined to meet changing conditions, and it is each CPA's responsibility to keep himself up to date in this respect.

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Responsibilities to Clients

A certified public accountant should be fair and candid with his clients and serve them to the best of his ability, with professional concern for their best interests, consistent with his responsibilities to the public.

.01 As a professional person, the CPA should serve his clients with competence and with professional concern for their best interests. He must not permit his regard for a client's interest, however, to override his obligation to the public to maintain his independence, integrity and objectivity. The discharge of this dual responsibility to both clients and the public requires a high degree of ethical perception and conduct.

.02 It is fundamental that the CPA hold in strict confidence all information concerning a client's affairs which he acquires in the course of his engagement. This does not mean, however, that he should acquiesce in a client's unwillingness to make disclosures in financial reports which are necessary to fair presentation.

.03 Exploitation of relations with a client for personal advantage is improper. For example, acceptance of a commission from any vendor for recommending his product or service to a client is prohibited.

.04 A CPA should be frank and straightforward with clients. While tact and diplomacy are desirable, a client should never be left in doubt about the CPA's position on any issue of significance. No truly professional man will subordinate his own judgment or conceal or modify his honest opinion merely to please. This admonition applies to all services including those related to management and tax problems.

.05 When accepting an engagement, a CPA should bear in mind that he may find it necessary to resign if conflict arises on an important question of principle. In cases of irreconcilable difference, he will have to judge whether the importance of the matter requires such an action. In weighing this question, he can feel assured that the practitioner who is independent, fair and candid is the better respected for these qualities and will not lack opportunities for constructive service.

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Responsibilities to Colleagues

A certified public accountant should conduct himself in a manner which will promote cooperation and good relations among members of the profession.

.01 The support of a profession by its members and their cooperation with one another are essential elements of professional character. The public confidence and respect which a CPA enjoys is largely the result of the cumulative accomplishments of all CPAs, past and present. It is, therefore, in the CPA's own interest, as well as that of the general public, to support the collective efforts of colleagues through professional societies and organizations and to deal with fellow practitioners in a manner which will not detract from their reputation and well-being.

.02 Although the reluctance of a professional to give testimony that may be damaging to a colleague is understandable, the obligation of professional courtesy and fraternal consideration can never excuse lack of complete candor if the CPA is testifying as an expert witness in a judicial proceeding or properly constituted inquiry.

.03 A CPA has the obligation to assist his fellows in complying with the Code of Professional Ethics and should also assist appropriate disciplinary authorities in enforcing the Code. To condone serious fault can be as bad as to commit it. It may be even worse, in fact, since some errors may result from ignorance rather than intent and, if let pass without action, will probably be repeated. In situations of this kind, the welfare of the public should be the guide to a member's action.

.04 While the Code proscribes certain specific actions in the area of relationships with colleagues, it should be understood that these proscriptions do not define the limits of desirable intraprofessional conduct. Rather, such conduct encompasses the professional consideration and courtesies which each CPA would like to have fellow practitioners extend to him.

.05 It is natural that a CPA will seek to develop his practice. However, in doing so he should not seek to displace another accountant in a client relationship by any means which will lessen the effectiveness of his technical performance or lessen his concern for the rights of third parties to reliable information. Further, he should not act in any way that reflects negatively on fellow practitioners.

.06 A CPA may provide service to those who request it, even though they may be served by another practitioner in another area of service, or he may succeed another practitioner at a client's request. In such circumstances it is always desirable and required in some situations before accepting an engagement that the CPA who has been approached should advise the accountant already serving the client. Such action is indicated not only by considerations of professional courtesy but by good business judgment.

.07 A client may sometimes request services requiring highly specialized knowledge. If the CPA lacks the expertise necessary to render such services, he should call upon a fellow practitioner for assistance or refer the entire engagement to another. Such assistance or referral brings to bear on the client's needs both the referring practitioner's knowledge of the client's affairs and the technical expertise of the specialist brought into the engagement. If both serve the client best in their own area of ability, all parties are well served as is the public.

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Other Responsibilities and Practices

A certified public accountant should conduct himself in a manner which will enhance the stature of the profession and its ability to serve the public.

.01 In light of the importance of their function, CPAs and their firms should have a keen consciousness of the public interest and the needs of society. Thus, they should support efforts to achieve equality of opportunity for all, regardless of race, religious background or sex, and should contribute to this goal by their own service relationships and employment practices.

.02 The CPA is a beneficiary of the organization and character of his profession. Since he is seen as a representative of the profession by those who come in contact with him, he should behave honorably both in his personal and professional life and avoid any conduct that might erode public respect and confidence.

.03 Solicitation to obtain clients through false, misleading and deceptive statements or acts is prohibited under the Rules of Conduct because it will lessen the professional effectiveness and the independence toward clients which is essential to the best interests of the public.

.04 Advertising, which is false, misleading and deceptive, is also prohibited because such representations will mislead some of the public and thereby reduce or destroy the profession's usefulness to society. A CPA should seek to establish a reputation for competence and character, through actions rather than words. There are many ways this can be done such as by making himself known through public service, by civic and political activities, and by joining associations and clubs. It is desirable for him to share his knowledge with interested groups by accepting requests to make speeches and write articles. Whatever publicity occurs as a natural by-product of such activities is entirely proper.

.05 In his work, the CPA should be motivated more by desire for excellence in performance than for material reward. This does not mean that he need be indifferent about compensation. Indeed, a professional man who cannot maintain a respectable standard of living is unlikely to inspire confidence or to enjoy sufficient peace of mind to do his best work.

.06 In determining fees, a CPA may assess the degree of responsibility assumed by undertaking an engagement as well as the time, manpower and skills required to perform the service in conformity with the standards of the profession. He may also take into account the value of the service to the client, the customary charges of professional colleagues and other considerations. No single factor is necessarily controlling.

.07 Clients have a right to know in advance what rates will be charged and approximately how much an engagement will cost. However, when professional judgments are involved, it is usually not possible to set a fair charge until an engagement has been completed. For this reason CPAs should state their fees for proposed engagements in the form of estimates which may be subject to change as the work progresses.

.08 Other practices prohibited by the Rules of Conduct include using any firm designation or description which might be misleading, or practicing as a professional corporation or association which fails to comply with provisions established by Council to protect the public interest.

.09 A member, while practicing public accounting, may not engage in a business or occupation which is incompatible therewith. While certain occupations are clearly incompatible with the practice of public accounting, the profession has never attempted to list them, for in most cases the individual circumstances indicate whether there is a problem. For example, there would be a problem of conflict of interest if a practicing CPA were to serve on a tax assessment board since he would be open to accusations of favoring his clients whether this was done or not. Moreover, they might, under some circumstances, create a conflict of interest in the CPA's independence relationship with his clients.

.10 Paying a commission to outsiders is prohibited in order to eliminate the temptation to compensate anyone for referring a client. Receipt of a commission is proscribed since practitioners should look to the client, and not to others, for compensation for services rendered. The practice of paying a fee to a referring CPA irrespective of any service performed or responsibility assumed by him is proscribed because there is no justification for a CPA to share in a fee for accounting services where his sole contribution was to make a referral.

.11 Over the years the vast majority of CPAs have endeavored to earn and maintain a reputation for competence, integrity and objectivity. The success of these efforts has been largely responsible for the wide public acceptance of accounting as an honorable profession. This acceptance is a valuable asset which should never be taken for granted. Every CPA should constantly strive to see that it continues to be deserved.

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RULES OF CONDUCT: DEFINITIONS AND APPLICABILITY

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ET Section 91

Definitions

Effective March 1, 1973, unless otherwise indicated

.01 The following definitions of terminology are applicable wherever such terminology is used in the Rules and Interpretations.

.02 **Client.** The person(s) or entity which retains a member or his firm, engaged in the practice of public accounting, for the performance of professional services.

.03 **Council.** The Council of the American Institute of Certified Public Accountants.

.04 **Enterprise.** Any person(s) or entity, whether organized for profit or not, for which a CPA provides services.

.05 **Firm.** A proprietorship, partnership, or professional corporation or association engaged in the practice of public accounting, including individual partners or shareholders thereof.

.06 **Financial statements.** Statements and footnotes related thereto that purport to show financial position which relates to a point in time or changes in financial position which relate to a period of time, and statements which use a cash or other incomplete basis of accounting. Balance sheets, statements of income, statements of retained earnings, statements of changes in financial position, and statements of changes in owners' equity are financial statements.

.07 Incidental financial data included in management advisory services reports to support recommendations to a client and tax returns and supporting schedules do not, for this purpose, constitute financial statements; and the statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

.08 **Institute.** The American Institute of Certified Public Accountants.

.09 **Interpretations of Rules of Conduct.** Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the Rules of Conduct.

.10 **Member.** A member, associate member, or international associate of the American Institute of Certified Public Accountants.

.11 **Practice of public accounting.** Holding out to be a CPA or public accountant and at the same time performing for a client one or more types of services rendered by public accountants. The term shall not be limited by a more restrictive definition which might be found in the accountancy law under which a member practices.

.12 **Professional services.** One or more types of services performed in the practice of public accounting.

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ET Section 92

Applicability of Rules

Effective March 1, 1973, unless otherwise indicated

.01 The Institute's Code of Professional Ethics derives its authority from the bylaws of the Institute which provide that the Trial Board may, after a hearing, admonish, suspend, or expel a member who is found guilty of infringing any of the bylaws or any provisions of the Rules of Conduct.*

.02 The Rules of Conduct which follow apply to all services performed in the practice of public accounting including tax and management advisory services except (a) where the wording of the rule indicates otherwise and (b) that a member who is practicing outside the United States will not be subject to discipline for departing from any of the rules stated herein so long as his conduct is in accord with the rules of the organized accounting profession in the country in which he is practicing. However, where a member's name is associated with financial statements in such a manner as to imply that he is acting as an independent public accountant and under circumstances that would entitle the reader to assume that United States practices were followed, he must comply with the requirements of Rules 202 and 203.

.03 A member may be held responsible for compliance with the Rules of Conduct by all persons associated with him in the practice of public accounting who are either under his supervision or are his partners or shareholders in the practice.

.04 A member engaged in the practice of public accounting must observe all the Rules of Conduct. A member not engaged in the practice of public accounting must observe only Rules 102 and 501 since all other Rules of Conduct relate solely to the practice of public accounting.

.05 A member shall not permit others to carry out on his behalf, either with or without compensation, acts which, if carried out by the member, would place him in violation of the Rules of Conduct.

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*Bylaws Section 7.4. [BL section 740.]

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INDEPENDENCE, INTEGRITY AND OBJECTIVITY

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ET Section 101

Independence

Effective March 1, 1973, unless otherwise indicated

.01 Rule 101—Independence. A member or a firm of which he is a partner or shareholder shall not express an opinion on financial statements of an enterprise unless he and his firm are independent with respect to such enterprise. Independence will be considered to be impaired if, for example:

A. During the period of his professional engagement, or at the time of expressing his opinion, he or his firm

1. (a) Had or was committed to acquire any direct or material indirect financial interest in the enterprise; or

   (b) Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the enterprise; or

2. Had any joint closely held business investment with the enterprise or any officer, director, or principal stockholder thereof which was material in relation to his or his firm's net worth; or

3. Had any loan to or from the enterprise or any officer, director, or principal stockholder thereof. This latter proscription does not apply to the following loans from a financial institution when made under normal lending procedures, terms, and requirements:

   (a) Loans obtained by a member or his firm which are not material in relation to the net worth of such borrower.

   (b) Home mortgages.

   (c) Other secured loans, except loans guaranteed by a member's firm which are otherwise unsecured.

B. During the period covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion, he or his firm

1. Was connected with the enterprise as a promoter, underwriter or voting trustee, a director or officer or in any

→ *The next page is 4411-3.* ←

capacity equivalent to that of a member of management or of an employee; or

2. Was a trustee for any pension or profit-sharing trust of the enterprise.

The above examples are not intended to be all-inclusive. [As amended March 31, 1978.]

Interpretations under Rule 101—Independence

.02 **101-1—Directorships.** Members are often asked to lend the prestige of their name as a director of a charitable, religious, civic or other similar type of nonprofit organization whose board is large and representative of the community's leadership. An auditor who permits his name to be used in this manner would not be considered lacking in independence under Rule 101 so long as he does not perform or give advice on management functions, and the board itself is sufficiently large that a third party would conclude that his membership was honorary.

[Note: The following modification of Interpretation 101-1 is to become effective with respect to fiscal years beginning after February 29, 1980.]

101-1—Honorary directorships and trusteeships. Members are often asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic or similar nature by being named as a director or a trustee. A member who permits his name to be used in this manner and who is associated with the financial statements of the organization would not be considered lacking in independence under Rule 101 so long as (1) his position is purely honorary, (2) it is identified as honorary in all letterheads and externally circulated materials in which he is named as a director or trustee, (3) he restricts his participation to the use of his name, and (4) he does not vote or otherwise participate in management functions.

It is presumed that organizations to which members lend only the prestige of their names will have sufficiently large boards of directors or trustees to clearly permit the member to limit his participation consistent with the foregoing restriction.

.03 **101-2—Retired partners and firm independence.** A retired partner having a relationship of a type specified in Rule 101 with a client of his former firm would not be considered as impairing the firm's independence with respect to the client provided that he is no longer active in the firm, that the fees received from such client do not have a material effect on his retirement benefits and that he is not held out as being associated with his former partnership.

.04 **101-3—Accounting services.** Members in public practice are sometimes asked to provide manual or automated bookkeeping or data processing services to clients who are of insufficient size to employ an adequate internal accounting staff. Computer systems design and programming assistance are also rendered by members either in conjunction with data processing services or as a separate engagement. Members who perform such services and who are engaged in the practice of public accounting are subject to the bylaws and Rules of Conduct.

On occasion members also rent "block time" on their computers to their clients but are not involved in the processing of transactions or maintaining the client's accounting records. In such cases the sale of block time constitutes a business rather than a professional relationship and must be considered together with all other relationships between the member and his client to determine if their aggregate impact is such as to impair the member's independence.

When a member performs manual or automated bookkeeping services, concern may arise whether the performance of such services would impair his audit independence—that the performance of such basic accounting services would cause his audit to be lacking in a review of mechanical accuracy or that the accounting judgments made by him in recording transactions may somehow be less reliable than if made by him in connection with the subsequent audit.

Members are skilled in, and well accustomed to, applying techniques to control mechanical accuracy, and the performance of the record-keeping function should have no effect on application of such techniques. With regard to accounting judgments, if third parties have confidence in a member's judgment in performing an audit, it is difficult to contend that they would have less confidence where the same judgment is applied in the process of preparing the underlying accounting records.

Nevertheless, a member performing accounting services for an audit client must meet the following requirements to retain the appearance that he is not virtually an employee and therefore lacking in independence in the eyes of a reasonable observer.

1. The CPA must not have any relationship or combination of relationships with the client or any conflict of interest which would impair his integrity and objectivity.

2. The client must accept the responsibility for the financial statements as his own. A small client may not have anyone in his employ to maintain accounting records and may rely on the CPA for this purpose. Nevertheless, the client must be sufficiently knowledgeable of the enterprise's activities and financial condition and the applicable accounting principles so that he can reasonably accept such responsibility, including, specifically, fairness of valuation and presentation and adequacy of disclosure. When necessary, the CPA must discuss accounting matters with the client to be sure that the client has the required degree of understanding.

3. The CPA must not assume the role of employee or of management conducting the operations of an enterprise. For example, the CPA shall not consummate transactions, have custody of assets or exercise authority on behalf of the client. The client must prepare the source documents on all transactions in sufficient detail to identify clearly the nature and amount of such transactions and maintain an accounting control over data

processed by the CPA such as control totals and document counts. The CPA should not make changes in such basic data without the concurrence of the client.

4. The CPA, in making an examination of financial statements prepared from books and records which he has maintained completely or in part, must conform to generally accepted auditing standards. The fact that he has processed or maintained certain records does not eliminate the need to make sufficient audit tests.

When a client's securities become subject to regulation by the Securities and Exchange Commission or other federal or state regulatory body, responsibility for maintenance of the accounting records, including accounting classification decisions, must be assumed by accounting personnel employed by the client. The assumption of this responsibility must commence with the first fiscal year after which the client's securities qualify for such regulation.

.05 **101-4—Effect of family relationships on independence.** Rule of Conduct 101 proscribes relationships which impair a member's independence through direct financial interests, material indirect financial interests, or other involvements. Relationships which arise through family bloodlines and marriage give rise to circumstances that may impair a member's independence.

1. *Financial and business relationships ascribed to the member.* It is well accepted that the independence of a member may be impaired by the financial interests and business relationships of the member's spouse, dependent children, or any relative living in a common household with or supported by the member. The financial interests or business relationships of such family, dependents or relatives in a member's client are ascribed to the member; in such circumstances the independence of the member or his firm would be impaired under Rule 101.

2. *Financial and business relationships that may be ascribed to the member.*

Close Kin

Family relationships may also involve other circumstances in which the appearance of independence is lacking. However, it is not reasonable to assume that all kinships, per se, will impair the appearance of independence since some kinships are too remote. The following guidelines to the effect of kinship on the appearance of independence have evolved over the years:

A presumption that the appearance of independence is impaired arises from a significant financial interest, investment, or business relationship by the following close kin in a member's client: non-dependent children, brothers and sisters, grandparents, parents, parents-in-law, and the respective spouses of any of the foregoing.

If the close kin's financial interest in a member's client is material in relationship to the kin's net worth, a third party could conclude that the member's objectivity is impaired with respect to the client since the kinship is so close. In addition, financial interests held by close kin may result in an indirect financial interest being ascribed to the member.

The presumption that the appearance of independence is impaired would also prevail where a close kin has an important role or responsible executive position (e. g., director, chief executive or financial officer) with a client.

Geographical separation from the close kin and infrequent contact may mitigate such impairment except with respect to:

a. a partner participating in the engagement or located in an office participating in a significant portion of the engagement,

b. a partner in the same office or one who maintained close personal relationships with partners participating in a significant portion of the engagement,

c. a partner who, as a result of his administrative or advisory positions, is involved in the engagement, or

d. a staff member participating in the engagement or located in an office participating in a significant portion of the engagement.

If a member does not or could not reasonably be expected to have knowledge of the financial interests, investments and business relationships of his close kin, such lack of knowledge would preclude an impairment of objectivity and appearance of independence.

3. ***Financial and business relationships that are not normally ascribed to the member.***

Remote Kin

A presumption that the appearance of independence is impaired would not normally arise from the financial interests and business relationships of remote kin: uncles, aunts, cousins, nephews, nieces, other in-laws, and other kin who are not close.

The financial interests and business relationships of these remote kin are not considered either direct or indirect interests ascribed to the member. However, the presumption of no impairment with remote kin would be negated if other factors indicating a closeness exist, such as living in the same household with the member, having financial ties, or jointly participating in other business enterprises.

Summary

Members must be aware that it is impossible to enumerate all circumstances wherein the appearance of a member's independence might be questioned by third parties because of family relationships. In situations involving the assessment of relationships with both close and remote kin, members must consider whether geographical proximity, strength of personal and other business relationships and other factors—when viewed together with financial interests in question—would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to the member's objectivity and appearance of independence.

.06 **101-5—Meaning of the term "normal lending procedures, terms and requirements".** Rule 101(A)(3) prohibits loans to a member from his client except for certain specified kinds of loans from a client financial institution when made under "normal lending procedures, terms and requirements." The member would meet the criteria prescribed by this rule if the procedures, terms and requirements relating to his loan are reasonably comparable to those relating to other loans of a similar character committed to other borrowers during the period in which the loan to the member is committed. Accordingly, in making such comparison and in evaluating whether his loan was made under "normal lending procedures, terms and requirements", the member should consider all the circumstances under which the loan was granted including

1. The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the member or his firm.
2. Repayment terms.
3. Interest rate, including "points".
4. Requirement to pay closing costs in accordance with the lender's usual practice.
5. General availability of such loans to the public.

Related prohibitions (which may be more restrictive) are prescribed by certain state and federal agencies having regulatory authority over such financial institutions.

.07 **101-6—The effect of actual or threatened litigation on independence.** Rule of Conduct 101 prohibits the expression of an opinion on financial statements of an enterprise unless a member and his firm are independent with respect to the enterprise. In some circumstances, independence may be considered to be impaired as a result of litigation or the expressed intention to commence litigation.

Litigation between client and auditor

In order for the auditor to fulfill his obligation to render an informed, objective opinion on the client company's financial statements, the relationship between the management of the client and the auditor must be characterized by complete candor and full disclosure regarding all aspects of the client's business operations. In addition, there must be an absence of bias on the part of the auditor so that he can exercise dispassionate professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against the auditor, the auditor and the client management may be placed in adversary positions in which the management's willingness to make complete disclosures and the auditor's objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the auditor and his client company or its management are in threatened or actual positions of material adverse interests by reason of actual or intended litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.
2. The commencement of litigation by the auditor against the present management alleging management fraud or deceit would be considered to impair independence.
3. An expressed intention by the present management to commence litigation against the auditor alleging deficiencies in audit work for the client is considered to impair independence if the auditor concludes that there is a strong possibility that such a claim will be filed.
4. Litigation not related to audit work for the client (whether threatened or actual) for an amount not material to the

member's firm [1] or to the financial statements of the client company would not usually be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

Litigation by security holders

The auditor may also become involved in litigation ("primary litigation") in which he and the client company or its management are defendants. Such litigation may arise, for example, when one or more stockholders bring a stockholders' derivative action or a so-called "class action" against the client company or its management, its officers, directors, underwriters and auditors under the securities laws. Such primary litigation in itself would not alter fundamental relationships between the client company or its management and auditor and therefore should not be deemed to have an adverse impact on the auditor's independence. These situations should be examined carefully, however, since the potential for adverse interests may exist if cross-claims are filed against the auditor alleging that he is responsible for any deficiencies or if the auditor alleges fraud or deceit by the present management as a defense. In assessing the extent to which his independence may be impaired under these conditions, the auditor should consider the following additional guidelines:

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and auditor in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the member's firm [1] or to the financial statements of the client.

2. The assertion of cross-claims against the auditor by underwriters would not usually impair independence if no such claims are asserted by the company or the present management.

[1] Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment.

3. If any of the persons who file cross-claims against the auditor are also officers or directors of other clients of the auditor, the auditor's independence with respect to such other clients would not usually be impaired.

Other third-party litigation

Another type of third-party litigation against the auditor may be commenced by a lending institution, other creditor, security holder or insurance company who alleges reliance on financial statements of the client examined by the auditor as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may commence litigation (under subrogation rights) against the auditor in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect the auditor's independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the auditor and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the auditor alleges, in his defense, fraud or deceit by the present management.

If the real party in interest in the litigation (e. g., the insurance company) is also a client of the auditor ("the plaintiff client"), the auditor's independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the member's firm [2] or to the financial statements of the plaintiff client. If the auditor concludes that such litigation is not material to the plaintiff client or his firm and thus his independence is not impaired, he should nevertheless ensure that professional personnel assigned to the audit of either of the two clients have no involvement with the audit of the other.

Effects of impairment of independence

If the auditor believes that the circumstances would lead a reasonable person having knowledge of the facts to conclude that the actual or intended litigation poses an unacceptable threat to the auditor's independence he should either (a) disengage himself to avoid the appearance that his self-interest would affect his objectivity, or (b) disclaim an opinion because of lack of independence as prescribed by Section 517 of *Statement on Auditing Standards No. 1.* Such disengagement may take the form of resignation or cessation of any audit work then in progress pending resolution of the issues between the parties.

[2] See footnote 1.

Termination of impairment

The conditions giving rise to a lack of independence are usually eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between auditor and client. The auditor should carefully review the conditions of such resolution to determine that all impairments to his objectivity have been removed.

Actions permitted while independence is impaired

If the auditor was independent when his report was initially rendered, he may re-sign such report or consent to its use at a later date while his independence is impaired provided that no post-audit work is performed by such auditor during the period of impairment. The term "post-audit work", in this context, does not include inquiries of subsequent auditors, reading of subsequent financial statements, or such procedures as may be necessary to assess the effect of subsequently discovered facts on the financial statements covered by his previously issued report.

.08 **101-7—Application of Rule 101 to professional personnel.** The term "he and his firm" as used in the first sentence of Rule 101 means (1) all partners or shareholders in the firm and (2) all full and part-time professional employees participating in the engagement or located in an office participating in a significant portion of the engagement.

.09 **101-8—Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships with a Member's Client.**

Introduction

Rule 101, Independence, provides in part that "A member or a firm of which he is a partner or shareholder shall not express an opinion on financial statements of an enterprise unless he and his firm are independent with respect to such enterprise. Independence will be considered to be impaired if for example, (A) . . . during the period of his professional engagement, or at the time of expressing his opinion, he or his firm . . . had or was committed to acquire any direct or material indirect financial interest in the enterprise . . . (B) during the period covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion, he or his firm . . . was connected with the enterprise . . . in any capacity equivalent to that of a member of management . . ."

This interpretation deals with the effect on the appearance of independence of financial interests in nonclients that are related in various ways to a client. Some of the relationships discussed herein result in a financial interest in the client, while others would place the member in a capacity equivalent to that of a member of management.

Situations in which the nonclient investor is a partnership are not covered in this interpretation because the interests of the partnership are ascribed directly to the partners. A member holding a direct financial interest in a partnership that invests in his client has, as a result, a direct financial interest in the client, which impairs his independence.

Terminology

The following specially identified terms are used in this Interpretation as indicated:

1. *Client.* The enterprise with whose financial statements the member is associated.
2. *Member.* In this Interpretation the term "member" means (a) a member, (b) a partner or shareholder in the firm or (c) a full or part-time professional employee participating in the engagement or located in an office participating in a significant portion of the engagement.
3. *Investor.* In this Interpretation the term "investor" means (a) a parent or (b) another investor (including a natural person but not a partnership) that holds an interest in another company ("investee"), but only if the interest gives such other investor the ability to exercise significant influence over operating and financial policies of the investee. The criteria established in paragraph 17 of Accounting Principles Board Opinion Number 18 shall apply in determining the ability of an investor to exercise such influence.
4. *Investee.* In this Interpretation, the term "investee" means (a) a subsidiary or (b) an entity that is subject to significant influence from an investor. A limited partnership in which a client-investor holds a limited partnership interest would not be considered an "investee" subject to this interpretation unless the limited partner were in a position to exercise significant influence over operating and financial policies of the limited partnership.

5. *Material Investee.* An investee is presumed to be material if:

   (a) the investor's aggregate carrying amount of investment in and advances to the investee exceeds 5% of the investor's consolidated total assets, or

   (b) the investor's equity in the investee's income from continuing operations before income taxes exceeds 5% of the investor's consolidated income from continuing operations before income taxes.

   When the investor is a nonclient and its carrying amount of investments in and advances to the client investee is not readily available, the investor's proportionate share of the client investee's total assets may be used in the calculation described in (a) above.

   If the income of an investor or investee from continuing operations before income taxes of the most recent year is clearly not indicative of the past or expected future amounts of such income, the reference point for materiality determinations should be the average of the incomes from continuing operations before income taxes of the preceding 3 years.

   If a member has a financial interest in more than one nonclient investee of a client investor, the investments in and advances to such investees, and the equity in the income from continuing operations before income taxes of all such investees must be aggregated for purposes of determining whether such investees are material to the investor.

   The 5% guidelines for identifying a material investee are to be applied to financial information available at the beginning of the engagement. A minor change in the percentage resulting from later financial information, which a member does not and could not be expected to anticipate at the beginning, may be ignored.

6. *Material financial interest.* A financial interest is presumed to be material to a member if it exceeds 5% of the member's net worth. If the member has financial interests in more than one investee of one investor, such interests must be aggregated for purposes of determining whether the member has a material financial interest as described in the preceding sentence.

Interpretation

Where a nonclient investee is material to a client investor, any direct or material indirect financial interest of a member in the nonclient investee would be considered to impair the member's independence with respect to the client. Likewise, where a client investee is material to a nonclient investor, any direct or material indirect financial interest of a member in the nonclient investor would be considered to impair the member's independence with respect to the client.

The remainder of this Interpretation discusses whether, in the other situations listed below, a member's financial interest in nonclient investor or nonclient investee of an audit client will impair the member's independence.

These situations are discussed in the following sections:

(1) Nonclient investee is not material to client investor.

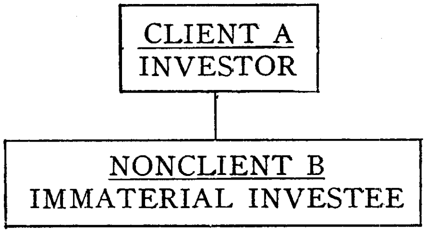
(2) Client investee is not material to nonclient investor.

Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The member should make a reasonable inquiry to determine whether such relationships exist, and where they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to the member's independence.

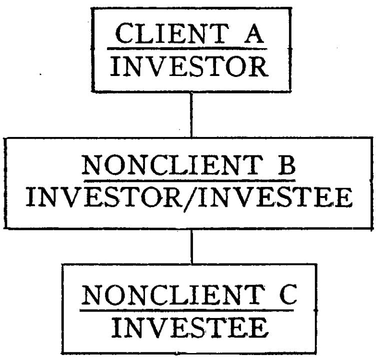
In general, in brother-sister common control situations, an immaterial financial interest of a member in the nonclient investee would not impair the independence of a member with respect to the client investee provided the member could not significantly influence the nonclient investor. In like manner in a joint venture situation, an immaterial financial interest of a member in the nonclient investor would not impair the independence of the member with respect to the client investor provided that the member could not significantly influence the nonclient investor.

If a member does not and could not reasonably be expected to have knowledge of the financial interests or relationships described in this interpretation, such lack of knowledge would preclude an impairment of independence.

(1) NONCLIENT INVESTEE IS NOT MATERIAL TO CLIENT INVESTOR

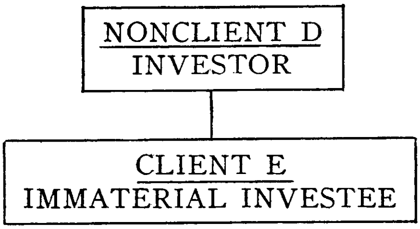


An immaterial financial interest of a member in Nonclient B (investee) would not be considered to impair the member's independence with respect to Client A (investor). A material financial interest of a member in Nonclient B would be considered to impair the member's independence with respect to Client A. The reason for this is that through its ability to influence Nonclient B, Client A could enhance or diminish the value of the member's financial interest in Nonclient B by an amount material to the member's net worth without a material effect on its own financial statements. As a result, the member would not appear to be independent when reporting on the financial statements of Client A.



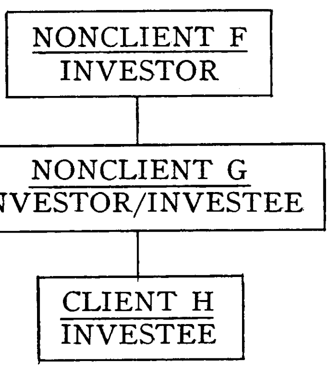
If Nonclient B (investee of Client A) had an investee, Nonclient C, the determination as to whether a financial interest in Nonclient C would be considered to impair the member's independence would be based on the same rules as above for Nonclient B, except that the materiality of Nonclient C is measured in relation to Client A, rather than to Nonclient B.

(2) CLIENT INVESTEE IS NOT MATERIAL TO NONCLIENT INVESTOR



Except as indicated in the next paragraph, a financial interest of a member in Nonclient D (investor) would not be considered to impair the member's independence with respect to Client E (investee) even if the financial interest in Nonclient D were material to the member's net worth. The reason for this is that, since Client E is immaterial to Nonclient D, the member would not appear to be in a position to enhance his investment in Nonclient D.

If the member's financial interest in Nonclient D (investor) is sufficiently large to allow the member to significantly influence the actions of Nonclient D, the member's independence would be considered to be impaired. The reason for this is that a financial interest sufficient to allow the member to significantly influence the actions (operating and financial policies, intercompany transactions, etc.) of the investor could permit the member to exercise a degree of control over the client that would place the member in a capacity equivalent to that of a member of management. Such relationship would be considered to impair independence under Rule 101(b)(1).



If Client H were an investee of nonclient G, who was an investee of another investor, Nonclient F, the determination as to whether a financial interest in Nonclient F would be considered to impair the member's independence would be based on the same rules as above for Nonclient G, except that the materiality of Client H is measured in relation to Nonclient F, rather than to Nonclient G.

Effective Date

To permit the orderly compliance with this Interpretation, the effective date is January 1, 1980 but earlier compliance is encouraged.

The next page is 4421.

ET Section 102

Integrity and Objectivity

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 102—Integrity and objectivity.** A member shall not knowingly misrepresent facts, and when engaged in the practice of public accounting, including the rendering of tax and management advisory services, shall not subordinate his judgment to others. In tax practice, a member may resolve doubt in favor of his client as long as there is reasonable support for his position.

The next page is 4431.

ET Section 191

Ethics Rulings on Independence, Integrity and Objectivity

1. Acceptance of a Gift

.001 *Question*—Would the independence of a member's firm be considered to be impaired if an employee or partner accepts a gift or other unusual consideration from a client?

.002 *Answer*—If an employee or partner accepts more than a token gift from a client, even with the knowledge of the member's firm, the appearance of independence may be lacking.

2. Association Membership

.003 *Question*—If a member joined a trade association which is a client, would the independence of the member's firm be considered to be impaired with respect to the association?

.004 *Answer*—Independence of the member's firm would not be considered to be impaired provided he did not serve in any capacity equivalent to that of a member of management.

3. Member as Cosigner of Checks

.005 *Question*—A member has been requested to accept the responsibility in emergency situations of cosigning checks with a designated employee of a client. Would the independence of the member's firm be considered to be impaired under these circumstances?

.006 *Answer*—Independence of the member's firm would be considered to be impaired since such activities are management functions.

4. Payroll Preparation Services

.007 *Question*—A member's firm performs payroll preparation services for its clients. A single bank account in the firm's name is used to clear all checks. Individual employee checks are cosigned by a member of the firm as well as by an officer of each of the respective clients. The clients reimburse the firm for the net amount of the payrolls. Would the independence of the member's firm be considered to be impaired with respect to clients who avail themselves of this service?

.008 *Answer*—Independence of the member's firm would be considered to be impaired because the service does not conform to the requirements of Interpretation 101-3.

5. Member as Bookkeeper

.009 *Question*—A client plans to process receipts, disbursements, and other documents of original entry and to transmit this raw data to a member's firm for further processing, either on a computer or manually, into a general ledger and other statistical reports. Would the independence of the member's firm be considered to be impaired under these circumstances?

.010 *Answer*—If the services performed conform to the requirements of Interpretation 101-3, independence of the member's firm would not be considered to be impaired.

6. Member's Spouse as Bookkeeper of Client

.011 *Question*—The spouse of a member is employed as a bookkeeper by an audit client. Would the independence of the member's firm be considered to be impaired under these circumstances?

.012 *Answer*—Independence of the member's firm would not necessarily be considered to be impaired. The performance of write-up work within the requirements of Interpretation 101-3, would not necessarily impair his independence if done by the member himself. Therefore, the spouse of a member could perform the same functions as the member without impairing the independence of the member's firm. If, however, the spouse's scope of responsibilities or activities extends beyond the bookkeeping function into areas of accounting or management decisions, independence of the member's firm would be considered to be impaired.

7. Member as Contract Bookkeeper

.013 *Question*—A member proposes to enter into contract with a client to supervise office personnel on a monthly fee basis, approve vouchers for payment, and prepare monthly and quarterly operating reports. Would the independence of the member's firm be considered to be impaired with respect to the client?

.014 *Answer*—Independence of the member's firm would be considered to be impaired since management functions are being performed.

8. Member Providing Accounting and Management Advisory Services

.015 *Question*—A member has provided extensive accounting and management advisory services for a client. In that connection, the member has attended board meetings, interpreted financial statements, forecasts and other analyses, counseled on potential expansion plans, and counseled on negotiations with bankers. Would the independence of the member's firm be considered to be impaired under these circumstances?

.016 *Answer*—The services described are those often provided by members for clients. If the services performed conform to the requirements of Interpretation 101-3, independence of the member's firm would not be considered to be impaired.

9. Member as Representative of Creditors' Committee

.017 *Question*—A member has been asked to perform the following functions for a creditors' committee in control of a debtor corporation which will continue to operate under its existing management subject to extension agreements:

a. Cosign checks issued by the debtor corporation.

b. Cosign purchase orders in excess of established minimum amounts.

c. Exercise general supervision to insure compliance with budgetary controls and pricing formulas established by management, with the consent of the creditors, as part of an overall program aimed at the liquidation of deferred indebtedness.

Would the independence of the member's firm be considered to be impaired with respect to the debtor corporation?

.018 *Answer*—Independence of the member's firm would be considered to be impaired under each of the three situations described since these are management functions.

10. Member as Legislator

.019 *Question*—A member is an elected legislator in a local government. The city manager, who is responsible for all administrative functions, is also an elected official. Would the independence of the member's firm be considered to be impaired with respect to the governmental entity?

.020 *Answer*—Independence of the member's firm would be considered to be impaired if the member served as an elected legislator in a municipal body at the same time his firm is engaged as auditor for the body, even though the city manager is an elected official rather than an appointee of the legislature.

11. Member as Executor or Trustee

.021 *Question*—A member has been asked to serve as an executor and trustee of the estate of an individual who owns the majority of the stock of a closely held corporation. Would the independence of the member's firm be considered to be impaired under these circumstances?

.022 *Answer*—The mere designation of a member to become executor or trustee would not impair independence of the member's firm. Actual service in either capacity, however, would impair independence.

12. Member as Trustee

.023 *Question*—A tax exempt charitable foundation is the sole beneficiary of the estate of the foundation's deceased organizer. If a member becomes a trustee of the foundation, would the independence of the member's firm be considered to be impaired with respect to (1) the foundation and (2) the estate?

.024 *Answer*—If a member accepted the invitation to become a trustee of the foundation, independence of the member's firm would be considered to be impaired with respect to both the foundation and the estate.

13. Member as Bank Stockholder

.025 *Question*—A member in public practice holds a stock interest in a bank. Would the independence of the member's firm be considered to be impaired with respect to a client which has borrowings with the bank?

.026 *Answer*—The member's stock ownership in the bank creates an indirect financial interest with respect to the bank's customers. To the extent that such an indirect financial interest is not material, independence of the member's firm would not be considered to be impaired.

14. Member on Board of Directors of United Fund

.027 *Question*—A member serves as a director and assistant treasurer of a local United Fund, which operates as a federated fund-raising organization from which the Boy Scouts and the Legal Aid Society receive funds. Would the independence of the member's firm be considered to be impaired with respect to the local Boy Scout council and Legal Aid Society?

.028 *Answer*—Independence of the member's firm would not be considered to be impaired provided that the United Fund does not exercise managerial control over the independent groups participating in the fund-raising organization.

15. Retired Partner as Director

.029 *Question*—A member has withdrawn from his firm after an association of several years and has become an officer and director of several corporations audited by the firm. The member proposes to maintain an office in the firm's suite, to receive phone calls through the switchboard and to perform services for the firm for which he would be compensated on an hourly basis. Would the independence of the member's former firm be considered to be impaired with respect to the clients in which the member is an officer and director?

.030 *Answer*—Independence of the member's former firm would be considered to be impaired since it appears the member is still closely associated with the firm.

16. Member on Board of Directors of Nonprofit Social Club

.031 *Question*—A member serves on the board of directors of a nonprofit social club. Would the independence of the member's firm be considered to be impaired with respect to the club?

.032 *Answer*—Independence of the member's firm would be considered to be impaired since the board of directors has the ultimate responsibility for the affairs of the club. The exception in Interpretation 101-1 was intended primarily to cover those situations in which a member lends his name to some worthy cause without assuming important administrative or financial responsibilities.

17. Member as Stockholder in Country Club

.033 *Question*—A member belongs to a country club in which membership requirements involve the acquisition of a pro rata share of equity or debt securities. Would the independence of the member's firm be considered to be impaired with respect to the country club?

.034 *Answer*—Independence of the member's firm would not be considered to be impaired since membership in such a club is essentially a social matter. Accordingly, such equity or debt ownership is not considered to be a direct financial interest within the meaning of Rule 101. However, the member should not take part in the management of the club.

18. Member as City Council Chairman

.035 *Question*—A member is the chairman of a city council. Would the independence of the member's firm be considered to be impaired with respect to state governmental agencies and other governments within the state?

.036 *Answer*—Independence of the member's firm would not be considered to be impaired with respect to any governmental unit except those under the council's control.

19. Member on Deferred Compensation Committee

.037 *Question*—A member has been invited by a client to serve on a committee which administers the client's deferred compensation program. Service on this committee will entail general supervisory services but will not involve participation in company management. Would the independence of the member's firm be considered to be impaired under these circumstances?

.038 *Answer*—Independence of the member's firm would be considered to be impaired since service on a committee of this type would be participation, even though minor, in management functions. The member could render helpful consulting assistance without joining the committee.

20. Member Serving on Governmental Advisory Unit

.039 *Question*—A member serves on a citizens' committee which is studying possible changes in the form of a county government he audits. The member also serves on a committee appointed to make a study of the financial status of a state. Would the independence of the member's firm be considered to be impaired with respect to a county which is in that state?

.040 *Answer*—Independence of the member's firm would not be considered to be impaired with respect to the county through the member's service on either committee.

21. Member as Director of Retirement and Profit-Sharing Trust

.041 *Question*—A member has been asked to serve in the dual capacity of director of an enterprise and auditor of the financial statements of that enterprise's profit-sharing and retirement trust. Would the independence of the member's firm be considered to be impaired with respect to the trust?

.042 *Answer*—Independence of the member's firm would be considered to be impaired with respect to the enterprise's profit-sharing and retirement trust since as director of the enterprise, the member would be involved in management functions.

22. Family Relationship, Brother

.043 *Question*—A brother of a member is a stockholder and one of three vice presidents of a closely held corporation. The member is a partner in a CPA firm in the same locale. Would the independence of the member's firm be considered to be impaired with respect to this corporation because of the member's relationship with its officer-stockholder?

.044 *Answer*—The appearance of independence is lacking since the relationships between the member and his brother are presumed to be so close as to suggest that the member may not be objective in his examination.

23. Family Relationship, Uncle by Marriage

.045 *Question*—The wife of a member has an uncle by marriage. Personal contacts with the uncle are infrequent (approximately once a year). The uncle owns one-third of a company and serves as one of its officers. Would the independence of the member's firm be considered to be impaired with respect to the company?

.046 *Answer*—In the absence of special circumstances, the appearance of independence would not be lacking since the family relationship is sufficiently remote.

24. Family Relationship, Father

.047 *Question*—The father of a member serves on a school board. Would the independence of the member's firm be considered to be impaired with respect to the school district?

.048 *Answer*—The appearance of independence would be lacking with respect to any period during which the member's father served on the school board since the relationship between father and son is presumed to be so close as to suggest that the member may not be objective in his examination.

25. Family Relationship, Son

.049 *Question*—The son of a member is a director of a savings and loan association. The member's firm has been asked to audit the financial statements of the association. The son is a practicing attorney, and there is no financial relationship between father and son. Would the independence of the member's firm be considered to be impaired under these circumstances?

.050 *Answer*—The appearance of independence would be lacking with respect to any period during which the member's son served as a director of a client since the relationship between father and son is presumed to be so close as to suggest that the member may not be objective in his examination.

26. Family Relationship, Son

.051 *Question*—A member purchased stock in a client public corporation and created a trust as an educational fund for his minor son. The trust securities were not material to the member, but were material in relation to the son's personal net worth. Would the independence of the member's firm be considered to be impaired with respect to the client corporation?

.052 *Answer*—Independence of the member's firm would be considered to be impaired since the stock would be considered a direct financial interest and, consequently, materiality is not a factor.

27. Family Relationship, Spouse as Trustee

.053 *Question*—The spouse of a member is a trustee of certain trusts. Would the independence of the member's firm be considered to be impaired with respect to an audit client if the trust purchased shares of that client?

.054 *Answer*—The control of the trust by a spouse has consistently been imputed to the other spouse for purposes of the independence rule. Accordingly, purchase by the trust of shares in an audit client would cause the independence of the member's firm to be considered to be impaired.

28. Cash Account with Brokerage Client

[.055—.056] [Superseded by Ethics Ruling No. 59.]

29. Member as Bondholder

.057 *Question*—A member's firm audits the financial statements of a municipal authority. The outstanding bonded indebtedness of this municipal authority amounts to $2,500,000. Members of the CPA firm own $25,000 of the bonds. Would the independence of the member's firm be considered to be impaired with respect to the authority?

.058 *Answer*—Independence of the member's firm would be considered to be impaired since the members have a direct financial interest in that authority. Because the interest is direct, materiality is not an issue.

30. Financial Interest by Employee

.059 *Question*—A professional employee of a member's firm owns stock in an audit client. Would the independence of the member's firm be considered to be impaired with respect to this client?

.060 *Answer*—The appearance of independence of the member's firm would be considered to be impaired if the professional staff employee of the member's firm was either involved in the engagement or located in the office of the firm participating in a significant portion of the audit. An employee of a member's firm who is not in such circumstances might have an immaterial financial interest in the audit client of his firm without impairing the appearance of independence of his firm.

31. Financial Interest in Co-Op Apartment

.061 *Question*—A member's firm has been retained as the auditors of a cooperative apartment house. The owner of each unit has a vote in the co-op. Would the independence of the member's firm be considered to be impaired with respect to the co-op if one of its partners took an apartment in it?

.062 *Answer*—Independence of the member's firm would not be considered to be impaired under the circumstances, provided the terms of the partner's lease were comparable with the terms of the leases of the other occupants and the partner did not serve as an officer or otherwise participate in the management of the cooperative.

32. Mortgage Loan to Member's Corporation

.063 *Question*—A member is president and substantial stockholder of a company which is indebted to a savings and loan association on a loan secured by a first mortgage on a company building. Would the independence of the member's firm be considered to be impaired with respect to the savings and loan association?

.064 *Answer*—Independence of the member's firm would not be considered to be impaired provided the mortgage loan was made under normal lending procedures and requirements of the savings and loan association. However, the member is cautioned that state and federal agencies regulating the savings and loan association may have regulations to the contrary.

33. Retirement Plan Offer

.065 *Question*—A member has been offered the opportunity to join in a client employee benefit plan. Would the independence of the member's firm be considered to be impaired under these circumstances?

.066 *Answer*—Independence of the member's firm would be considered to be impaired if he accepted the "employee" designation for the purpose of entering the client's employee benefit plan.

34. Member as Auditor of Common Trust Funds

.067 *Question*—A large bank having a number of common trust funds has requested a member's firm to audit the financial statements of one of the funds. Would the independence of the member's firm be considered to be impaired with respect to the fund if (1) a partner had an immaterial financial equity interest in the bank or (2) the firm had a revolving loan agreement with the bank pursuant to which seasonal financings were made?

.068 *Answer*—(1) The audit of the common trust funds of the bank would involve auditing the trusteeship and custodianship activities and responsibilities of the bank. With respect to independence, no significant difference exists between the bank and the common trust funds which it maintains. Therefore, if a partner of the firm owns stock in the bank, he and the firm would have a direct financial interest in the bank and independence would be considered to be impaired with respect to the bank's common trust funds without regard to materiality of the equity interest.

(2) Whether under the revolving loan agreement the independence of the member's firm would be considered to be impaired would be determined by the criteria set forth in Rule 101 A.3 of the Code of Professional Ethics.

35. Stockholder in Mutual Funds

.069 *Question*—A member owns shares in a regulated mutual investment fund which holds shares of stock in clients of the member's firm. Would the independence of the member's firm be considered to be impaired with respect to the client enterprises whose stock is held by the fund?

.070 *Answer*—Securities of the member's clients held by the mutual fund in question represent indirect financial interests of the member in securities of his clients. However, this indirect interest through ownership of mutual fund securities by a member would not normally be considered to impair the independence of the member's firm since investment decisions are management functions of the mutual fund over which the member has no influence. If the portfolio of the mutual fund was heavily invested in a client's securities, such indirect financial interest of the member could become material and impair the independence of the member's firm.

36. Stockholder in Investment Club

.071 *Question*—A member owns a one-tenth interest in an investment club. Would the independence of the member's firm be considered to be impaired with respect to a client in which the investment club holds shares?

.072 *Answer*—Independence of the member's firm would be considered to be impaired since the ownership of stock in a client through an investment club is considered a direct financial interest. Under these circumstances materiality is not an issue.

37. Retired Partner as Co-Trustee

.073 *Question*—A member's firm is negotiating a merger with another partnership. The senior partner of the latter will not become a partner of the new firm but will serve it as a consultant to facilitate the orderly transition of the clients from his former firm to the new firm. The payout of his partnership equity will be fixed and paid out over a ten-year period, unrelated to future profits. The consultant serves as a co-trustee of an estate which has a material interest in a client corporation. Would the independence of the member's new firm be considered to be impaired with respect to that client?

.074 *Answer*—Independence of the member's new firm would not be considered to be impaired since the consultant is not a partner in the new firm, does not participate in its activities, and does not share in its profits.

38. Member as Co-Fiduciary with Client Bank

.075 *Question*—A member serves with a client bank in a co-fiduciary capacity with respect to an estate or trust. Would the independence of the member's firm be considered to be impaired with respect to the bank or its trust department?

.076 *Answer*—Independence of the member's firm would not be considered to be impaired provided the assets in the estate or trust were not material in relation to the total assets of the bank and/or trust department.

39. Member as Stock Transfer Agent and/or Registrar

.077 *Question*—Would the independence of a member's firm be considered to be impaired with respect to an audit client for whom the member serves as an officially appointed stock transfer agent and/or registrar?

.078 *Answer*—Independence of the member's firm would be considered to be impaired under Rule 101 B.1 since the functions performed by the member as transfer agent and/or registrar would be considered equivalent to that of a member of management or of an employee. Functions such as distribution of dividends and warrants and the legal transfer of the shares of outstanding capital stock would cause the independence of the member's firm to be considered to be impaired.

[40.] [Controller Entering Public Practice]

[.079—.080] [Deleted]

41. Member as Auditor of Mutual Insurance Company

.081 *Question*—A member's firm has been asked to serve as auditors for a mutual insurance company which has been funding a retirement plan for the firm's employees. Contributions made by the firm are invested and managed by the insurance company in a pooled separate account for this and similar contracts. Would the independence of the member's firm be considered to be impaired under these circumstances?

.082 *Answer*—Independence of the member's firm would not be considered to be impaired if such funds held for the benefit of their employees are not material in relation to the net worth of the insurance company.

42. Members as Life Insurance Policy Holders

.083 *Question*—A member's firm has been asked to serve as auditors for a stock life insurance company which underwrites group term life insurance policies for the firm's partners, payable to the designated beneficiaries, not the firm. The proceeds would very likely constitute a significant part of each partner's estate. Would the independence of the member's firm be considered to be impaired under these circumstances?

.084 *Answer*—The firm's independence would not be considered to be impaired so long as the amount at risk is not material to the insurance company's underwriting activities.

43. Member's Employee as Treasurer of a Client

.085 *Question*—Would the independence of a member's firm be considered to be impaired if an employee serves as treasurer of a client which is a charitable organization?

.086 *Answer*—Independence of the member's firm would be considered to be impaired since management functions are involved.

44. Past Due Billings

[.087—.088] [Superseded by Ethics Ruling No. 52.]

45. Past Due Billings: Client in Bankruptcy

.089 *Question*—A client in bankruptcy had not met his obligations in regard to amounts due the member's firm for services rendered prior to the effective date of the bankruptcy. Would the independence of the member's firm be considered to be impaired with respect to the client as "debtor in possession" or as a trustee in bankruptcy because of the existing claims against the bankrupt estate?

.090 *Answer*—Independence of the member's firm would not be considered to be impaired with respect to the client as "debtor in possession" or as the trustee since, under these circumstances, the member's claim against the client for unpaid fees is fixed as of the date of filing of the petition of bankruptcy.

46. Member as General Counsel

[.091—.092] [Superseded by Ethics Ruling No. 51.]

47. Member as Auditor of Mutual Fund and Shareholder of Investment Adviser/Manager

.093 *Question*—A member is a shareholder of a mutual fund's investment adviser/manager. Would the independence of the member's firm be considered to be impaired with respect to the mutual fund?

.094 *Answer*—Independence of the member's firm would be considered to be impaired with respect to the mutual fund because the investment adviser, though usually a separate business entity, is responsible under contract for various management functions of the fund. Further, its fees are normally a function of fund net asset value. Conversely, if the member is a shareholder in the mutual fund, the independence of the member's firm would not be considered to be impaired with respect to the fund's investment adviser since the value of the fund is dependent upon the investment management advice of the adviser, not on his financial position.

48. Faculty Member as Auditor of a Student Fund

.095 *Question*—A tenured member on the faculty of a university is asked to audit the financial statements of the Student Senate Fund. The university has the following connections with this fund:

1. The basic faculty-administration-student relationship.

2. It acts as a collection agent for student fees and remits them to the Student Senate.

3. It requires that a member of the administration approve Student Senate checks by signing them.

Would the independence of the member's firm be considered to be impaired under these circumstances? Would independence be considered to be impaired if the member was in public practice and served as a part-time faculty member?

.096 *Answer*—Under either situation posed, independence of the member's firm would be considered to be impaired with respect to the Student Senate Fund since the member would be auditing several of the management functions performed by the university, his employer.

49. Investor and Investee Companies

[.097—.098] [Superseded by Interpretation No. 101-8.]

50. Family Relationship, Brother-in-law

.099 *Question*—The brother of a member's spouse is a chief financial officer of a closely held corporation. The member is a partner in a CPA firm located in the same geographical area. The member and his spouse have frequent social contacts with the brother and jointly own a summer vacation home. Would the independence of the member's firm be considered to be impaired with respect to this corporation?

.100 *Answer*—Interpretation 101-4 states in part that a presumption that the appearance of independence is impaired would not normally arise from the financial and business relationships of remote kin who are not close. Based on the circumstances described, however, the relationship between the member and the brother-in-law is considered to be so close that the presumption of no impairment with such remote kin is negated and independence would appear to be impaired.

51. Member Providing Legal Services

.101 *Question*—A member in public practice who is also an attorney has been asked to provide legal services to a client for whom he also serves as auditor. Would the independence of the member be considered to be impaired with respect to the client?

.102 *Answer*—Rule of Conduct 101 and related pronouncements prohibit a member from expressing an opinion on the financial statements of a client the member also serves in any capacity having the appearance of being equivalent to any management function. The rule thus prohibits an auditor from serving as an officer, director or employee regardless of the actual responsibility of those positions. Independence of the member would be considered to be impaired if the legal services rendered result in undue identification with the management of the client or involvement with a client's affairs to such a degree as to place him virtually in the position of being an employee. Further, since the designation "general counsel" would appear to describe an ongoing state of such prohibited management equivalency to an objective observer, a member identified as "general counsel" cannot be considered to be independent.

52. Past Due Fees

.103 *Question*—A member's client has been unable to meet his current obligations. As a result, substantially all amounts due the member's firm for the preceding year are unpaid and past due. Would the independence of the member's firm be considered to be impaired with respect to the client for the current year?

.104 *Answer*—Independence of the member's firm may be impaired if more than one year's fees due from a client for professional services remain unpaid for an extended period of time. Such amounts, when they are long past due according to a firm's normal billing terms, take on some of the characteristics of a loan within the meaning of Rule 101. Under these conditions, it may appear that the practitioner is providing working capital for his client and that the collection of past due amounts may depend on the nature of the auditor's report on the client's financial statements.

At the time a member issues a report on a client's financial statements, the client should not be indebted to the member for more than one year's fees. Accordingly, unless the amounts involved are clearly insignificant to both the client and the member, independence is considered to be impaired if fees for all professional services rendered for prior years are not collected before the issuance of the member's report for the current year.

53. Member as Auditor of Employee Benefit Plan and Sponsoring Company

.105 *Question*—A member has been asked to examine the financial statements of an employee benefit plan established for the employees of an audit client company. Would the independence of the member's firm with respect to the employee benefit plan be considered to be impaired by reason of his relationship as auditor of the sponsoring company?

.106 *Answer*—Independence of the member's firm with respect to the employee benefit plan would not be considered to be impaired by reason of his serving as auditor of the sponsoring company.

54. Member Providing Actuarial Services

.107 *Question*—If a member's firm renders actuarial services to a client, may the member also express an opinion on the client's financial statements?

.108 *Answer*—Even though the member's firm provides actuarial services (the results of which are incorporated in the client's financial statements), if all of the significant matters of judgment involved are determined or approved by the client and the client is in a position to have an informed judgment on the results, the member's independence would not be impaired by such activities.

55. Independence During MAS Systems Implementation

.109 *Question*—A member's firm has been requested by an audit client to perform a non-recurring engagement involving the implementation of an information and control system. In setting up the new system and only during the period of conversion to the system, the member's firm will arrange interviews for client's hiring of new personnel, and instruct and oversee the training of current client personnel. Would the independence of the member's firm be considered to be impaired with respect to the client if it performs this engagement?

.110 *Answer*—Independence of the member's firm would not be considered impaired under these circumstances provided the client makes all significant management decisions related to the hiring of new personnel and the implementation of the system. The member's firm must also take reasonable precautions to restrict his supervisory activities to initial instruction and training of personnel, and he should avoid direct supervision of the actual operation of the system or any related activities that would constitute undue involvement in or identification with management functions.

56. Executive Search

.111 *Question*—A member's firm's audit client is establishing a new operation in another locality. The client has asked the member's firm to recruit and hire for the company a controller and a cost accountant for its new operation. Would the independence of the member's firm be impaired with respect to the client by virtue of performing this engagement?

.112 *Answer*—Independence of the member's firm would be considered impaired under Rule of Conduct 101 B.1 since decisions as to employment of personnel are considered a management function. However, a member's firm may perform services consisting of recommending a position description and candidate specifications, searching for and initially screening candidates, and recommending qualified candidates to the client. Such consulting assistance would not impair independence provided client management is responsible for any ultimate hiring decision.

57. MAS Engagement to Evaluate Service Bureaus

.113 *Question*—A member's firm has been asked by a client to evaluate various commercial service bureaus and recommend a particular service bureau for processing the client's accounting records. Several partners in the member's firm have a material financial interest in a service bureau which would be one of the potential vendors. Does acceptance of this engagement create possible violations of the Code of Professional Ethics?

.114 *Answer*—There would be a possible violation of Rule 102. A recommendation by the firm that the client use the outside service bureau in which partners have a material financial interest raises a serious question as to whether the firm appears to have subordinated its judgment to those partners having a financial interest in the service bureau.*

58. Member as Lessor

.115 *Question*—A member owns a building and leases a portion of the space to a client. Would the independence of the member be impaired with respect to the client lessee?

.116 *Answer*—The leasing of property to a client creates a commercial business relationship beyond the normal professional

* Consult Rule of Conduct 505 and Interpretation 505-1 for possible application.

relationship, resulting in an indirect financial interest in that client. Rule of Conduct 101 A1 provides that independence would be considered impaired if the member's indirect financial interest in a client is material to the member.

59. Account with Brokerage Client

.117 *Question*—A member's partners and staff have accounts with a brokerage firm client, as a result of which they leave securities and cash on deposit with such client. Would the independence of the member's firm be considered to be impaired under these circumstances?

.118 *Answer*—The Securities Investor Protection Corporation (SIPC) provides securities customers with protection up to a maximum of $50,000, with the stipulation that the protection on cash being held for the customer is limited to $20,000. Independence of the member's firm would not be considered to be impaired if partners and staff had securities and/or cash accounts (non-margin) with a brokerage firm client which were not in excess of this protection. A margin account, however, creates a loan relationship between the customer and the brokerage firm, which under Rule 101 A3 of the Rules of Conduct would cause independence to be considered impaired.

60. Employee Benefit Plans—Member's Relationships with Participating Employer(s)

.119 *Question*—A member has been asked to audit and to report on the financial statements of an employee benefit plan. A plan may have one or more participating employers. Must the member maintain his independence with respect to each participating employer in order to be considered independent of the plan?

.120 *Answer*—Except as described below, in order to be considered independent with respect to an employee benefit plan the member must remain independent within the provisions of Rule 101 with respect to the employer who is the sole sponsor of the plan, or, in the case of a multi-employer plan, with respect to any employer on whom the plan has material financial impact.

The exceptions referred to above are:

1. A financial interest, direct or indirect, in a non-client employer will not impair the member's independence with respect to the plan if:
    a. The financial interest is not large enough to permit the member to exercise significant influence over operating and financial policies of the employer, and

b. The financial interest is not material in relation to the net worth of the member or his firm.

The result is the same whether the financial interest is held by the member, ascribed to him under Interpretation 101-4 (dealing with family relationships), or held by a trust or estate of which the member is a trustee, executor or administrator.

2. A loan to or from a non-client employer or any of its officers, directors or principal stockholders will not impair the member's independence with respect to the plan if the loan is not material in relation to the net worth of either the borrower or the lender.

61. Participation of Member's Spouse in Employee Stock Ownership Plan of Client

.121 *Question*—The spouse of a member is employed by a client of the firm with whose financial statements the firm is associated. The position is one that would not, in itself, impair independence. The spouse participates in the client's employee stock ownership plan. Would the independence of the member's firm be considered to be impaired with respect to such client by virtue of the spouse's participation in the stock ownership plan?

.122 *Answer*—Impairment of independence does not arise unless the member is (1) a partner or shareholder of his firm or (2) a full or part-time professional employee participating in the engagement or located in an office participating in a significant portion of the engagement.

Until the right of possession with respect to the shares exists, the interest in the plan is deemed to be an indirect financial interest in the client, ascribed to the member; accordingly, until such right exists independence will not be impaired unless the indirect financial interest is material to the member's net worth.

When the right to possession occurs, the interest in the plan is ascribed to the member as a direct financial interest in the client; accordingly, independence is impaired unless the spouse disposes of such shares.

62. Member and Client Are Limited Partners in a Limited Partnership

(As used in this ruling, the term "client" means any client with whose financial statements the member or his firm is associated)

.123 *Question*—A member owns a limited partnership interest in a limited partnership in which a client (and/or an officer, director or principal stockholder thereof) also owns a limited partnership interest. The interest of the member is material to his net worth. Is the member's interest considered to be a "joint closely held business investment," as that term is used in Rule 101.A.2?

.124 *Answer*—A limited partnership interest of a member in a limited partnership in which a client also owns a limited partnership interest would not be considered to be a "joint closely held business investment" if the following conditions are met:

1. The member and all investor client(s) are and remain passive investors and take no active role in the formation or management of the limited partnership. They make no decisions and have no voice in the conduct of its affairs except in remote circumstances, such as dissolution of the partnership or the appointment of new general partners.
2. The aggregate interest in the limited partnership of the member and his firm represents less than 20 percent of the interest of all limited partners in the partnership.
3. The aggregate interest in the limited partnership of any investor client (and/or its officers, directors or principal stockholders) represents less than 20 percent of the interest of all limited partners in the partnership.
4. If a member owns a limited partnership interest in a limited partnership in which two or more clients (and/or their officers, directors or principal stockholders) own limited partnership interests, the aggregate interest in the limited partnership of the member and his firm, and all investor clients (and/or their officers, directors or principal stockholders), shall represent less than 50 percent of the interest of all limited partners in the partnership. Under the above circumstances, the value of the member's interest would not be dependent upon any action of his client (or clients). Accordingly, the member's independence would not be considered to be impaired.

   If a member does not and could not reasonably be expected to have knowledge of the limited partnership/client relationship, such lack of knowledge would preclude an impairment of independence.

ET Section 200

GENERAL AND TECHNICAL STANDARDS

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ET Section 201

General Standards

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 201—General standards.** A member shall comply with the following general standards as interpreted by bodies designated by Council, and must justify any departures therefrom.

A. Professional competence. A member shall undertake only those engagements which he or his firm can reasonably expect to complete with professional competence.

B. Due professional care. A member shall exercise due professional care in the performance of an engagement.

C. Planning and supervision. A member shall adequately plan and supervise an engagement.

D. Sufficient relevant data. A member shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to an engagement.

E. Forecasts. A member shall not permit his name to be used in conjunction with any forecast of future transactions in a manner which may lead to the belief that the member vouches for the achievability of the forecast.

[As amended March 31, 1978.]

Interpretations under Rule 201—General Standards

.02 **201-1—Competence.** A member who accepts a professional engagement implies that he has the necessary competence to complete the engagement according to professional standards, applying his knowledge and skill with reasonable care and diligence, but he does not assume a responsibility for infallibility of knowledge or judgment.

Competence in the practice of public accounting involves both the technical qualifications of the member and his staff and his ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques and the technical subject matter involved, and to the capability to exercise sound judgment in applying such knowledge to each engagement.

The member may have the knowledge required to complete an engagement professionally before undertaking it. In many cases, however, additional research or consultation with others may be necessary during the course of the engagement. This does not ordinarily represent a lack of competence, but rather is a normal part of the professional conduct of an engagement.

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

.03 **201-2—Forecasts.** Rule 201 does not prohibit a member from preparing, or assisting a client in the preparation of, forecasts of the results of future transactions. When a member's name is associated with such forecasts, there shall be the presumption that such data may be used by parties other than the client. Therefore, full disclosure must be made of the sources of the information used and the major assumptions made in the preparation of the statements and analyses, the character of the work performed by the member, and the degree of the responsibility he is taking.

The next page is 4571.

ET Section 202

Auditing Standards

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 202—Auditing standards.** A member shall not permit his name to be associated with financial statements in such a manner as to imply that he is acting as an independent public accountant unless he has complied with the applicable generally accepted auditing standards * promulgated by the Institute. Statements on Auditing Standards issued by the Institute's Auditing Standards Executive Committee are, for purposes of this rule, considered to be interpretations of the generally accepted auditing standards, and departures from such statements must be justified by those who do not follow them.

[As amended March 31, 1978.]

Interpretation under Rule 202—Auditing Standards

.02 **202-1—Unaudited financial statements.** Rule 202 does not preclude a member from associating himself with the unaudited financial statements of his clients. The Rule states in part that "A member shall not permit his name to be associated with financial statements in such a manner as to imply that he is acting as an independent public accountant unless he has complied with the *applicable* (Italics provided) generally accepted auditing standards promulgated by the Institute."

In applying this provision to situations in which a member's name is associated with unaudited financial statements, it is necessary to recognize that the standards were specifically written to apply to audited financial statements. The fourth reporting standard, however, was made sufficiently broad to be applicable to unaudited financial statements as well.

The fourth reporting standard states in part:

". . . In *all* cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, *if any*, and the degree of responsibility he is taking." (Italics provided)

* Ten generally accepted auditing standards are listed in Appendix A.

Those sections of *Statements on Auditing Standards* and related guides which deal with unaudited financial statements provide guidance to members associated with such statements.

→ *The next page is 4581.* ←

ET Section 203

Accounting Principles

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 203—Accounting principles.** A member shall not express an opinion that financial statements are presented in conformity with generally accepted accounting principles if such statements contain any departure from an accounting principle promulgated by the body designated by Council * to establish such principles which has a material effect on the statements taken as a whole, unless the member can demonstrate that due to unusual circumstances the financial statements would otherwise have been misleading. In such cases his report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Interpretations under Rule 203—Accounting principles

.02 **203-1—Departures from established accounting principles.** Rule 203 was adopted to require compliance with accounting principles promulgated by the body designated by Council to establish such principles. There is a strong presumption that adherence to officially established accounting principles would in nearly all instances result in financial statements that are not misleading.

However, in the establishment of accounting principles it is difficult to anticipate all of the circumstances to which such principles might be applied. This rule therefore recognizes that upon occasion there may be unusual circumstances where the literal application of pronouncements on accounting principles would have the effect of rendering financial statements misleading. In such cases, the proper accounting treatment is that which will render the financial statements not misleading.

The question of what constitutes unusual circumstances as referred to in Rule 203 is a matter of professional judgment in-

* See Appendix B, Council Resolution Designating the Financial Accounting Standards Board as the Body to Establish Accounting Principles.

volving the ability to support the position that adherence to a promulgated principle would be regarded generally by reasonable men as producing a misleading result.

Examples of events which may justify departures from a principle are new legislation or the evolution of a new form of business transaction. An unusual degree of materiality or the existence of conflicting industry practices are examples of circumstances which would not ordinarily be regarded as unusual in the context of Rule 203.

.03 **203-2—Status of FASB interpretations.** Council is authorized under Rule 203 to designate a body to establish accounting principles and has designated the Financial Accounting Standards Board as such body. Council also has resolved that FASB Statements of Financial Accounting Standards, together with those Accounting Research Bulletins and APB Opinions which are not superseded by action of the FASB, constitute accounting principles as contemplated in Rule 203.

In determining the existence of a departure from an accounting principle established by a Statement of Financial Accounting Standards, Accounting Research Bulletin or APB Opinion encompassed by Rule 203, the division of professional ethics will construe such Statement, Bulletin or Opinion in the light of any interpretations thereof issued by the FASB.

The next page is 4591.

ET Section 204

Other Technical Standards

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 204—Other Technical Standards.** A member shall comply with other technical standards promulgated by bodies designated by Council * to establish such standards, and departures therefrom must be justified by those who do not follow them.

[As amended March 31, 1978.]

→ *The next page is 4601.* ←

* See Appendix D, Council Resolutions Designating Bodies to Promulgate Technical Standards.

ET Section 291

Ethics Rulings on General and Technical Standards

1. Association of Name with Unaudited Statements Where Member is Not Independent

.001 *Question*—A member in the practice of public accounting is a minority stockholder, officer, and director of a corporation for which his firm performs management and accounting services. As a corporate officer, the member has prepared financial statements for the corporation for presentation to a bank. The accounting firm was paid for the member's services in connection with the preparation of the statements, and the bank was made aware that the statements were not audited. What are the ethical considerations?

.002 *Answer*—Section 516 of Statement on Auditing Standards 1 [AU section 516, Volume 1, AICPA PROFESSIONAL STANDARDS.] provides that when a CPA submits to his client or another unaudited financial statements which he has prepared, he is deemed to be associated with the statements. This association is deemed to exist even though the CPA does not append his name to the financial statements.

The member, as an officer, can prepare the statements for the corporation. But because he is also engaged in public practice and the corporation is a client of his firm, he should disclaim an opinion as he is lacking in independence. The financial statements should also be marked "Unaudited—see accompanying disclaimer of opinion." (Section 517 of Statement on Auditing Standards 1.) [AU section 517.]

2. Opinion by Member Not in Public Practice

.003 *Question*—A member has become an employee of a corporation with extensive outside interests. The employer asks the member to perform examinations of these corporate interests and to express an opinion for internal purposes only. Would there be any violation of the Code if these examinations were made and an opinion were expressed by the member?

.004 *Answer*—The member is not in practice as a public accountant and may perform services required by his employer, including performing an examination of outside corporate interests. He may use his CPA designation in his internal reports if his status as an employee is made clear. The internal reports should be issued on his employer's letterhead and should make no reference to generally accepted auditing standards. If the internal reports are made available to third parties, the member should use only his title as an employee and omit any reference to his CPA designation.

3. Controller, Preparation of Financial Statements

.005 *Question*—A corporation which employs a member as controller is audited by a firm of CPAs. The controller examines the financial statements of a subsidiary corporation. Can the outside firm accept the controller's opinion or report on these financial statements as one meeting the requirements of generally accepted auditing standards?

.006 *Answer*—It could not, since, as an employee of the corporation, the controller cannot express an independent opinion on financial statements of the subsidiary.

4. Two-Year Opinion—Prior Year Previously Unaudited

.007 *Question*—A member was engaged for one fiscal year to prepare unaudited financial statements. He was engaged by the same client for the following fiscal year to perform an audit in accordance with generally accepted auditing standards. May he express an unqualified opinion on the statements of income and changes in financial position for the two fiscal years?

.008 *Answer*—Nothing would prevent the member from expressing such an unqualified opinion provided he carried out necessary audit procedures. The fact that the member had originally disclaimed an opinion on the preceding year's financial statements because they were unaudited would not preclude him from subsequently expressing an opinion on the audited statements for that year.

In performing his audit for the current year, it is assumed that the member made his audit in conformity with generally accepted auditing standards and performed all auditing procedures considered necessary in the circumstances including observation of the taking of the physical inventory. He would then be able to express an unqualified opinion on the balance sheet at the close of the current year.

For example, even though the member did not observe the taking of the physical inventories at the beginning of the current year and at the beginning of the preceding year, he may be able to satisfy himself as to such prior inventories through appropriate procedures (see section 331.13 of Statement on Auditing Standards No. 1). [AU section 331.13.] If he can satisfy himself as to the prior inventories and if he audits the statements of income and changes in financial position for the preceding year in accordance with generally accepted auditing standards, he should be able to express an unqualified opinion on those statements for the two years. The member is not required to disclose that he did not observe the taking of the earlier inventories although he may wish to do so. [AU section 509.12.]

If the member is not able to satisfy himself as to the inventory at the beginning of the current year and the inventory enters materially into the determination of results of operations and changes in financial position, he would be unable to express an opinion on the statements of income and changes in financial position for the current year. His report on the financial statements for that year would follow the illustration in section 542.05 of Statement on Auditing Standards No. 1. [AU section 542.05.]

It is assumed the member has been able to satisfy himself as to the consistency of the application of generally accepted accounting principles (see section 420 of Statement on Auditing Standards No. 1). [AU section 420.]

5. Unaudited Interim Financial Statements

.009 *Question*—Unaudited interim reports issued by clients sometimes contain the auditor's name listed on the cover or elsewhere along with the company's officers, board of directors, and legal counsel. Would this listing constitute an "association" of a member's name with financial statements as that term is used in Rule 202 of the Code of Professional Ethics?

.010 *Answer*—Yes, such a listing would be considered an "association" of a member's name with the accompanying financial statements as that term is used in Rule 202. Accordingly, in such circumstances, each financial statement in such a report should be marked "unaudited."

The auditor should also be aware that section 516.04 of Statement on Auditing Standards 1 [AU section 516.04.] states that a disclaimer of opinion should accompany unaudited financial statements with which the CPA is associated. Accordingly, he may suggest to his client that wording such as the following be included in the interim report: "The financial information included in this interim report has been prepared by management without audit by independent public accountants who do not express an opinion thereon. Semiannual (annual) reports will contain audited financial statements."

The member should have a clear understanding with his client with respect to issuance of interim reports which display the name of the member's firm along with unaudited financial statements, and he should not permit his name to be associated with the financial statements in a manner which might lead a reader to believe that the auditor is assuming some degree of responsibility for the unaudited statements.

6. Letterhead

.011 *Question*—A member performs accounting services on a gratis basis for a private club of which he is treasurer. His firm does no work for the club. Would it be proper for him to issue financial statements in connection with his accounting services for the club on his firm letterhead with a disclaimer for lack of independence?

.012 *Answer*—It would be preferable for the stationary of the club to be used for presentation of the financial statements with an indication that the auditor is acting as treasurer. However, should he use his firm's letterhead, section 517 of Statement on Auditing Standards 1 [AU section 517.] is applicable.

7. Non-CPA Partner

.013 *Question*—May a member who is in partnership with non-CPAs sign reports with the firm name and below it affix his own signature with the designation "Certified Public Accountant"?

.014 *Answer*—This would not be improper, provided it is clear that the partnership itself is not being held out as composed entirely of CPAs.

8. Subcontractor Selection for MAS Engagements

.015 *Question*—A member has been engaged to design and program a computer system. The engagement is well within his competence. He plans to retain a contract programming organization as a subcontractor to provide additional qualified manpower. What procedures should he consider in making his selection of a subcontractor?

.016 *Answer*—When selecting subcontractors the member has a responsibility to assure himself that they have the professional qualifications, technical skills and other resources required. Factors that can be helpful in evaluating a prospective subcontractor include business, financial and personal references from banks, from other CPAs, and from other customers of the subcontractor; the subcontractor's professional reputation and recognition; published materials (articles and books authored); and the practitioner's personal evaluation of the subcontractor.

9. Supervision of Technical Specialist on MAS Engagements

.017 *Question*—A member would like to add to his staff a systems analyst who specializes in developing computer systems. Must the member be able to perform all of the services that the specialist can perform in order to be able to supervise him?

.018 *Answer*—The member must be qualified to supervise and evaluate the work of specialists in his employ. Although supervision does not require that he be qualified to perform each of the specialist's tasks, he should be able to define the tasks and evaluate the end product.

ET Section 300

RESPONSIBILITIES TO CLIENTS

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ET Section 301

Confidential Client Information

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 301—Confidential client information.** A member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client.

This rule shall not be construed (a) to relieve a member of his obligation under Rules 202 and 203, (b) to affect in any way his compliance with a validly issued subpoena or summons enforceable by order of a court, (c) to prohibit review of a member's professional practices as a part of voluntary quality review under Institute authorization or (d) to preclude a member from responding to any inquiry made by the ethics division or Trial Board of the Institute, by a duly constituted investigative or disciplinary body of a state CPA society, or under state statutes.

Members of the ethics division and Trial Board of the Institute and professional practice reviewers under Institute authorization shall not disclose any confidential client information which comes to their attention from members in disciplinary proceedings or otherwise in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with an aforementioned duly constituted investigative or disciplinary body.

Interpretation under Rule 301—Confidential client information

.02 **301-1—Confidential information and technical standards.** The prohibition against disclosure of confidential information obtained in the course of a professional engagement does not apply to disclosure of such information when required to properly discharge the member's responsibility according to the profession's standards. The prohibition would not apply, for example, to disclosure, as required by Section 561 of Statement on Auditing Standards No. 1 [AU section 561], of subsequent discovery of facts existing at the date of the auditor's report which would have affected the auditor's report had he been aware of such facts.

→ The next page is 4681. ←

ET Section 302

Contingent Fees

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 302—Contingent fees.** Professional services shall not be offered or rendered under an arrangement whereby no fee will be charged unless a specified finding or result is attained, or where the fee is otherwise contingent upon the findings or results of such services. However, a member's fees may vary depending, for example, on the complexity of the service rendered.

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.

→ *The next page is 4691.* ←

ET Section 391

Ethics Rulings on Responsibilities to Clients

1. Computer Processing of Clients' Returns

.001 *Question*—May a member make use of an outside service bureau for the processing of clients' tax returns? The member's firm would control the input of information and the computer service would perform the mathematical computations and print the return. Is there any violation of the confidential relationship in the fact that client information leaves the member's office?

.002 *Answer*—A member may utilize outside services to process tax returns. He must take all necessary precautions to be sure that the use of outside services does not result in the release of confidential information.

2. Distribution of Client Information to Trade Associations

.003 *Question*—A member's firm is requested by a trade association to supply profit and loss percentages taken from the reports of the accountants' clients. The association would distribute them to its members. May the firm comply with the request?

.004 *Answer*—Rule 301 would not be violated if the firm has the clients' permission to distribute the figures.

3. Information to Successor Accountant About Tax Return Irregularities

.005 *Question*—A member withdrew from an engagement on discovering irregularities in his client's tax return. May he reveal to the successor accountant why the relationship was terminated?

.006 *Answer*—Rule 301 is not intended to help an unscrupulous client cover up illegal acts or otherwise hide information by changing CPAs. If the member is contacted by the successor he should, at a minimum, suggest that the successor ask the client to permit the member to discuss all matters freely with the successor. The successor is then on notice of some conflict. Because of the serious legal implications, the member should seek legal advice as to his status and obligations in the matter.

4. Prior Client Relationship

.007 *Question*—A member's firm was replaced after 20 years as auditors of an international union. The firm was then retained by certain members of local unions who brought suit against the international union charging misuse of funds, mismanagement, etc. The member's firm was asked to examine the records of the international union for a period which included part of the period during which it served as the international's auditors. Would the special examination violate Rule 301 because of the former client relationship?

.008 *Answer*—There appears to be such a serious conflict of interest that the member's firm should not accept the engagement.

5. Records Retention Agency

.009 *Question*—May a member use a records-retention agency to store his clients' records, working papers, and so forth?

.010 *Answer*—There is no objection to the use of such a records center. However, responsibility for preserving the confidential nature of the records rests with the member.

6. Revealing Client Information to Competitors

.011 *Question*—A municipality in a particular state enforces a personal property tax on business inventories, fixtures and equipment, and machinery by retaining a firm of CPAs to examine the books and records of the businesses to be sure the proper amount has been declared. In the course of its engagement, the CPA firm will examine sales, purchases, gross profit percentages, and inventories as well as fixed asset accounts. A member serving one of the companies involved objects to these procedures on the ground that information gathered from the books and records of his client could be inadvertently conveyed to competitors by employees of the CPA firm doing the audit. Is such an engagement ethically proper?

.012 *Answer*—It would be proper for a member's firm to perform such services. It should be emphasized to everyone concerned that Rule 301 prohibits members from revealing to others any confidential information obtained in their professional capacity.

7. Revealing Names of Employer's Clients

.013 *Question*—A staff member wishes to submit his resume to another firm. May he include as part of his experience the names of companies for which he performed audits?

.014 *Answer*—The mere engagement of a member's firm is often a confidential matter between accountant and client. Unless the company is publicly held, a member should not reveal the fact that he had served on an assignment without the client's permission.

8. Fee as Percentage of Bond Issue

.015 *Question*—Is it proper for a member to determine his fee for services rendered in connection with a bond issue as a percentage of the total amount of the bond issue?

.016 *Answer*—The member's fee for services rendered in connection with a bond issue should not be based upon the percentage of the total amount of the issue since that amount is often, in part, influenced by the findings of the member. Furthermore, the receipt of a fee by a member in connection with such work should not be contingent upon whether or not the bond issue is sold.

The member's fee should be related to services rendered and should not be determined by his findings or the results of his findings.

9. Finder's Fee

.017 *Question*—Would the occupation of finder for a client in the acquisition of another company be considered incompatible with public accounting? If a member may serve as finder, would he violate Rule 302 by charging a fee contingent upon the acquisition and based on a percentage of the acquisition price?

.018 *Answer*—The occupation of finder is not incompatible with public accounting. Rule 302, which prohibits a member from rendering a service for a fee contingent upon the results of such service, would prohibit such fee arrangements. The receipt of a fee should be determined by the service to be rendered and should not depend on whether or not the sale takes place; nor should the amount of the fee be based on a percentage of the acquisition price.

10. Fee as Expert Witness

.019 *Question*—May a member, as an expert witness in a damage suit, receive compensation based on the amount awarded the plaintiff?

.020 *Answer*—Such an agreement would violate Rule 302, which prohibits contingent fees. Compensation for expert testimony may be at a standard per diem rate for such services or at a fixed sum previously agreed upon.

11. Fee Contingent on Mortgage Commitment

.021 *Question*—A member provides accounting services in connection with construction projects financed primarily by FHA-insured mortgages. His fee for such services is determined as a fixed percentage of the mortgage commitment finally granted by FHA. Prior to such commitment the member would have offered advisory accounting services. If no commitment was granted, no fee would be charged for advisory services. Is this arrangement permissible?

.022 *Answer*—A fee based on the percentage of a mortgage obtained would be a contingent fee, for the amount of the commitment could vary directly with the results of the member's services.

12. Fee as a Percentage of Tax Savings

.023 *Question*—May a member base his fee for preparing a tax return on how much in taxes he can save his client?

.024 *Answer*—Basing a fee for preparing a tax return on the amount saved in taxes would be a violation of Rule 302. A properly prepared return results in a proper tax liability, and there is no basis for computing a saving. To make a fee contingent upon the amount of taxes saved presumes a tax liability has been established which an accountant is attempting to reduce, whereas all persons concerned with the preparation of a tax return should attempt to determine only the correct tax liability. A member who computes his fee in the manner suggested in the question would also violate Rule 501.

13. Contingent Fees to Fire Adjuster

.025 *Question*—A member's client is a public fire adjuster who assists insured persons in negotiating settlements of fire losses with insurance companies. The adjuster's fee is based on a percentage of the recovery. In negotiating such settlements, the adjuster needs financial statements for a three-year period, prepared without audit from the books and records of the insured. Could the member provide such services for a fee which would be a percentage of the fee received by the adjuster?

.026 *Answer*—Since the fee is dependent upon the amount of the settlement, it is a contingent fee in violation of Rule 302.

14. Use of Confidential Information on MAS Engagements

.027 *Question*—In the course of performing a feasibility study a non-client outside source has provided pertinent information to the member's firm with the understanding that the source and the details of the information will not be disclosed. The information, which the firm believes is pertinent, directly affects its conclusions and recommendations. How may this information be utilized in connection with the feasibility study engagement and related conclusions and recommendations?

.028 *Answer*—Rule of Conduct 301 regarding confidential client information is not directly applicable to the circumstances described; however, Rule of Conduct 501—Acts Discreditable—is applicable to situations involving confidential relationships with non-clients. For an engagement in which it appears likely that the development of pertinent information will have to come from outside non-client sources, and such information must remain confidential, the terms of the engagement with the client should specify that the confidences of outside non-client sources will not be divulged by the member's firm even when they might affect the outcome of the engagement. If the use of confidential outside sources is necessary and the terms of the engagement are silent regarding disclosure of source and details, the member should promptly seek the approval of the client to present his recommendations without making disclosures that include confidential information. If the client does not agree to this, the member should withdraw rather than breach a confidence or improperly limit the inclusion of information in his final recommendation.

15. Earlier Similar MAS Study with Negative Outcome

.029 *Question*—A prospective client has asked a member's firm to study the desirability of his using a newly developed electronic ticketing system for his business. A recent study made for another client leads the member's firm to believe that the system would not be desirable for him. Must the firm state its reservations at the risk of disclosing information acquired while performing an assignment for a client competitor?

.030 *Answer*—Rule of Conduct 301 provides that a member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. Knowledge and expertise which results in a special competence in a particular field can be provided to a client without violating the confidence of another client. Reservations that the firm may have concerning the electronic ticketing system should be communicated to the prospective client provided the details of the other client's engagement are not disclosed. If, however, circumstances are such that the prospective client would clearly know the origin of the information on which the member's reservations are based, and such information is sensitive, the engagement should not be accepted without clearance with the first client.

ET Section 400

RESPONSIBILITIES TO COLLEAGUES

[Reserved.]

ET Section 500

OTHER RESPONSIBILITIES AND PRACTICES

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The next page is 4831.

ET Section 501

Acts Discreditable

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 501—Acts discreditable.** A member shall not commit an act discreditable to the profession.

Interpretations under Rule 501—Acts Discreditable

.02 **501-1—Client's records and accountant's workpapers.** Retention of client records after a demand is made for them is an act discreditable to the profession in violation of Rule 501. The fact that the statutes of the state in which a member practices may specifically grant him a lien on all client records in his possession does not change the ethical standard that it would be a violation of the Code to retain the records to enforce payment.

A member's working papers are his property and need not be surrendered to the client. However, in some instances a member's working papers will contain data which should properly be reflected in the client's books and records but which for convenience have not been duplicated therein, with the result that the client's records are incomplete. In such instances, the portion of the working papers containing such data constitutes part of the client's records, and copies should be made available to the client upon request.

If a member is engaged to perform certain work for a client and the engagement is terminated prior to the completion of such work, the member is required to return or furnish copies of only those records originally given to the member by the client.

Examples of working papers that are considered to be client's records would include:

a. Worksheets in lieu of books of original entry (e. g., listings and distributions of cash receipts or cash disbursements on columnar working paper).

b. Worksheets in lieu of general ledger or subsidiary ledgers, such as accounts receivable, job cost and equipment ledgers or similar depreciation records.

c. All adjusting and closing journal entries and supporting details. (If the supporting details are not fully set forth in the explanation of the journal entry, but are contained in analyses of accounts in the accountant's working papers, then copies of such analyses must be furnished to the client.)

d. Consolidating or combining journal entries and worksheets and supporting detail used in arriving at final figures incorporated in an end product such as financial statements or tax returns.

Any working papers developed by the member incident to the performance of his engagement which do not result in changes to the clients' records or are not in themselves part of the records ordinarily maintained by such clients, are considered to be solely "accountant's working papers" and are not the property of the client, e. g.:

> The member may make extensive analyses of inventory or other accounts as part of his selective audit procedures. Even if such analyses have been prepared by client personnel at the request of the member, they nevertheless are considered to be part of the accountant's working papers.
>
> Only to the extent such analyses result in changes to the client's records would the member be required to furnish the details from his working papers in support of the journal entries recording such changes unless the journal entries themselves contain all necessary details.

Once the member has returned the client's records to him or furnished him with copies of such records and/or necessary supporting data, he has discharged his obligation in this regard and need not comply with any subsequent requests to again furnish such records.

If the member has retained in his files copies of a client's records already in possession of the client, the member is not required to return such copies to the client.

.03 **501-2—Discrimination in employment practices.** Discrimination based on race, color, religion, sex, age or national origin in hiring, promotion or salary practices is presumed to constitute an act discreditable to the profession in violation of Rule 501.

The next page is 4841.

ET Section 502

Advertising and Other Forms of Solicitation

Effective March 31, 1978, unless otherwise indicated

.01 **Rule 502—Advertising and Other Forms of Solicitation.** A member shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive.

[As amended March 31, 1979.]

Interpretations under Rule 502—Advertising and Other Forms of Solicitation

.02 **502-1—Informational Advertising.** Advertising that is informative and objective is permitted. Such advertising should be in good taste and be professionally dignified. There are no other restrictions, such as on the type of advertising media, frequency of placement, size, artwork, or type style. Some examples of informative and objective content are—

1. Information about the member and the member's firm, such as—
   a. Names, addresses, telephone numbers, number of partners, shareholders or employees, office hours, foreign language competence, and date the firm was established.
   b. Services offered and fees for such services, including hourly rates and fixed fees.
   c. Educational and professional attainments, including date and place of certifications, schools attended, dates of graduation, degrees received, and memberships in professional associations.
2. Statements of policy or position made by a member or a member's firm related to the practice of public accounting or addressed to a subject of public interest.

.03 **502-2—False, Misleading, or Deceptive Acts.** Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that—

1. Create false or unjustified expectations of favorable results.
2. Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
3. Consist of self-laudatory statements that are not based on verifiable facts.
4. Make comparisons with other CPAs.
5. Contain testimonials or endorsements.
6. Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

[.04] [502-3]—[Deleted]

.05 **502-4—Self-Designation as Expert or Specialist.** Claiming to be an expert or specialist is prohibited because an AICPA program with methods for recognizing competence in specialized fields has not been developed and self-designation would be likely to cause misunderstanding or deception.

[As amended May 22, 1979.]

.06 **502-5—Engagements Obtained Through Efforts of Third Parties.** Members are often asked to render professional services to clients or customers of third parties. Such third parties may have obtained such clients or customers as the result of their advertising and solicitation efforts.

Members are permitted to enter into such engagements. The member has the responsibility to ascertain that all promotional efforts are within the bounds of the Rules of Conduct. Such action is required because the members will receive the benefits of such efforts by third parties, and members must not do through others what they are prohibited from doing themselves by the Rules of Conduct.

The next page is 4871.

ET Section 503

Commission

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 503—Commission.** A member shall not pay a commission to obtain a client, nor shall he accept a commission for a referral to a client of products or services of others. This rule shall not prohibit payments for the purchase of an accounting practice or retirement payments to individuals formerly engaged in the practice of public accounting or payments to their heirs or estates.

Interpretation under Rule 503—Commissions

.02 **503-1—Fees in payment for services.** Rule 503, which prohibits payment of a commission to obtain a client, was adopted to avoid a client's having to pay fees for which he did not receive commensurate services. However, payment of fees to a referring public accountant for professional services to the successor firm or to the client in connection with the engagement is not prohibited.

The next page is 4881.

ET Section 504

Incompatible Occupations

Effective March 1, 1973, unless otherwise indicated

.01 Rule 504—Incompatible occupations. A member who is engaged in the practice of public accounting shall not concurrently engage in any business or occupation which would create a conflict of interest in rendering professional services.

[As amended March 31, 1978.]

The next page is 4891.

ET Section 505

Form of Practice and Name

Effective March 1, 1973, unless otherwise indicated

.01 **Rule 505—Form of practice and name.** A member may practice public accounting, whether as an owner or employee, only in the form of a proprietorship, a partnership or a professional corporation whose characteristics conform to resolutions of Council. (See Appendix C.)

A member shall not practice under a firm name which includes any fictitious name, indicates specialization or is misleading as to the type of organization (proprietorship, partnership or corporation). However, names of one or more past partners or shareholders may be included in the firm name of a successor partnership or corporation. Also, a partner surviving the death or withdrawal of all other partners may continue to practice under the partnership name for up to two years after becoming a sole practitioner.

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

Interpretation under Rule 505—Form of practice and name

.02 **505-1—Investment in commercial accounting corporation.** A member in the practice of public accounting may have a financial interest in a commercial corporation which performs for the public services of a type performed by public accountants and whose characteristics do not conform to resolutions of Council, provided such interest is not material to the corporation's net worth, and the member's interest in and relation to the corporation is solely that of an investor.

The next page is 4901.

ET Section 591

Ethics Rulings on Other Responsibilities and Practices

1. Retention of Records

[.001—.002] [Superseded by Interpretation 501-1.]

2. Fees: Collection of Notes Issued in Payment

.003 *Question*—A member's firm made arrangements with a bank to collect notes issued by a client in payment of fees due, and so advised the delinquent client. Is this procedure ethical?

.004 *Answer*—The procedure followed does not violate any provision of the Code.

3. Employment by Non-CPA Firm

.005 *Question*—A member is considering employment with a public accounting firm made up of one or more non-CPA practitioners. If he is employed by such a firm, what are his responsibilities under the Rules of Conduct?

.006 *Answer*—A member so employed must comply with all the Rules of Conduct. If he becomes a partner in such a firm, he will then in addition be held responsible for compliance with the Rules of Conduct by all persons associated with him.

[4.—7.]

[.007—.014] [Deleted]

8. Change of Control of Client Company

.015 *Question*—A member states that control of a client company has been obtained by a second company which is served by another accounting firm. Would there be any violation of Rule 502 if the member communicated with the holding company and the accounting firm in an effort to retain his client?

.016 *Answer*—The member would be free to do so because of the existing client relationship.

[9.—19.]

[.017—.038] [Deleted]

20. Trade Association Analysis

.039 *Question*—A trade association has engaged a member to perform an analysis of specific problems affecting members of the association. The results of his analysis, bearing his firm's name, will be reproduced by the association and distributed to its members. Would Rule 502 prohibit such distribution?

.040 *Answer*—Rule 502 should not be interpreted to preclude an association from distributing to its members the results of an analysis it had engaged a member to perform. It would also be permissible for the member to be identified in the report with his firm affiliation. His report is interpretive, and a reader would be entitled to know by whom it was prepared.

21. Trade Association Survey

.041 *Question*—A trade association engaged a member's firm to conduct a survey. The association mailed a questionnaire to its members with a covering letter to request that replies be sent to the member's firm, which is mentioned by name. Does Rule 502 prohibit the accounting firm from being thus identified?

.042 *Answer*—In requesting from its members information which could be considered confidential, it would be proper for the association to identify the member's firm to whom replies should be directed.

[22.—32.]

[.043—.064] [Deleted]

33. Course Instructor

.065 *Question*—What responsibility does a member have for the information included in advertising material used to promote a course which he has been asked to conduct?

.066 *Answer*—It is of value to prospective students to know the instructor's background—such as degrees he holds, professional society affiliations, and the name of his firm. The member has the responsibility to ascertain that all promotional efforts are within the bounds of Rule 502.

[34.—37.]

[.067—.074] [Deleted]

38. CPA Title, Controller of Bank

.075 *Question*—A member not in public practice is controller of a bank. May the member permit the bank to use his CPA title on bank stationery and in paid advertisements listing the officers and directors of the bank?

.076 *Answer*—The use of the CPA title on bank stationery by a member not in public practice is proper. It would also be proper for the CPA title of the member to appear in paid advertisements of the bank that list the officers and directors.

[39.—44.]

[.077—.088] [Deleted]

45. CPA Title on Agency Letterhead

[.089—.090] [Superseded August, 1975.]

[46.—62.]

[.091—.124] [Deleted]

63. Directory Listing, White Pages

[.125—.126] [Superseded February, 1976.]

[64.—73.]

[.127—.146] [Deleted]

74. Firm Name on Tax Booklet

.147 *Question*—A member's firm has been retained by stockbrokerage clients to prepare annually a booklet on tax aspects of security transactions. The clients bear the printing costs and the accounting firm's time charges. A legend on the cover of the booklet states that it was prepared by "Jones & Smith, Certified Public Accountants." The clients mail the booklet with an end-of-month statement to their customers. Is there any objection to this practice?

.148 *Answer*—Members are not discouraged from writing books and articles, or from distributing material which is of benefit to both the public and the profession. A member's firm may properly prepare such technical booklets for clients for a fee.

[75.—77.]

[.149—.154] [Deleted]

78. Letterhead: Lawyer-CPA

.155 *Question*—May a member who is also admitted to the Bar represent himself on his letterhead as both an attorney and a CPA, or should he use separate letterheads in the conduct of the two practices?

.156 *Answer*—The Code does not prohibit the simultaneous practice of accounting and law by a member licensed in both professions. Either a single or separate letterheads may be used, provided the information with respect to the CPA designation complies with Rule 502. However, the member should also consult the rules of the applicable Bar Association.

[79.—81.]

[.157—.162] [Deleted]

82. Newsletter

.163 *Question*—A publishing company has discussed the possibility of issuing a newsletter on financial management under a member's name. His name would be featured prominently. The letter would be sold for a fee, and subscriptions would be solicited by direct mail or other forms of advertising. Would this arrangement violate the Code?

.164 *Answer*—No, if (1) the letter bearing the member's name was written by him or under his supervision and (2) he ensures that those promoting such a publication do not make statements concerning the author or his writings that would be in violation of Rule 502.

[83.—85.]

[.165—.170] [Deleted]

86. Paid for by Others, Name in Client Ad

.171 *Question*—A member's client proposes to use public advertising to assure readers that certain financial or statistical facts regarding its products or services are genuine. May a member's firm engaged to verify such facts ethically permit its name to be used in such advertising?

.172 *Answer*—Accounting firms are often asked to perform unusual services with which their names may be associated. A member's firm may perform such services and its name may be associated with related public advertising provided that such advertising is not misleading and the member's report and the financial or statistical facts are included in their entirety.

[87.—90.]

[.173—.180] [Deleted]

91. Press Release on Change in Staff

[.181—.182] [Superseded March, 1975.]

92. Press Release on Change in Staff

[.183—.184] [Superseded March, 1975.]

[93.—100.]

[.185—.200] [Deleted]

101. Specialization, Acquisitions and Mergers

.201 *Question*—The members of a firm have formed a separate partnership which, they maintain, is not practicing public accounting but is specializing in work relating to acquisitions and mergers. May the separate partnership indicate on its letterhead that it specializes in this field?

.202 *Answer*—Since services performed by the separate partnership are considered services of a type performed by public accountants, the Rules of the Code would apply to both partnerships in which the partners hold themselves out as CPAs. Interpretation 502-4 would prohibit the partnerships from indicating a specialty on business stationery.

[102.—107.]

[.203—.214] [Deleted]

108. Member Interviewed by the Press

.215 *Question*—What ethical standards should a member observe when he is interviewed by the press?

.216 *Answer*—When interviewed by a writer or reporter, the member should observe the limitations imposed on him by the Rules of Conduct. The member may not provide the press with any information for publication that he could not publish himself.

109. Compensation from Nonpractitioners

.217 *Question*—A member proposes to render a management service to clients by arranging for the purchase of supplies from a supplier who offers a discount. The supplier, who is also a client, feels that the member's fee should be increased as compensation for providing this service. Would this constitute a violation of Rule 503? Would the answer be any different if the supplier was not a regular client of the member's firm?

.218 *Answer*—Accepting a commission from the supplier, whether or not he is a regular client, would violate Rule 503 which states that a member may not accept a commission for referral of products and services of others to a client. However, assisting clients in obtaining the best equipment at the best price is a legitimate professional service, and the member may properly charge for the time and effort devoted to this activity.

110. Computer Service Franchise

.219 *Question*—A member in public practice wishes to be a representative of a computer tax service. The computer organization provides services only to tax practitioners. That member would be expected to utilize his professional contacts to introduce the service to other practitioners and to promote its use by them. He would receive a fee from the computer tax service for each tax return processed for a practitioner from within his franchise area. Would this arrangement constitute a violation of Rules 503 and 504?

.220 *Answer*—Rule 503 provides that a member may not accept commissions or participate in fees from others for services referred to his clients. Since the proposed activity would not involve services referred to his clients, but only to tax practitioners, Rule 503 does not apply. In regard to Rule 504, serving as a representative of a tax preparation computer center in itself would not create a conflict of interest within the practice of public accounting.

111. Purchase of Bookkeeping Practice

.221 *Question*—A member buys a bookkeeping firm's practice which is limited to monthly write-ups and tax return preparation. The purchase price is a percentage of the fees received from the bookkeeping firm's clients over a three-year period. Would there be a violation of Rule 503 in these circumstances?

.222 *Answer*—Since the rule prohibiting the payment of commissions was not intended to cover such situations, there would be no violation of Rule 503. This ruling is based on the assumption that the percentage of fees received is simply a means of determining the price that will be paid for the practice and that the arrangement will terminate at the end of the three-year period.

112. Referral

.223 *Question*—A member's firm has proposed to enter into an arrangement with a management specialist. The management specialist would seek engagements to prepare an operations survey that would suggest where improvements might be made. If the survey indicated deficiencies in the accounting systems, the consultant would recommend the member's firm to perform the proposed services. The member's firm would pay the specialist compensation for the referral. Would such an engagement be a violation of Rule 503?

.224 *Answer*—It would be improper to have such an arrangement because the member would be acquiring business through the payment of a commission in violation of Rule 503.

113. Member's Spouse as Insurance Agent

.225 *Question*—May a member in public practice refer life insurance assignments to his wife, who is a life insurance agent, or to an agent who will share a commission with the member's wife?

.226 *Answer*—Rule 503 would prohibit such referrals since the member would receive the economic benefit derived from the commission paid to his wife.

114. Member's Firm Paying Employee Bonuses

.227 *Question*—Does Rule 503, which states that a member shall not pay a commission to obtain a client, prohibit a member from paying bonuses or otherwise sharing the profits of professional accounting work with his employees where practice development is a factor in determining such bonus or profit-sharing amount?

.228 *Answer*—Rule 503 was not intended to prevent the sharing of the profits of professional work with employees, retired partners, and the heirs or estate of a deceased partner. It was not designed to prevent a firm from having some form of bonus or profit-sharing plan which includes recognition of practice development.

115. Actuary

.229 *Question*—A member's firm has acquired that portion of an insurance brokerage firm that performs actuarial and administrative services in connection with employee benefit plans. Would conduct of the operation as a separate partnership constitute a violation of Rule 504?

.230 *Answer*—Actuarial and administrative services in connection with employee benefit plans are a proper function of CPAs and are not incompatible with the practice of public accounting. As long as the organization adheres to all the provisions of the Code and bylaws, there would be no objection to this arrangement.

116. Bank Director

[.231—.232] [Superseded June, 1976.]

117. Consumer Credit Company Director

.233 *Question*—A consumer credit company purchases installment sales contracts from retailers and receives payments from consumers. May a practicing CPA serve as a director or officer of such a corporation?

.234 *Answer*—Yes, as long as he does not audit the corporation and does not participate in matters which might involve a conflict of interest.

[118.—126.]

[.235—.252] [Deleted]

127. State Controller

.253 *Question*—May a member serve in the office of the state controller and at the same time practice public accounting? The principal functions of the state controller are to maintain control over accounts for all state funds, administer disbursements, allocate revenue among county and local governments, and serve as ex officio member of several committees, boards, and commissions.

.254 *Answer*—It would be improper for a member to serve as state controller and practice public accounting on his own behalf at the same time since most if not all businesses are subject to some form of state control.

[128.—131.]

[.255—.262] [Deleted]

132. Tax Practice: Conflict of Interest

.263 *Question*—A member is in partnership with a non-CPA who is a former internal revenue agent with several years' experience as a practitioner specializing in taxes. Tax work accounts for approximately one-half of the firm's gross fees. The non-CPA has been asked to serve, without compensation, as the public member of the board of tax appeals recently established under a municipal income tax ordinance. Would his acceptance be advisable, provided he disqualified himself in any matter with which he was directly or indirectly connected?

.264 *Answer*—The position should be declined because the partnership would likely be unable to avoid future conflicts of interest.

[133.]

[.265—.266] [Deleted]

134. Association of Accountants Not Partners

.267 *Question*—Two members who are not partners share an office, have the same employees, have a joint bank account, and work together on each other's engagements. Would it be proper to have a joint letterhead showing both names, "Certified Public Accountants," and their addresses?

.268 *Answer*—In these circumstances the public would assume that a partnership existed. If any reports were to be issued under the joint heading, Rule 505 would be violated.

Members should not use a letterhead showing the names of two accountants when a partnership does not exist.

135. Association of Firms Not Partners

.269 *Question*—Three CPA firms wish to form an association —not a partnership—to be known as "Smith, Jones & Associates." Is there any impropriety in this?

.270 *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.

136. Audit with Former Partner

.271 *Question*—A member's firm consisting of one certified and one noncertified partner has been dissolved. One account was retained which the two practitioners plan to continue to service together. Should the audit report be submitted on partnership stationery?

.272 *Answer*—It would appear proper for the audit to be carried out jointly by the two former partners. The opinion should be presented on plain paper and signed somewhat as follows:

John Doe, Certified Public Accountant

Richard Roe, Accountant

Such a signature would leave no doubt as to whether a partnership existed, and the client and others would have the assurance that both accountants participated in the audit.

137. Nonproprietary Partners

.273 *Question*—A member's firm wishes to institute the designation "nonproprietary partner" to describe certain high-ranking staff men who were former partners of merged firms who did not qualify for partnership in the merging firm. With this title, they would be eligible to participate in the firm's pension plan. In holding themselves out to the public they would be required to use this designation. Is there any impropriety in the proposed title?

.274 *Answer*—The use of the designation "partner" should be restricted to those members of the firm who are legally partners. Those who are not parties to the partnership agreement should not hold themselves out in any manner which might lead others to believe that they are partners. The use of the designation "nonproprietary partner" by one who is not in fact a partner is considered misleading and therefore is not permitted.

138. Partner Having Separate Proprietorship

.275 *Question*—May a member be a partner of a firm of public accountants, all other members of which are noncertified, and at the same time retain for himself a practice of his own as a CPA?

.276 *Answer*—Rule 505 would not prohibit such a practice. However, clients and others interested should be advised about the dual position of the member to prevent any misunderstanding or misrepresentation.

139. Partnership with Public Accountant

.277 *Question*—May a member form a partnership for the practice of public accounting with a public accountant?

.278 *Answer*—While some state boards and CPA societies have rules prohibiting mixed partnerships, the Institute's Code does not prohibit a member from forming a partnership with a non-CPA. However, all partners would have to conform to the Code, and the partnership would not be permitted to represent itself as a partnership of CPAs.

140. Political Election

.279 *Question*—A member's firm, consisting of four members, practices under the name of the managing partner who is presently seeking election to high public office. If he is elected and withdraws from the partnership, may the three remaining partners continue to use the present firm name?

.280 *Answer*—It would not be a violation for the three remaining partners to continue to practice under the name of the managing partner followed by the designation "and Company."

141. Responsibility for Non-CPA Partner

.281 *Question*—Is a member who has formed a partnership with a noncertified public accountant ethically responsible for all the acts of the partnership?

.282 *Answer*—Yes. If the noncertified partner should violate the Code, the member would be held accountable.

[142.—143.]

[.283—.286] [Deleted]

144. Title: Partnership Roster

.287 *Question*—Is there any prohibition in the Code to the use of an established firm name in a different state where there is some difference in the roster of partners?

.288 *Answer*—It would be proper for the firm to use the established name in different states even though the roster of partners differed as long as the firm otherwise complies with Rule 505.

145. Firm Name of Merged Partnerships

.289 *Question*—When two partnerships merge, is it permissible for the newly merged firm to practice under a title which includes the name of a partner who had retired from one of the two firms prior to the merger?

.290 *Answer*—Rule 505 of the Code of Professional Ethics states that partnerships may practice under a firm title which includes the name or names of former partners. Since the retired partner was once a partner in one of the merged firms, it would be proper for his name to appear in the title of a newly created firm.

146. Membership Designation

.291 *Question*—On the letterhead of a partnership of members and noncertified public accountants, the designation "Members of the American Institute of Certified Public Accountants" appears in a manner which attempts to distinguish members of the Institute from nonmembers. Is such use of the designation of Institute membership by a mixed partnership permitted by Rule 505?

.292 *Answer*—Rule 505 states, "A firm may not designate itself as Members of the American Institute of Certified Public Accountants unless all of its partners or shareholders are members of the Institute." Individual members may be designated as such.

147. Firm Designation

.293 *Question*—May a member who is a sole proprietor or the sole shareholder in a professional corporation use in his firm title the designation "and Company" or "and Associates"?

.294 *Answer*—Rule 505 would prohibit the member from using in his firm title the designations "and Company," "and Associates," or "& Co.," since these may be interpreted to mean more than one partner or shareholder. This ruling would apply even to a member who employs a staff that might include other CPAs.

148. Firm Designation

.295 *Question*—May two members who have formed a partnership use in their firm title the designations "and Company" or "and Associates," or must such designations stand for an unidentified other partner?

.296 *Answer*—Because their firm is a true partnership, it would not be a violation of the Institute's Code for two members to use in their firm titles the designations "and Company" or "and Associates." Regulations of some state boards of accountancy require that there be at least one more partner than the number of names in the firm name when the words "and Company" are used.

[149.—154.]

[.297—.308] [Deleted]

155. Data Processing: Computer Corporation

.309 *Question*—A member's firm wishes to set up a computer corporation of which a firm of computer consultants would be equal owner. The corporation would perform consulting work through the member's firm only for clients of the firm. The corporation would not offer any services directly to the public. Would such an arrangement violate the Code?

.310 *Answer*—The proposed arrangement would not be a violation of Rules 503 and 505 if the corporation served only practitioners and, through them, their clients.

156. Data Processing: Consultant to Service Bureau

.311 *Question*—May a member in public practice assist a corporation in developing a tabulating service to be offered to the public? He would have no financial interest in the corporation and no representations would be made that he or any CPA was connected with the development of the tabulating service.

.312 *Answer*—This would not be a violation of the Code.

[157.]

[.313—.314] [Deleted]

158. Data Processing: Employee-Shareholder in Public Practice

.315 *Question*—A member having a public accounting practice is also president and a shareholder of a corporation whose main business is financing but which also engages in adjunct data processing services for the public. Is he acting in accord with Interpretation 505-1?

.316 *Answer*—Because the member is engaged in a public accounting practice his relationship to the corporation should be solely that of an investor, and his financial interest in the corporation should not be material to the corporation's net worth. His association with the data processing corporation should be limited to that of a consultant, as opposed to that of an officer and shareholder.

159. Data Processing: Fees Paid to Other CPAs

.317 *Question*—A member's firm A renders data processing services to its clients but uses the electronic equipment of CPA firm B. Firm B bills firm A at a reduced rate as compared to its normal billing rates for its own clients. Firm A then bills its clients at a higher rate than it was billed. Does this arrangement violate Rule 503?

.318 *Answer*—This arrangement is not a violation of Rule 503.

[160.—161.]

[.319—.322] [Deleted]

162. CPA Designation on Professional Organization Letterhead

[.323—.324] [Superseded August, 1975.]

[163.—166.]

[.325—.332] [Deleted]

167. Member Receiving Payment for Referral of Client to Others

.333 *Question*—A member has been approached by a company that sells limited partnership interests (tax shelter investments) in oil and gas properties with the proposal that:

1. the member investigate this investment venture to the extent he deems necessary and inform or recommend the investment to appropriate clients of the member's firm, and
2. the company will make a payment to the member, such payment being roughly equal to 5% of any amount invested by the firm's clients who invest because of the member's recommendation.

Would such an arrangement violate Rule 503 prohibiting commissions?

.334 *Answer*—The above arrangement would be a violation of Rule 503. This would be true whether:

1. the member's clients were aware of the payment arrangement or not, and
2. the payment was a stated percentage of amounts invested or arrived at through any other manner.

It would not be a violation of Rule 503 if the member were, on behalf of one or more of his firm's clients, to investigate a tax shelter or other investment venture and recommend such investments to these clients. His fee for such investigations should be charged to such clients. A member's fee is an integral part of the customary professional relationship with a client and such fees should comprise the only compensation for the rendering of services to his clients.

168. Audit Guides Issued by Governmental Agencies

.335 *Question*—A member has been asked to perform an audit for a grantee receiving funds from a governmental agency. The grantee is required to be audited, and the governmental agency overseeing the use of the funds has issued an audit guide, which states that the audit ". . . must be sufficiently comprehensive in scope to permit the expression of an opinion on the financial statements in the report and must be performed in accordance with generally accepted auditing standards and audit requirements set forth in the audit guide." The guide further states that the auditor is to evaluate compliance with applicable grant provisions and instructions from the governmental agency and that the auditor's report should state that the audit was made in accordance with the audit guide.

Must the auditor follow the requirements of the audit guide in addition to generally accepted auditing standards?

.336 *Answer*—Most agencies requiring audits of grantees request the auditor to submit his proposal in a form that includes an agreement to follow the requirements of the agency's audit guide. If the member has agreed to follow the requirements of an agency's audit guide, he is bound by such requirements in addition to generally accepted auditing standards. Accordingly, if he does not follow the audit guide requirements, he must disclose this fact in his report and the reasons therefor.

[169.—174.]

[.337—.348] [Deleted]

175. Bank Director

.349 *Question*—May a member in public practice serve as a director of a bank?

.350 *Answer*—Before accepting a bank directorship, the member should carefully consider the implications inherent in such service.

These fall generally into three categories:

(a) Confidentiality of Information—Rule 301 provides that a member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. This ethical requirement applies even though failure to disclose might constitute a breach of the member's fiduciary responsibilities as a director and thereby result in potential personal liability for damages to shareholders, depositors and others. The member must also consider whether his clients might have any inhibitions in consulting with him professionally concerning matters that may affect the client's relationship with the bank.

(b) Conflict of Interest—Even though a member may be released by a client from the ethical requirement of confidentiality, the member should not express a position or vote on decisions involving a client since the member's objectivity may be questioned because of his dual role with the client and the bank.

(c) Independence—The independence of a member serving as a bank director would be considered impaired with regard to any client in which the bank has a loan that is material to the client involved. If such a situation develops between the bank and a client, the member must either resign from the client engagement or his directorship or disclaim an opinion based on lack of independence as prescribed under section 517 of Statement on Auditing Standards No. 1.

In view of the above factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is engaged in public practice he should avoid the high probability of conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with his ability to serve his clients' interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances it would be more appropriate for the member as part of his public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit his activities to those which did not involve conflicts of interest, independence, or confidentiality problems.

176. Newsletters and Publications Prepared by Others

.351 *Question*—May a member permit a newsletter, tax booklet, or similar publication to be imprinted with his firm's name if it has not been prepared by his firm?

.352 *Answer*—Such imprinting would not be considered deceptive as to authorship under Rule 502 provided the outside author or publisher is clearly indicated. The firm's name should not be imprinted more prominently than the authorship or publisher credit. Such imprinting should read substantially as follows:

> We believe this bulletin/material, prepared outside our firm by author/publisher, would be of interest to you.
>
> (Firm's name)

177. Data Processing: Billing Services

.353 *Question*—A member in public practice plans to form a separate business to perform centralized billing services for local doctors. The member maintains that this service, which is similar to one currently offered and advertised by a local bank, does not constitute the practice of public accounting and that Rules 502 and 505 do not apply. Is the member correct in this conclusion?

.354 *Answer*—No, the service in question does in fact constitute service of a type performed by public accountants and consequently the member could proceed with this plan only if the operation were conducted in accordance with the Institute's Rules of Conduct.

178. Location of Separate Business

.355 *Question*—May a member engaged in the practice of public accounting concurrently operate a separate business or conduct an occupation from the same location?

.356 *Answer*—The simultaneous operation of an accounting practice and such other business or occupation, either in the same or separate offices, does not by itself violate Rule 504, unless a conflict of interest exists in rendering professional services.

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APPENDIXES

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ET Appendix A

Generally Accepted Auditing Standards*

As Adopted by The Membership in 1948 and 1949

General standards

1. The examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
3. Due professional care is to be exercised in the performance of the examination and the preparation of the report.

Standards of field work

1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
2. There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted.
3. Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination.

Standards of reporting

1. The report shall state whether the financial statements are presented in accordance with generally accepted principles of accounting.
2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.

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* See AU section 150, Volume 1, *AICPA Professional Standards.*

4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases, where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

The next page is 5131.

ET Appendix B

Council Resolution Designating the Financial Accounting Standards Board as the Body to Establish Accounting Principles

The following resolution of Council was approved at the spring meeting of Council on May 7, 1973:

WHEREAS in 1959 the Council designated the Accounting Principles Board to establish accounting principles, and

WHEREAS the Council is advised that the Financial Accounting Standards Board has become operational, it is

RESOLVED, that as of the date hereof the Financial Accounting Standards Board, in respect of Statements of Financial Accounting Standards finally adopted by such Board in accordance with its Rules of Procedure and the bylaws of the Financial Accounting Foundation, be, and hereby is, designated by this Council as the body to establish accounting principles pursuant to Rule 203 of the Rules of Conduct of the American Institute of Certified Public Accountants; provided, however, any Accounting Research Bulletins, or Opinions of the Accounting Principles Board presently issued or approved for exposure by the Accounting Principles Board prior to April 1, 1973, and finally adopted by such Board on or before June 30, 1973, shall constitute statements of accounting principles promulgated by a body designated by Council as contemplated in Rule 203 of the Rules of Conduct unless and until such time as they are expressly superseded by action of the FASB.

The next page is 5141.

ET Appendix C

Council Resolution Permitting Professional Corporations or Associations

The following resolution of Council was approved at the spring meeting of Council on May 6, 1969 and amended at the fall meeting of Council on October 12, 1974:

RESOLVED, that members may be officers, directors, stockholders, representatives or agents of a corporation offering services of a type performed by public accountants only when the professional corporation or association has the following characteristics:

1. *Name.* The name under which the professional corporation or association renders professional services shall contain only the names of one or more of the present or former shareholders or of partners who were associated with a predecessor accounting firm. Impersonal or fictitious names, as well as names which indicate a specialty, are prohibited.
2. *Purpose.* The professional corporation or association shall not provide services that are incompatible with the practice of public accounting.
3. *Ownership.* All shareholders of the corporation or association shall be persons engaged in the practice of public accounting as defined by the Code of Professional Ethics. Shareholders shall at all times own their shares in their own right, and shall be the beneficial owners of the equity capital ascribed to them.
4. *Transfer of Shares.* Provision shall be made requiring any shareholder who ceases to be eligible to be a shareholder to dispose of all of his shares within a reasonable period to a person qualified to be a shareholder or to the corporation or association.
5. *Directors and Officers.* The principal executive officer shall be a shareholder and a director, and to the extent possible, all other directors and officers shall be certified public accountants. Lay directors and officers shall not exercise any authority whatsoever over professional matters.
6. *Conduct.* The right to practice as a corporation or association shall not change the obligation of its shareholders, directors, officers and other employees to comply with the stan-

dards of professional conduct established by the American Institute of Certified Public Accountants.

7. *Liability.* The stockholders of professional corporations or associations shall be jointly and severally liable for the acts of a corporation or association, or its employees—except where professional liability insurance is carried, or capitalization is maintained, in amounts deemed sufficient to offer adequate protection to the public. Liability shall not be limited by the formation of subsidiary or affiliated corporations or associations each with its own limited and unrelated liability.

In a report approved by Council at the fall 1969 meeting, the Board of Directors recommended that professional liability insurance or capitalization in the amount of $50,000 per shareholder/officer and professional employee to a maximum of $2,000,000 would offer adequate protection to the public. Members contemplating the formation of a corporation under this rule should ascertain that no further modifications in the characteristics have been made.

ET Appendix D

Council Resolutions Designating Bodies to Promulgate Technical Standards

The following resolution of Council was adopted October 21, 1978:

WHEREAS: The membership of the Institute has adopted Rule 204 of the Rules of Conduct which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is

RESOLVED: That the Management Advisory Services Executive Committee is hereby designated to promulgate technical standards under Rule 204 with respect to the offering of management advisory services provided, however, that such standards do not deal with the broad question of what, if any, services should be proscribed, and provided further that any such statements are subject to review by affected senior technical committees of the Institute prior to issuance.

The following resolution of Council was adopted May 7, 1979:

WHEREAS: The membership of the Institute has adopted Rule 204 of the Rules of Conduct which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is

RESOLVED: That the Accounting and Review Services Committee is hereby designated to promulgate technical standards under Rule 204 with respect to unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market provided, however, that any such statements are subject to review by affected senior technical committees of the Institute prior to issuance.

The following resolution of Council was adopted May 7, 1979:

WHEREAS: The membership of the Institute has adopted Rule 204 of the Rules of Conduct which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is

RESOLVED: That the auditing standards board shall establish under statements on auditing standards the responsibilities of members with respect to standards of disclosure of financial information outside financial statements in published financial reports containing financial statements. For this purpose, the council designates the FASB as the body, under Rule 204 of the Rules of Conduct, to establish standards for the disclosure of such information.

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ET TOPICAL INDEX

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Bylaws of the American Institute of Certified Public Accountants

As Amended February 1, 1974

BL Section 100

I. NAME AND PURPOSE

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BL Section 101

Name and Purpose

As amended February 1, 1974

.01 The name of this organization shall be the American Institute of Certified Public Accountants. In keeping with the Institute's certificate of incorporation, its objectives shall be to unite certified public accountants in the United States; to promote and maintain high professional standards of practice; to assist in the maintenance of standards for entry to the profession; to promote the interests of CPAs; to develop and improve accounting education; and to encourage cordial relations between CPAs and professional accountants in other countries.

BL Section 200

II. ADMISSION TO MEMBERSHIP AND ASSOCIATION

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The next page is 5331.

BL Section 210

2.1 Members

As amended February 1, 1974

.01. Members of the Institute shall be

2.1.1 Members of the Institute at the effective date of these bylaws, and

2.1.2 Persons who shall qualify for admission as provided in section 2.2 of this article and who shall be admitted by the Board of Directors.

BL Section 220

2.2 Requirements for Membership

As amended February 1, 1974

.01 The following persons may qualify for admission as members of the Institute:

2.2.1 Those who are in possession of valid and unrevoked certified public accountant certificates issued by the legally constituted state authorities ("state," when it appears in these bylaws and in implementing resolutions of Council, shall be understood to include the states, territories, or territorial possessions of the United States or the District of Columbia), and

2.2.2 Who shall have passed an examination in accounting and other related subjects satisfactory to the Board of Directors.

The next page is 5351.

BL Section 230

2.3 Certificate of Membership

As amended February 1, 1974

.01 Upon admission each member shall be entitled to a certificate setting forth that he is a member of the Institute, but no certificate shall be issued until receipt of dues for the current year. Certificates of membership shall be returned to the secretary of the Institute upon suspension or termination of membership for disciplinary reasons.

BL Section 240

2.4 Right of Members to Describe Themselves as Such

As amended February 1, 1974

.01 A member of the Institute shall be entitled to use the designation "Member of the American Institute of Certified Public Accountants." A firm all of whose partners or shareholders are members shall be entitled to use the designation "Members of the American Institute of Certified Public Accountants."

The next page is 5371.

BL Section 250

2.5 International Associates

As amended February 1, 1974

.01 International associates shall include those who were international associates on the effective date of these bylaws. Thereafter, citizens of other countries who shall satisfy such requirements as the Council may prescribe may be admitted as international associates. The Council shall adopt rules governing such associate membership and indications thereof.

(See section 250 R.)

The next page is 5381.

BL Section 250 R

Implementing Resolutions Under Section 2.5 International Associates

As amended February 1, 1974

Resolved:

.01 That those persons who are not, and have not begun the process of becoming, citizens of the United States of America may qualify for admission as international associates of the Institute if they

(a) are of good moral character,

(b) have received a baccalaureate, master's, or Ph.D. degree, with concentration in accounting, conferred by an accredited college or university, in the United States of America or its territories, or its equivalent,

(c) have passed the Uniform Certified Public Accountant Examination in accordance with the regulations prescribed by the Board of Examiners, and

(d) are not practicing public accounting in the United States of America as proprietors, partners, principals, officers, or shareholders.

Further resolved:

.02 That upon admission and receipt of dues for the current year each international associate shall be entitled to a certificate of association stating that he is an international associate of the Institute, provided that the said certificate of associateship shall not be displayed in home or office during the recipient's stay in the United States in a manner that might mislead anyone to believe the recipient to be a CPA of any of the licensing jurisdictions of the United States; and such certificate shall be returned to the secretary upon suspension or termination of the association of an international associate for disciplinary reasons.

Further resolved:

.03 That termination of association of an international associate shall be governed by the provisions of Article VII of the Institute bylaws and, in addition, an international associateship shall be considered to be terminated when, having satisfied all the requirements of a licensing jurisdiction and having been issued a CPA certificate, an international associate either becomes eligible for membership in the AICPA, or, after a period of thirty-six months has elapsed from the date of his admission, has not returned to his homeland for a period of at least one year.

BL Section 300

III. ORGANIZATION AND PROCEDURE

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→ *The next page is 5401.* ←

BL Section 310

3.1 General

As amended February 1, 1974

.01 The organization of the Institute shall include the members, the Council, the Board of Directors, officers, and committees (including subcommittees, boards, sub-boards, task forces, and the like, standing or otherwise).

.02 The Board of Directors may from time to time organize the committees and staff of the Institute into divisions and, subject to section 3.6, may adopt rules of procedures and operating policies for such divisions.

The next page is 5411.

BL Section 320

3.2 Membership

As amended February 1, 1974, unless otherwise indicated

.01 The rights and powers of the membership of the Institute shall be as hereinafter defined.

3.2.1 Attendance at Meetings

Every member and international associate of the Institute shall be entitled to attend all meetings of the Institute.

3.2.2 Voting Rights

Every member, but no international associate, shall be entitled to vote in person, when in attendance, upon all questions brought before duly called meetings of the Institute, and by mail ballot for the election of Council members pursuant to sections 6.1 through 6.1.6, on proposed amendments to these bylaws or to the Code of Professional Ethics as provided in Article VIII, and upon proposed resolutions of the membership as provided in section 5.1.4.

3.2.3 Residence for Voting Purposes

The state from which a member may vote shall be that indicated by his mailing address as carried in the official records of the Institute, and may be either the state in which he resides or that in which his office is located.

3.2.4 Resolutions of the Membership

As provided in section 5.1.4, the members by mail ballot may enact resolutions of the membership, not inconsistent with these bylaws, which shall be binding upon the membership, the Council, the Board of Directors, officers, divisions, committees or boards, and staff.

3.2.5 Certain Positions to Be Held Only by Members

Only members of the Institute, as defined in section 2.1, may serve as officers of the Institute or as members of the Council, the Board of Directors, or any committee or board designated as "senior" by the Council (see section 3.6.1), or as "permanent" by these bylaws (see section 3.6.2); provided, however, that the secretary, who need not be a member of the Institute, and three representatives of the public, none of whom shall be members of the Institute, shall be members of the Board of Directors. [As amended, effective March 31, 1978.]

The next page is 5421.

BL Section 330

3.3 Council

As amended February 1, 1974, unless otherwise indicated

.01 The governing body of the Institute shall be the Council.

3.3.1 Composition

The Council shall be composed of

3.3.1.1 Members of the Institute directly elected by the membership in each state in accordance with sections 6.1.1 through 6.1.6;

3.3.1.2 Representatives of the recognized state societies of certified public accountants selected in accordance with section 6.2;

3.3.1.3 Twenty-one members-at-large selected in accordance with section 6.3;

3.3.1.4 The chairman of the Board, the vice chairman of the Board, the president, the three volunteer vice presidents, and the treasurer;

3.3.1.5 All past presidents of the American Institute of Accountants and the American Institute of Certified Public Accountants who served prior to December 31, 1973, and are members of the Institute;

3.3.1.6 All past chairmen of the Board of the American Institute of Certified Public Accountants who are members of the Institute; and

3.3.1.7 All members of the Board of Directors of the Institute, except the secretary, not otherwise on the Council. [As amended, effective March 31, 1978.]

3.3.2 Powers

The Council may exercise all powers requisite for the purposes of the Institute, not inconsistent with these bylaws or with duly enacted resolutions of the membership, including but not limited to the authority to prescribe the policies and procedures of the Institute and to enact resolutions binding upon the Board of Directors, the officers, divisions, committees or boards, and staff.

3.3.3 Reports to Membership

The actions of the Council shall be reported to the membership at least annually.

The next page is 5431.

BL Section 340

3.4 Board of Directors

As amended February 1, 1974

.01 Between meetings of the Council, the activities of the Institute shall be directed by the Board of Directors, the composition of which shall be prescribed by the Council.

(See section 340 R.)

3.4.1 Powers

The Board of Directors shall act as the executive committee of Council between meetings of Council, shall control and manage the property, business, and activities of the Institute, and shall take whatever action it deems desirable including the establishment of policies for the conduct of the affairs of the Institute consistent with the provisions of these bylaws, resolutions of the membership, or actions of the Council.

3.4.2 Reports to Council

The actions of the Board of Directors shall be reported to the Council at least semiannually.

BL Section 340 R

Implementing Resolution Under Section 3.4 Board of Directors

As amended February 1, 1974, unless otherwise indicated

Resolved:

.01 That the Board of Directors shall be composed of

(a) the chairman of the Board, the vice chairman of the Board, the vice presidents elected by the Council, the treasurer, and the immediate past chairman of the Board;

(b) the president and the secretary of the Institute;

(c) nine present or former members of the Council elected to the Board by the Council pursuant to section 6.3, to serve for three years or until the election of their successors; and

(d) three representatives of the public, who are not members of the Institute. [As amended, effective May 8, 1978.]

The next page is 5451.

BL Section 350

3.5 Officers Elected by Council

As amended February 1, 1974, unless otherwise indicated

.01 The officers of the Institute shall be a chairman of the Board of Directors, a vice chairman of the Board, who shall be the chairman of the Board nominee, three volunteer vice presidents, and a treasurer, all of whom shall be members having a CPA certificate as provided in section 2.2.1; a president, who shall be a member and full-time employee of the Institute, and a secretary, who shall be a full-time employee of the Institute, but need not be a member of the Institute. The chairman of the Board, the vice chairman, the treasurer, the president, and the secretary shall have such terms of office, powers, and privileges as the Council may prescribe.

[As amended, effective March 31, 1978.]

(See section 350 R.)

3.5.1 Officers Appointed by the Board of Directors

The Board of Directors may appoint staff vice presidents who shall be neither members of the Board nor of the Council and who shall perform such duties as may be assigned to them by the president.

The next page is 5461.

BL Section 350 R

Implementing Resolution Under Section 3.5 Officers

As amended February 1, 1974

Resolved:

Term of Office

.01 That the chairman of the Board, the vice chairman of the Board, the volunteer vice presidents, and the treasurer shall each be elected annually by the Council for a term of one year or until the election of his successor. Only the treasurer may succeed himself in the same office after serving a full term of one year.

Chairman of the Board

.02 That the chairman of the Board shall preside at meetings of members of the Institute, the Council, and the Board of Directors. He shall appoint committees and boards as provided in section 3.6 of the bylaws. He shall act as a spokesman for the Institute and appear on its behalf before other organizations.

Vice Chairman of the Board

.03 That the vice chairman shall be chairman-nominee of the Board of Directors and shall preside in the absence of the chairman at meetings of the Institute, the Council, and the Board of Directors. He shall familiarize himself with the duties of the office of chairman and shall perform such other related duties as may be assigned to him by the chairman.

Elected Vice Presidents

.04 That the duties of the elected vice presidents shall be those usually appertaining to the office of vice president. One of the elected vice presidents designated by the Board of Directors shall preside at meetings of the Institute or of the Council in the absence of the chairman of the Board and of the vice chairman of the Board. No two elected vice presidents shall be residents of the same state.

Treasurer

.05 That the treasurer shall familiarize himself with financial policies, investment policies, and the accounting procedures, controls, and financial reporting of the Institute, and shall consult with the president and the independent auditors on such matters, on which he shall advise the members of the Board of Directors and the president. He shall report thereon to the Board of Directors to the extent that he deems desirable or as the Board of Directors may direct, and shall perform such other related duties as may be assigned to him by the Council or the Board of Directors.

President

.06 That the president shall have full responsibility for the execution of the policies and programs of the Institute, act as a spokesman for the Institute, and perform such other services as may be assigned to him by the Council and the Board of Directors.

Secretary

.07 That the secretary of the Institute shall have the usual duties of a corporate secretary and shall perform such other related duties as may be assigned to him by the president. An assistant secretary to serve in his absence, who need not be a member of the Institute, may be appointed by the Board of Directors.

The next page is 5471.

BL Section 360

3.6 Committees

As amended February 1, 1974, unless otherwise indicated

.01 Except as otherwise provided by these bylaws or the Council (see section 3.6.1), the chairman of the Board, or his delegate, may appoint committees and boards with such duties, powers, responsibilities, and procedures as he may prescribe. The chairman of the Board, the president, and the secretary shall have the privilege of the floor at meetings of all committees and boards.

(See section 360 R.)

3.6.1 Senior Committees

The Council may designate any committee or board as a "senior" committee or board. The appointment by the chairman of the Board of members to senior committees or boards shall require the approval of the Board of Directors. The duties, powers, responsibilities, and procedures of senior committees and boards shall be as the Council may prescribe consistent with the specific provisions of these bylaws.

(See section 360 R.)

3.6.2 Permanent Committees, Boards, and Divisions

The following committees shall be permanent committees, boards, or divisions of the Institute: the nominations committee (see section 3.6.2.1); the professional ethics division (see section 3.6.2.2); the Trial Board (see section 3.6.2.3); and the Board of Examiners (see section 3.6.2.4).

(See section 360 R.)

3.6.2.1 Nominations Committee

There shall be a nominations committee composed of seven members of the Institute, elected by the Council in such manner as the Council shall prescribe. It shall be the responsibility of the Committee to make nominations for the offices of chairman of the Board, vice chairman of the Board, volunteer vice president, treasurer, the Board of Directors, the Trial Board, and the Council, as elsewhere provided in these bylaws, and to apportion among the states directly elected Council seats pursuant to section 6.1.2.

3.6.2.2 Professional Ethics Division

There shall be a professional ethics division whose executive committee shall serve as the ethics committee of the Institute, and there shall be such other committees within the division as the Board of Directors shall authorize. The division shall, with the concurrence of the Board of Directors, adopt rules governing procedures consistent with these bylaws or actions of Council to investigate potential disciplinary matters involving members and arrange for presentation of the case before the Trial Board where the committee finds prima facie evidence of infraction of these bylaws or of the Code of Professional Ethics, interpret the Code of Professional Ethics, propose amendments thereto, and perform such related services as the Council may prescribe.

3.6.2.3 Trial Board

There shall be a Trial Board consisting of members having a CPA certificate as provided in section 2.2.1 to adjudicate disciplinary charges against members of the Institute pursuant to section 7.4. Members of the Trial Board shall be elected by the Council for such terms as the Council may prescribe.

The Trial Board is empowered to adopt rules, consistent with these bylaws or actions of the Council, governing procedure in cases heard by it or any sub-board, and in connection with any application for review of a decision of a sub-board.

Decisions of any sub-board or the Trial Board shall be subject to review only by the Trial Board.

[As amended, effective March 31, 1978.]

(See section 360 R.)

3.6.2.4 Board of Examiners

There shall be a Board of Examiners appointed by the chairman of the Board of Directors subject to the approval of the Board of Directors. It shall supervise the preparation of a uniform examination which may be adopted by the legally constituted authorities of the states in examining candidates for the certified public accountant certificate and the conduct of the grading service offered by the Institute. The Board of Examiners shall formulate the necessary rules and regulations for the conduct of its work, but all such rules and regulations may be amended, suspended, or revoked by the

Board of Directors. The Board of Examiners may delegate to members of the Institute's staff or other duly qualified persons the preparation of examination questions and the operation of the grading service conducted by the Institute.

The next page is 5491.

BL Section 360 R

Implementing Resolutions Under Section 3.6 Committees

As amended February 1, 1974, unless otherwise indicated

Resolved:

.01 (1) That the following be designated as senior committees and boards:

- Accounting and review services committee
- Accounting standards division executive committee
- Auditing standards division executive committee
- Board of examiners
- Continuing professional education division executive committee
- Federal taxation division executive committee
- Management advisory services division executive committee
- Practice review committee
- Private companies practice section executive committee
- Professional ethics division executive committee
- Quality control standards committee
- SEC practice section executive committee

[As amended, effective May 8, 1978.]

.02 (2) That the following senior technical committees be authorized to make public statements, without clearance with the Council or the Board of Directors, on matters related to their area of practice:

- Accounting and review services committee
- Accounting standards division executive committee
- Auditing standards division executive committee
- Federal taxation division executive committee
- Management advisory services division executive committee
- Professional ethics division executive committee
- Quality control standards committee

[As amended, effective May 8, 1978.]

.03 (3) That the practice review committee is hereby authorized to review specific reports and related financial statements that appear to deviate from accepted standards, and to communicate to the reporting accountant or accounting firm the committee's comments or questions about the report or related financial statements. The committee's function is to be educational, not disciplinary, in nature.

The committee shall not refer a case to the professional ethics division except that it may refer a case under either of the following circumstances:

(a) A member, after reasonable notice, fails or refuses to make a substantive response to a letter of inquiry from the committee.

(b) A member, without reasonable grounds, fails to comply subsequently with technical standards with respect to a specific client where major deficiencies in such technical standards have previously been called to his or her attention by the committee.

No member of the professional ethics division shall be a member of the practice review committee.

The committee shall deal on a confidential basis with each report submitted to it and shall not communicate its views on the report to any person other than the accountant or accounting firm who signed the report, state CPA society committee having similar responsibilities that requests assistance in reviewing the report, or the professional ethics division with respect to a referred case. The committee shall not disclose the source of a report submitted to it.

The committee may advise the auditing standards executive committee and the accounting standards executive committee of problems that may need authoritative clarification.

[As amended, effective May 14, 1975.]

Under Section 3.6.2 Permanent Committees, Boards, and Divisions

Resolved:

.04 That at the Council meeting preceding the annual meeting the retiring chairman of the Board and the incoming chairman of the Board shall present their joint recommendations for members of the nominating committee for the current year, at least two of whom shall be members of the Council. Other nominations from the floor shall be permitted. Voting shall be by voice vote of the incoming Council, or, if requested by a majority of those present, by written ballot. A majority vote shall elect.

Under Section 3.6.2.3. Trial Board

[As amended, effective May, 1976.]

Resolved:

.05 That the powers of the "Trial Board" set forth in bylaw section 3.6.2.3 shall be exercised by the Joint Trial Board Division which shall consist of a system of regional trial boards and a National Review Board.

.06 Regional trial boards shall be created for each appropriate geographical region as agreements are entered into between the Institute and the various state societies as contemplated in section 7.4 of the bylaws. The number and geographical composition of such regions may be changed from time to time by the ethics division with the concurrence of the Board of Directors as appears appropriate to the efficient management of the business of the Joint Trial Board Division. No state society shall be included in a region without its consent.

.07 Each regional trial board shall be composed of twenty-five members in practice elected by the Board of Directors of the state societies in the region in proportion to the number of valid current CPA certificates in force in each of the states in that region at the time of such election. The regional trial board shall also include additional members from those states as to which it is necessary to bring that state's membership to a minimum of three, as well as a chairman and vice chairman who shall be elected for a three-year term by the Board of Directors of the Institute from persons who are members of both a state society in the region and the Institute. The Board of Directors shall also designate a secretary for each regional trial board who need not be a member thereof. No member of the Institute's professional ethics division or an ethics committee of a state CPA society having responsibility for investigating complaints and bringing disciplinary charges nor a member of a state board of accountancy charged with regulating the profession of public accountancy, or of any other state agency having similar responsibility shall be eligible for appointment to a regional trial board. [As amended, effective May 8, 1978.]

.08 The chairman of any regional trial board or its vice chairman, when acting as chairman, pursuant to rules to be adopted by the Joint Trial Board Division shall appoint from the members of the regional trial board a panel of not less than 5 members including a chairman, who may or may not be the chairman or vice chairman when acting as chairman of the particular regional trial board, to hear and adjudicate charges against members of the Institute or participating state societies in the region under the provisions of section 7.4 of these bylaws.

.09 The National Review Board shall consist of thirty-six members of the Institute in practice elected by Council. All persons elected to membership on the National Review Board shall also be members of a state society, and no more than three members of the National Review Board shall have their principal place of practice in any one state. No member of the Institute's professional ethics division or an ethics committee of a state CPA society having responsibility for investigating complaints and bringing disciplinary charges nor a member of a state board of accountancy charged with regulating the profession of public accountancy, or of any other state agency having similar responsibility shall be eligible for appointment to the National Review Board.

.10 The Joint Trial Board Executive Committee shall elect a chairman and vice chairman of the National Review Board from the membership of the National Review Board, the vice chairman to serve as chairman during any period of unavailability of the chairman. It shall also elect a secretary who need not be a member. [As amended, effective May 8, 1978.]

.11 The chairman or vice chairman when acting as chairman pursuant to rules of procedure to be adopted by the Joint Trial Board Division shall appoint from the members of the National Review Board a panel of not less than nine members including a chairman, who may or may not be the chairman or vice-chairman when acting as chairman of the National Review Board, to hear and adjudicate either charges against members when the National Review Board is a tribunal of first instance, or to exercise the reviewing jurisdiction as provided in Council resolution under section 7.4 of these bylaws, which section shall govern as to the appointment of the ad hoc committees as called for therein.

.12 Upon the initial creation of any regional trial board and the National Review Board the terms of members thereof shall be staggered as follows: one-third shall serve a term of one year; a second one-third shall serve a term of two years; and a third one-third shall serve a term of three years. One third of the membership of each regional trial board and the National Review Board shall be elected annually thereafter.

BL Section 400

IV. FINANCIAL MANAGEMENT AND CONTROLS

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The next page is 5521.

BL Section 401

Financial Management and Controls

As amended February 1, 1974

.01 The Council shall have authority to prescribe such procedures as it deems appropriate to assure adequate budgetary and financial controls. Budgets shall be prepared and presented as the Council shall prescribe.

(See section 401 R.)

BL Section 401R

Implementing Resolution Under Article IV Financial Management and Controls

As amended February 1, 1974

Resolved:

.01 That annual budgets and projections of revenues and expenditures for the succeeding four years shall be prepared by the Institute's staff, reviewed and approved by the Board of Directors, and presented to Council for approval at its meeting preceding the annual meeting; such budgets shall be in a form indicating the costs of the principal programs and activities of the Institute; material variations from the annual budget shall be reported to the Council at its spring meeting by the Board of Directors; receipt of such report without rejection shall constitute authority to continue expenditures for purposes indicated in the annual budget, as modified and presented at the spring meeting, until a new budget for the following fiscal year is approved by the Council. However, the Board of Directors may, between meetings of Council, authorize additional expenditures in total not to exceed five percent of budgeted revenues from all sources.

The next page is 5541.

BL Section 410

4.1 Audit

As amended February 1, 1974

.01 The Council shall, for each fiscal year, appoint a certified public accountant or certified public accountants to express an opinion on the financial statements of the Institute and its affiliated organizations. The financial statements of the Institute and the report of the auditor or auditors for each fiscal year shall be published for the information of the membership.

BL Section 420

4.2 Committee on Audit

As amended February 1, 1974

.01 The chairman of the Board shall appoint from among the members of the Board of Directors, other than the officers, a committee on audit to make arrangements with the auditor or auditors for their examination and to review the audit report.

The next page is 5561.

BL Section 430

4.3 Execution of Instruments on Behalf of the Institute

As amended February 1, 1974

.01 All checks, drafts, deeds, mortgages, bonds, contracts, reports, proxies, and other instruments may be executed on behalf of the Institute by such officers or employees as the Council or the Board of Directors may from time to time designate, either generally or in specific instances.

BL Section 440

4.4 Limitation of Personal Liability for Financial Loss

As amended February 1, 1974

.01 No personal liability shall attach to any officer or any member of Council, the Board of Directors, or any committee, board, or division for financial losses resulting from the exercise of judgment, in good faith, in the performance of his assigned duties.

The next page is 5581.

BL Section 450

4.5 Dues

As amended February 1, 1974

.01 The Council shall determine the annual dues which shall be paid by each member and international associate in accordance with such classifications as it deems appropriate, and may require dues of a different amount for each class so created.

.02 Dues shall be payable on or before the first day of each fiscal year of the Institute or in such other manner as the Council shall prescribe. For new members or international associates, dues shall be apportioned to the end of the fiscal year.

.03 No dues shall be paid by members or international associates of the Institute while they are engaged in military service of the United States or its allies during war. Individual members or international associates may be excused from payment of dues for reasonable cause by the treasurer.

The next page is 5591.

BL Section 460

4.6 Fiscal Year

As amended February 1, 1974

.01 The fiscal year of the Institute shall be as the Council shall prescribe.

(See section 460 R.)

BL Section 460 R

Implementing Resolution Under Section 4.6 Fiscal Year

As amended February 1, 1974

Resolved:

.01 The fiscal year of the Institute shall be the twelve months beginning August 1 and ending July 31.

BL Section 500

V. MEETINGS OF THE INSTITUTE AND THE COUNCIL

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The next page is 5615.

BL Section 501

Meetings of the Institute and the Council

As amended February 1, 1974

.01 This article shall govern meetings of the Institute and of the Council. The Board of Directors shall determine the dates of meetings of Council and the matters to be presented for action.

The next page is 5621.

BL Section 510

5.1 Meetings of the Institute

As amended February 1, 1974

.01 The membership shall meet pursuant to sections 5.1.1 through 5.1.3, conduct its business pursuant to section 5.1.3, and may adopt resolutions pursuant to section 5.1.4. Meetings of the membership shall be known as meetings of the Institute.

5.1.1 Regular Meetings of the Institute

There shall be a regular meeting of the Institute within three months after the close of the fiscal year, on a date to be fixed by the Board of Directors. This meeting shall also be known as the annual meeting of the Institute.

5.1.2 Special Meetings of the Institute

The chairman of the Board shall call special meetings of the Institute when so requested by the Council or the Board of Directors, or upon the written request of at least two hundred members of the Institute or any thirty members of Council. Special meetings of the Institute shall be held at places designated by the Board of Directors. No business shall be transacted at a special meeting of the Institute other than that for which the meeting shall have been convened.

5.1.3 Notice of Meetings of the Institute

Notice of each meeting of the Institute, whether regular or special, shall be mailed to each member of the Institute, at his mailing address as shown on the official records of the Institute, at least thirty days prior to the date of such meeting.

5.1.4 Resolution of the Membership by Mail Ballot

A majority of the members of the Institute, assembled at any duly called corporate meeting of the Institute at which a quorum is present, may direct that the chairman of the Board submit any question to the entire membership for a vote by mail. Any resolution enacted in such a mail ballot by two-thirds of the members voting shall be declared by the chairman of the Board a resolution of the membership and shall be binding, if consistent with these bylaws, upon the Council, the Board of Directors, committees, boards, divisions, officers, and staff. Mail ballots shall be valid and counted only if received within sixty days after date of the mailing of ballot forms.

The next page is 5631.

BL Section 520

5.2 Meetings of Council

As amended February 1, 1974

.01 Meetings of the Council shall be governed by sections 5.2.1 through 5.2.5, section 5.3, and section 6.7.

5.2.1 Regular Meetings of Council

Regular meetings of the Council shall be held prior to the annual meeting of the Institute, and on such other dates as the Council or the Board of Directors may designate.

5.2.2 Special Meetings of Council

The chairman of the Board shall call special meetings of the Council when requested to do so by the Board of Directors, or when requested in writing by at least thirty members of the Council. Special meetings of the Council shall be held at places designated by the Board of Directors.

5.2.3 Mail Ballot in Lieu of Special Meeting of Council

In lieu of a special meeting of the Council, the chairman of the Board, with the approval of the Board of Directors, may submit any question to the Council for a vote by mail, and any action therein approved in writing by not less than two-thirds of the whole membership of the Council shall be declared by the chairman of the Board an act of the Council and shall be recorded in the minutes of the Council.

5.2.4 Notice

Notice of each meeting of the Council shall be sent to each member of the Council, at his mailing address as shown in the official records of the Institute, at least twenty-one days before such meeting. Such notice, as far as practicable, shall contain a statement of the business to be transacted.

5.2.5 Minutes

A copy of the minutes of each meeting of the Council shall be forwarded to each member of the Council within forty-five days after such meeting.

BL Section 530

5.3 General Provisions Governing Meetings

As amended February 1, 1974

.01 The following general provisions shall govern quorum and parliamentary procedure.

5.3.1 Meetings—Quorum

Two hundred members of the Institute shall constitute a quorum for the transaction of any business duly presented at any meeting of the Institute. Thirty members of Council shall constitute a quorum of the Council. Ten members of the Board of Directors shall constitute a quorum of the Board.

5.3.2 Meetings—Rules of Parliamentary Procedure Applicable

The rules of parliamentary procedure contained in *Robert's Rules of Order Revised* shall govern all meetings of the Institute and of the Council.

BL Section 600

VI. ELECTION OF COUNCIL, BOARD OF DIRECTORS, AND OFFICERS OF THE INSTITUTE

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BL Section 601

Election of Council, Board of Directors, and Officers of the Institute

As amended February 1, 1974

.01 Except for ex officio members of Council (see sections 3.3.1.4 through 3.3.1.7), the election of members of the Council, the Board of Directors, and officers of the Institute shall be in accordance with the provisions of this article.

The next page is 5661.

BL Section 610

6.1 Members of Council Directly Elected by Members of the Institute

As amended February 1, 1974

.01 Members of Council directly elected by the membership in the respective states (see section 3.3.1.1) shall be elected in accordance with sections 6.1.1 through 6.1.6 as supplemented by Council resolution.

6.1.1 At Least One Member of Council Directly Elected by Membership of Each State

There shall be at least one member of Council directly elected by the members of the Institute in each state having one or more persons enrolled upon the membership lists of the Institute.

6.1.2 Number and Allocation of Directly Elected Council Seats Among the States

The total number of directly elected members of Council, in addition to those provided for by section 6.1.1, shall be eighty-five except as modified by section 6.1.2.1. The number of seats, excluding those extended by section 6.1.2.1, shall be equitably allocated among the states in direct proportion to the number of Institute members enrolled from each state.

6.1.2.1 Unexpired Terms Unaffected by Reduced Allocation

No member of Council directly elected by the membership in any state shall lose his seat for the term he then serves should the allocation of that state be diminished by virtue of section 6.1.2; but no state's allocation of directly elected Council seats shall be extended by this section beyond the natural expiration of a seat's full term or its vacation by the member filling it, whichever first occurs.

6.1.2.2 Allocation to Be Made by Nominations Committee

The nominations committee shall make the allocation provided in section 6.1.2. It shall be made at five-year intervals, at least nine months prior to annual meetings to be held each calendar year which ends in one and in six, and shall govern the five annual elections immediately following. It shall be based upon the membership figures and addresses carried on the books of the Institute the last day of the fiscal year immediately preceding the date of such determination.

6.1.3 Term of Office

Except as specified by this section 6.1.3, the term of office of a directly elected member of the Council shall commence when his election is announced by the chairman of the Board of Directors at the meeting of the Council immediately preceding the annual meeting of the Institute, as prescribed by section 6.7, and shall run until the announcement of the election of new directly elected members of the Council at the meeting of the Council immediately preceding the annual meeting of the Institute three years after his election. If any such member of the Council shall not serve his full term, the vacancy so created may be filled pursuant to section 6.6. The term of office of any member directly elected by the members in his state to fill such vacancy shall be the remainder of the three-year term with respect to which the vacancy occurred.

No member having served for two consecutive full terms as a directly elected member of the Council shall be eligible to serve another such term until at least one year after the completion of his second consecutive full term.

6.1.4 Number of Council Seats to Be Filled by Election

The number of Council seats to be filled in a state's quota of directly elected members of the Council for any given year shall be the number of its allocation of directly elected Council seats less the number of members of the Council from that state filling such seats for terms running through that year.

6.1.5 Nominations

At least eight months prior to the annual meeting of the Institute, the nominations committee shall request, from the recognized society of certified public accountants in each state for which any vacancies (see section 6.1.4) will arise in the coming year, the names of at least two suggested candidates from the state represented by such society to fill each such vacancy. The committee shall give due consideration to the names so submitted, but shall not be required to select its nominees from among such names. In the absence of a satisfactory response from any such state society, the nominations committee shall select the nominees from such state.

The nominations committee shall make its nominations for directly elected members of the Council at least six months prior to the annual meeting of the Institute. Notice of such nominations shall be published to the membership by the secretary at least five months prior to the annual meeting of the Institute. Any twenty members of the Institute from any given state for which a vacancy shall arise may submit to the secretary independent nominations for directly elected members of the Council from that state provided that such nominations be filed with the secretary at least four months prior to the annual meeting of the Institute.

6.1.6 Election

The nominees of the nominations committee for directly elected seats on Council shall be declared elected by the secretary if no independent nominations are filed for such seats as required by section 6.1.5.

The secretary shall mail to all members of the Institute in each state in which there is a contest for a directly elected seat on Council, at least ninety days prior to the annual meeting of the Institute, mail ballots containing the names of nominees from that state nominated by the nominations committee and the names of nominees independently nominated. Each ballot shall contain an announcement that votes will be counted only if received by the secretary at least forty-five days before the annual meeting of the Institute. Election to contested seats on Council shall be determined by a majority of the votes received from each jurisdiction by that date. Mail ballots shall be counted by the secretary, who shall certify the results for publication to the membership. Newly elected members shall be notified promptly and advised to attend the initial meeting of Council prior to the annual meeting of the Institute. They shall take office as provided in section 6.7.

(See section 610 R.)

The next page is 5681.

BL Section 610R

Implementing Resolution Under Section 6.1 Members of Council Directly Elected by Members of the Institute

As amended February 1, 1974

Under Section 6.1.6 Election

Resolved:

.01 That the withdrawal of a nomination for whatever reason after the balloting has commenced will not be acted upon until the certification of election has been completed. Vacancies then arising will be filled in accordance with section 6.6 of the bylaws, except that in states where the number of nominees exceeds the number of vacancies, the vacancy created by any withdrawal will be filled by that nominee having the highest number of votes after all other vacancies have been filled.

BL Section 620

6.2 Selection of Members of Council to Represent State Societies

As amended February 1, 1974

.01 Each recognized state society of certified public accountants shall designate, in a manner it deems appropriate, an Institute member to represent it on the Council. The term of each member of the Council so designated shall commence upon notification of the secretary by the society designating him at the meeting of Council immediately preceding the annual meeting of the Institute and shall run for one year or until the designation of his successor, provided that no such member of the Council shall represent a state society for more than six consecutive years.

The next page is 5701.

BL Section 630

6.3 Election of Members-at-Large of Council, Board of Directors, Chairman of the Board, Vice Chairman of the Board, Volunteer Vice Presidents and Treasurer

As amended February 1, 1974, unless otherwise indicated

.01 Seven Institute members, without regard to the states in which they reside, shall be elected annually by the Council as members-at-large of the Council, at its meeting immediately preceding the annual meeting of the Institute, and immediately prior to the installation of the members of the Council newly elected under section 6.1, for a term of three years or until the election of their successors. At the same meeting, but subsequent to the installation of such newly elected members of the Council, including members-at-large, the Council shall elect the chairman of the Board, the vice chairman of the Board, the volunteer vice presidents and the treasurer, and three Institute members of the Board of Directors. Such members of the Board of Directors shall serve for a term of three years or until election of their successors. The Council shall also elect three representatives of the public, who are not members of the Institute, to the Board of Directors in 1978—one for a term of three years, one for a term of two years and one for a term of one year. Thereafter, the Council shall elect one public representative annually for a term of three years, who shall serve until election of a successor. Nominations for all such positions shall be made by the nominations committee at least six months prior to the annual meeting of the Institute, and notice thereof shall be published to the membership of the Institute at least five months prior to such annual meeting. Independent nominations may be made by any twenty members of the Council if filed with the secretary at least four months prior to the annual meeting of the Institute. No nominations from the floor will be recognized. A majority of votes shall elect. Nominees may be invited to the meeting at which the election is to be held and those elected shall take office as prescribed in section 6.7.

[As amended, effective March 31, 1978.]

.02 No member having served for two consecutive full terms as a member-at-large of the Council shall be eligible to serve another such term until at least one year after the completion of his second consecutive full term.

6.3.1 Re-election to Board of Directors

No elected member of the Board of Directors who has served a full three-year term shall be eligible for re-election to such a term until the meeting of the Council one year after the completion of his full three-year term.

The next page is 5711.

BL Section 640

6.4 Election of the President and the Secretary

As amended February 1, 1974

.01 Election of the president and secretary shall be by the Council and shall be conducted as the Council may prescribe.

(See section 640 R.)

Implementing Resolution Under Section 6.4 Election of the President and the Secretary

As amended February 1, 1974

Resolved:

.01 That the Board of Directors shall recommend to the Council persons to be elected as president and secretary, respectively, to serve until their successors are elected. Other nominations shall be permitted from the floor. Voting may be by voice vote, or, upon request of a majority of those present, by written ballot. A majority vote shall elect.

→ *The next page is 5721.* ←

BL Section 650

6.5 Forfeiture of Office for Nonattendance

As amended February 1, 1974

.01 Any directly elected member or member-at-large of Council who shall be absent from three consecutive meetings shall forfeit his seat.

BL Section 660

6.6 Vacancies

As amended February 1, 1974

.01 Vacancies in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute, occurring between annual meetings of the Institute, may be filled by election of replacements by the Council, either at a meeting of Council or by mail ballot, under such conditions as the Council may prescribe. If the Council should so replace a directly elected member of the Council, such interim appointment will run only until his seat is filled by direct election of the membership of his state as provided in these bylaws.

.02 Pending action by the Council to fill a vacancy among any of the elected officers of the Institute, the Board of Directors may appoint a temporary successor to act in the capacity indicated.

(See section 660 R.)

The next page is 5741.

BL Section 660 R

Implementing Resolution Under Section 6.6 Vacancies

As amended February 1, 1974

Resolved:

.01 That if a vacancy occurs in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute between annual meetings of the Institute, the Board of Directors shall recommend replacements for election by Council. Voting on such replacement may be conducted by mail ballot, in which case provision shall be made for write-in votes, or at the next meeting of Council, as may appear most desirable in the circumstances. If the voting takes place at a Council meeting, nominations from the floor shall be permitted; voting may be by voice vote, or, at the request of a majority of those present, by written ballot. A majority vote shall elect. In any event, persons elected to fill vacancies in the Board of Directors, in the Council, or in any of the offices of the Institute shall serve only for the remainder of the unexpired term of the previous incumbent or until a successor is elected.

BL Section 670

6.7 Election Meeting of Council

As amended February 1, 1974

.01 At the meeting of the Council immediately preceding the annual meeting of the Institute, following the completion of such other business as the Council may transact, the Council shall elect new members-at-large of the Council pursuant to section 6.3. New members-at-large shall then take office, replacing those members-at-large whose terms shall have expired. Then the presiding officer shall announce the installation of members of the Council newly elected under section 6.1, at which time they shall take office, replacing those directly elected members of Council whose terms shall have expired. Election of officers, new members of the Board of Directors, and others shall then be held, and each officer or member of the Board of Directors so elected shall replace his predecessor upon such election, provided, however, that the retiring chairman of the Board shall continue in office through the end of the annual meeting of the Institute.

BL Section 700

VII. TERMINATION OF MEMBERSHIP AND DISCIPLINARY SANCTIONS

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The next page is 5771.

BL Section 701

Termination of Membership and Disciplinary Sanctions

As amended February 1, 1974

.01 This article shall govern the termination or suspension of membership in the Institute, whether imposed as a matter of discipline or voluntarily sought, and the imposition of any other disciplinary sanction, including censure or admonition, whether public or private, or imposition of conditions for retention of membership.

BL Section 710

7.1 Resignation of Membership

As amended February 1, 1974

.01 Resignations of members shall be in writing and may be offered at any time. Actions on such resignations and applications for reinstatement of resigned members shall be taken by the Board of Directors under such provisions as the Council may prescribe. Council may make separate provision for action on resignations of members not in good standing or against whom disciplinary proceedings or investigations are pending, and on applications for reinstatement of persons whose resignation was accepted when in such classification.

(See section 710 R.)

→ The next page is 5791. ←

BL Section 710R

Implementing Resolution Under Section 7.1 Resignation of Membership

As amended February 1, 1974

Resolved:

.01 That the Board of Directors shall act upon resignation of members, which shall become effective on the date of acceptance, but no action shall be taken on the resignation of a member with respect to whom charges are under investigation by the professional ethics division, or against whom a complaint is pending before the Trial Board, unless the division or the Trial Board, as the case may be, recommends that such resignation be accepted. If a person whose resignation was accepted when he was under investigation or the object of a complaint should subsequently apply for reinstatement, the Board of Directors shall not reinstate such person without the consent of the division or the Trial Board, as the case may be.

BL Section 720

7.2 Termination of Membership for Nonpayment of Financial Obligation

As amended February 1, 1974

.01 The Board of Directors may, in its discretion, terminate the membership of a member who fails to pay his dues or any other obligation to the Institute within five months after such debt has become due. Any membership so terminated may be reinstated by the Board of Directors, under such conditions and procedures as the Council may prescribe.

(See section 720 R.)

7.2.1 Termination of Affiliation of International Associate

The Council may terminate the affiliation of an International Associate in its discretion.

The next page is 5811.

BL Section 720 R

Implementing Resolution Under Section 7.2 Termination of Membership for Nonpayment of Financial Obligation

As amended February 1, 1974

Resolved:

.01 That if a person whose membership has terminated for nonpayment of dues or other financial obligation shall apply for reinstatement, the Board of Directors, in its discretion, may reinstate him, provided that he shall have paid to the Institute all dues and other obligations owing by him to the Institute at the time his membership was terminated.

Further resolved:

.02 That no person shall be considered to have resigned in good standing if at the time of his resignation he was in debt to the Institute for dues or other obligations. A member submitting his resignation after the beginning of the fiscal year, but before expiration of the time limit for payment of dues or other obligations, may attain good standing by paying dues prorated according to the portion of the fiscal year which has elapsed, provided obligations other than dues shall have been paid in full.

.03 A member who has resigned or whose membership has terminated in any manner may not file a new application for admission but may apply for reinstatement under this resolution or applicable provisions of the bylaws.

The next page is 5821.

BL Section 730

7.3 Disciplinary Suspension and Termination of Membership Without Hearing

As amended February 1, 1974

.01 Membership in the Institute shall be suspended or terminated without a hearing for disciplinary purposes as provided in sections 7.3.1 and 7.3.2, under such conditions and by such procedure as shall be prescribed by the Council.

(See section 730 R.)

7.3.1 Criminal Conviction of Member

Membership in the Institute shall be suspended without a hearing should there be filed with the secretary of the Institute a judgment of conviction imposed upon any member for

7.3.1.1 A crime defined as a felony under the law of the convicting jurisdiction;

7.3.1.2 The willful failure to file any income tax return which he, as an individual taxpayer, is required by law to file;

7.3.1.3 The filing of a false or fraudulent income tax return on his or a client's behalf; or

7.3.1.4 The willful aiding in the preparation and presentation of a false and fraudulent income tax return of a client; and

shall be terminated in like manner upon the similar filing of a final judgment of conviction.

7.3.2 Suspension or Revocation of Certificate

Membership in the Institute shall be suspended without a hearing should a member's certificate as a certified public accountant, or license or permit to practice as such or to practice public accounting be suspended as a disciplinary measure by any governmental authority, but such suspension of membership shall terminate upon reinstatement of the certificate; or such membership in the Institute shall be terminated without hearing should such certificate, license, or permit be revoked, withdrawn, or cancelled as a disciplinary measure by any governmental authority. The Council shall provide for the consideration and disposition by the Trial Board, with or without hearing, of a timely written petition of any member that his membership should not be suspended or terminated pursuant to this section 7.3.2.

7.3.3 Trial Board Disciplining Not Precluded

Application of the provisions of section 7.3.1 and section 7.3.2 shall not preclude the summoning of the member concerned to appear before the Trial Board or a sub-board pursuant to section 7.4.

→ The next page is 5831. ←

automatic suspension shall cease upon the expiration of the period of suspension so specified.

.04 (4) That the membership of a member whose certificate as a certified public accountant, or license or permit to practice as such or to practice public accounting has been revoked, withdrawn, or cancelled as a disciplinary measure by any governmental authority shall, except as provided in paragraph (6) of this resolution, become automatically terminated upon the expiration of thirty days after the mailing of a notice of such termination, as provided in paragraph (5) of this resolution. Such notice shall be mailed within a reasonable time after a statement of such governmental authority showing that such certificate, license, or permit has been revoked, withdrawn, or cancelled and specifying the cause of such revocation, withdrawal, or cancellation has been filed with the secretary of the Institute.

.05 (5) That notices of suspension or termination pursuant to paragraph (1), (2), (3), or (4) of this resolution shall be signed by the secretary of the Institute and mailed by registered mail, postage prepaid, addressed to the member concerned at his last known address according to the records of the Institute.

.06 (6) That the operation of paragraph (3) or (4) of this resolution shall become postponed if, within thirty days after mailing the notice of suspension or termination, the secretary of the Institute receives a request from the member concerned that the pertinent provision shall not become operative. The request shall state briefly the facts and reasons relied upon. All such requests shall be referred to the Trial Board for action thereon by the Trial Board or by an ad hoc committee thereof consisting of at least five members appointed by the chairman of the Trial Board or vice chairman, when acting as chairman.

.07 If the request is denied, the suspension or termination, as the case may be, shall become effective upon such denial, and the member concerned shall be so notified in writing by the secretary. No appeal to the Trial Board shall be allowable with respect to a denial of such a request by the ad hoc committee.

.08 If the request is granted, the suspension or termination, as the case may be, shall not become effective. In such event, the secretary shall transmit the matter to the professional ethics division to take whatever action it considers proper in the circumstances.

.09 A determination that paragraph (3) or (4) of this resolution shall not become operative shall be made only when it clearly appears that, because of exceptional or unusual circumstances, it would be inequitable to permit such automatic suspension or termination.

The next page is 5851.

BL Section 740

7.4 Disciplining of Member by Trial Board

As amended February 1, 1974

.01 Under such conditions and by such procedure as the Council may prescribe, the Trial Board or a sub-board thereof may, by the two-thirds vote of the members present and voting, expel a member (except as otherwise provided in section 7.4.3), or by a majority vote of the members present and voting, may suspend a member for a period not to exceed two years not counting any suspension imposed under sections 7.3.1 and 7.3.2, or may impose such lesser sanctions as the Council may prescribe on any member if

7.4.1 He infringes any of these bylaws or any provision of the Code of Professional Ethics;

7.4.2 He is declared by a court of competent jurisdiction to have committed any fraud;

7.4.3 He is held by the Trial Board or a sub-board thereof to have been guilty of an act discreditable to the profession, or to have been convicted of a criminal offense which tends to discredit the profession; provided that should the Trial Board or sub-board find by a majority vote that he has been convicted by a criminal court of an offense involving moral turpitude, or any of the offenses enumerated in section 7.3.1, the penalty shall be expulsion;

7.4.4 He is declared by any competent court to be insane or otherwise incompetent;

7.4.5 His certificate as a certified public accountant or license or permit to practice as such or to practice public accounting is suspended, revoked, withdrawn, or cancelled as a disciplinary measure by any governmental authority; or

7.4.6 He fails to cooperate with the professional ethics division in any disciplinary investigation involving him or his partner or employee by not responding to interrogatories of a committee of the professional ethics division within thirty days of their posting by registered mail, postage prepaid, to him at his last known address shown on the books of the Institute.

.02 With respect to a member residing in a state which has entered into an agreement approved by the Institute's Board of Directors for the conduct of joint Trial Board hearings, disciplinary hearings shall be conducted before such joint Trial Board.

(See section 740 R.)

The next page is 5871.

BL Section 740 R

Implementing Resolution Under Section 7.4 Disciplining of Member by Trial Board

As amended effective August 1, 1975, unless otherwise indicated

Resolved:

.01 (1) Any complaint preferred against a member under Section 7.4 of the bylaws shall be submitted to the professional ethics division, which in turn may refer the complaint for investigation and recommendation to an ethics committee (or its equivalent) of a state society of certified public accountants which has made an agreement with the Institute of the type authorized in Section 7.4 of the bylaws. If, upon consideration of the complaint, investigation, and/or recommendation thereon, it appears to the division that a prima facie case is established showing a violation of any applicable bylaws or any provision of the Code of Professional Ethics of the Institute or any state society making an agreement with the Institute referred to above or showing any conduct discreditable to a certified public accountant, the professional ethics division or the ethics committee of such state society shall report the matter to the Secretary of the Joint Trial Board Division, who shall summon the member involved to appear in answer at the next convenient meeting of a panel of the appropriate regional trial board or a panel of the National Review Board appointed to hear the case under paragraph 3(b), provided, however, that with respect to a case falling within the scope of Section 7.3 of the bylaws the division shall have discretion as to when and whether to report the matter to the Secretary before such summoning.

.02 (2)

(a) If the professional ethics division or state society ethics committee shall dismiss any complaint preferred against a member or shall fail to initiate its investigation within ninety days after such complaint is presented to it in writing, the member preferring the complaint may present the complaint in writing to the National Review Board, provided, however, that this provision shall not apply to a case falling within the scope of Section 7.3.

(b) The chairman of the National Review Board shall cause such investigation to be made of the matter as he may deem necessary, and shall either dismiss the complaint or refer it to the Secretary of the Joint Trial Board Division who shall summon the member involved thereby to appear before the panel appointed in paragraph (c) hereof to hear the case.

(c) Prior to causing the investigation referred to in paragraph (a), the chairman (or vice chairman when acting as chairman) of the National Review Board shall designate eighteen members of the National Review Board to refrain from such investigation in order that nine of them may be appointed to an independent hearing panel if necessary. He shall report the names of such members to the Secretary of the Joint Trial Board Division prior to any action under paragraph (a).

.03 (3) For the purpose of adjudicating charges against persons subject thereto as provided in the foregoing paragraphs of this resolution, the following must take place:

(a) The Secretary of the Joint Trial Board Division shall mail to the member concerned, at least thirty days prior to the proposed hearing by the appropriate regional trial panel appointed to hear the case under the rules of procedure of the Joint Trial Board Division, written notice of the charges to be adjudicated. Such notice, when mailed by registered mail, postage prepaid, addressed to the respondent concerned at his last known address according to the records of the Institute, or any participating state society if the case involves a person who is not a member of the AICPA under an agreement contemplated by section 7.4 of the bylaws, shall be deemed properly served. [As amended, effective May 8, 1978.]

(b) Within thirty days of the mailing of the notice set forth in paragraph (a) every respondent must move to exercise any right he may have under the rules of procedure of the Joint Trial Board Division to request a trial before a panel of the National Review Board rather than the regional trial board to which he has been summoned under paragraph (a). Any hearing in the matter shall be conducted according to the rules of procedure of the Joint Trial Board Division which shall provide that such request shall not be granted as a matter of right but shall be considered by an ad hoc committee to be appointed by the chairman of the National Review Board or its vice chairman when acting as chairman and composed of not less than three (3) members of the National Review Board. The ad hoc committee shall decide if the request shall be granted or denied. The ad hoc committee's decision on this question shall be final and subject to no further review. If the request is granted the charges shall be heard by a panel of the National Review Board constituted as set forth in resolution under Section 3.6.2.3 of the bylaws. In those cases in which such a request is granted and a panel of the National Review Board makes a decision, there shall be no further appeal of any kind.

(c) After hearing the evidence presented by the professional ethics division or other complainant and by the respondent, the appropriate trial panel hearing the case, a quorum present, by vote of the members present and voting, may, in a manner consistent with Section 7.4 of the AICPA bylaws, admonish, suspend for a period of not more than two years, or expel the member against whom the complaint is made, provided that in any case in which the appropriate trial panel finds that a member has departed from the profession's ethical standards, it may also direct the member concerned to complete specified professional development courses and to report to the professional ethics division upon such completion.

(d) In a case decided by a regional trial board the member concerned may request a review by a panel of the National Review Board of the decision provided such a request for review is filed with the Secretary of the Joint Trial Board Division at the principal office of the Institute within thirty days after the decision of the regional trial board, and that such information as may be required by the rules of the Joint Trial Board Division shall be filed with such request. Such a review shall not be a matter of right. Each such request for a review shall be considered by an ad hoc committee to be appointed by the chairman of the National Review Board or its vice chairman in the event of the chairman's unavailability, and shall appoint an ad hoc committee of not less than three members of the National Review Board who did not participate in any prior proceedings in the case to consider each such request for review. The ad hoc committee shall have the power to decide whether or not such request for review by a panel of the National Review Board shall be granted. The ad hoc committee's decision shall be final and subject to no further review. If such request for review is allowed, a panel of the National Review Board as constituted as set forth in the resolution under Section 3.6.2.3 of the bylaws shall review the decision of the regional trial board in accordance with the rules of the Joint Trial Board Division. On such review, the panel of the National Review Board may affirm, modify, or reverse all or any part of the decision of the regional trial board or make such other disposition of the case as it deems appropriate.

The National Review Board may by general rule indicate the character of reasons which may be considered to be of sufficient importance to warrant an ad hoc committee granting a request for review.

(e) Any decision of any regional trial board, or any panel of the National Review Board including any decision of an ad hoc committee shall become effective when made, unless the decision of the panel or committee indicates otherwise, in which latter event it shall become effective at the time determined by the panel or committee. Any decision of a regional trial board shall become effective as follows:

(i) Upon the expiration of thirty days after it is made, if no request for review is properly filed within such thirty-day period.

(ii) Upon the denial of a request for review, if such request has been properly filed within such thirty-day period and is denied by an ad hoc committee.

(iii) Upon the effective date of a decision of a panel of the National Review Board affirming the decision of an appropriate trial panel in cases where a review has been granted by an ad hoc committee.

(f) A quorum of any panel or ad hoc committee shall consist of a majority of those appointed, unless otherwise provided in the rules of the joint Trial Board Division.

.04 (4) In cases where the professional ethics division concludes that a prima facie violation of the Code of Professional Ethics or bylaws is not of sufficient gravity to warrant further formal action, it may issue an administrative reprimand, provided, however, that there will be no publication of such administrative reprimand in the Institute's principal membership periodical and the member concerned is notified of his right to a hearing on the issues before the appropriate trial panel should he choose to have a hearing on the issues. [As amended, effective May 8, 1978.]

.05 (5) In cases involving departures from any section of the Code of Professional Ethics, the professional ethics division may direct the member or members concerned to complete specified professional development courses.

The next page is 5881.

BL Section 750

7.5 Reinstatement

As amended February 1, 1974

.01 The Council may prescribe the conditions and procedures under which members suspended or terminated under section 7.3 and 7.4 may be reinstated.

(See section 750 R.)

→ *The next page is 5891.* ←

BL Section 750 R

Implementing Resolution Under Section 7.5 Reinstatement

As amended effective August 1, 1975, unless otherwise indicated

Resolved:

.01 (1) That at any time after the publication in a membership periodical of the Institute of a statement of a case and decision, on application of the member concerned, the appropriate panel of either the regional trial board or the National Review Board which last heard the case and whose decision provides the basis for the publication, may, by a two-thirds vote of the members present and voting, recall, rescind, or modify such decision, which action shall be published in the membership periodical of the Institute. The denial of an application under this section shall not prevent the member concerned from applying for reinstatement under section (2) hereof.

.02 (2) That

(a) Should a judgment of conviction or an order of a governmental authority on which the suspension or termination of membership was based under section 7.3 of the bylaws be reversed or otherwise set aside or invalidated, such suspension shall terminate or such member shall become reinstated when a certified copy of the order reversing or otherwise setting aside or invalidating such conviction or order is filed with the secretary of the Joint Trial Board Division, who shall refer the matter to the professional ethics division for whatever action it deems appropriate.

(b) A member who has been suspended or expelled by the Joint Trial Board Division pursuant to section 7.4 of the bylaws may request that the suspension terminate or request reinstatement if a judgment of conviction, an order or finding of any court, or an order of the governmental authority on which the suspension or expulsion was based has been reversed or otherwise set aside or invalidated. Such request shall be referred to the Joint Trial Board Division whereupon a hearing panel of the National Review Board composed of five members designated by the Chairman of the National

Review Board may, after investigating all related circumstances, terminate the suspension or reinstate the member concerned by a majority vote of the members present and entitled to vote. [As amended, effective May 8, 1978.]

(c) Except as provided in subparagraphs (a) and (b) of this paragraph (2), a member whose membership has been automatically terminated under section 7.3, or who has been expelled by or had his resignation accepted by a panel of the Joint Trial Board Division may, at any time after three years from the effective date of such termination, expulsion, or acceptance of resignation, request reinstatement of his membership. Such request shall be referred to the Joint Trial Board Division, whereupon a hearing panel of the National Review Board composed of five members designated by the Chairman of the National Review Board may, after investigation, reinstate such member on such terms and conditions as it shall determine to be appropriate. If an application for reinstatement under this subparagraph is denied, the member concerned may again apply for reinstatement at any time after two years from the date of such denial. [As amended, effective May 8, 1978.]

The next page is 5901.

BL Section 760

7.6 Publication of Disciplinary Action

As amended February 1, 1974

.01 Notice of disciplinary action pursuant to section 7.3 or 7.4 hereof, together with a statement of the reasons therefor, may be published in such form and manner as the Council may prescribe.

(See section 760 R.)

The next page is 5903.

BL Section 760 R

Implementing Resolution Under Section 7.6 Publication of Disciplinary Action

As amended effective
September 17, 1977

Resolved:

.01 That notice of disciplinary action taken under Section 7.3 or 7.4 of the bylaws and the basis therefor shall be published in a membership periodical of the Institute. In the case of a suspension or termination pursuant to Section 7.3 of the bylaws, such notice shall be in a form approved by the chairman of the Trial Board or the vice chairman when acting as such, and shall disclose the name of the member concerned. In any action pursuant to Section 7.4 of the bylaws, the Trial Board or sub-board hearing the case shall decide, by a majority vote of the members present and voting, on the form of the notice of the case and the decision to be published which shall disclose the name of the member involved when the member is found guilty. The statement and decision, as released by the chairman, Trial Board or sub-board, shall be published in a membership periodical of the Institute. No such publication shall be made until such decision has become effective.

→ *The next page is 5921.* ←

BL Section 770

7.7 Disciplinary Sections Not to Be Applied Retroactively

As amended February 1, 1974

.01 Sections 7.3 and 7.4 shall not be applied to offenses of wrongful conduct occurring prior to its effective date, but such offenses shall be subject to discipline under the bylaws of the Institute in effect at the time of their occurrence.

BL Section 800

VIII. AMENDMENTS

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BL Section 801

Amendments

As amended February 1, 1974

.01 Amendments to these bylaws and the Code of Professional Ethics shall be accomplished in a manner consistent with this Article.

8.1 Proposals to Amend the Bylaws

As amended February 1, 1974

.01 Proposals to amend the bylaws may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, or by the Board of Directors.

The next page is 5961.

BL Section 820

8.2 Proposals to Amend the Code of Professional Ethics

As amended February 1, 1974

.01 Proposals to amend the Code of Professional Ethics may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, by the Board of Directors, or by the professional ethics division.

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BL Section 830

8.3 Submission to Council via Board of Directors

As amended February 1, 1974

.01 All such proposals to amend the bylaws or the Code of Professional Ethics, unless made at a meeting of the Council or the Board of Directors, shall be submitted in writing to the Board of Directors. The Board of Directors shall submit all such proposals, accompanied by its recommendation, to the Council for action.

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BL Section 840

8.4 Submission to Membership by Mail Ballot

As amended February 1, 1974

.01 If approved by the Council the proposed amendment shall be submitted to all of the members of the Institute for a vote by mail ballot on or after ninety days following such approval. If at least two-thirds of those voting approve such proposal, it shall become effective as an amendment to the bylaws or to the Code of Professional Ethics, as applicable. Mail ballots shall be considered valid and counted only if received in the Institute's principal office within sixty days from the date of mailing the ballots to the members.

BL Section 900

GENERAL

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BL Section 911

Objectives of the American Institute of Certified Public Accounts

.01 *Note:* The following statement of the Institute's objectives reflects a series of actions by Council over the last decade. The objectives set forth here supplement, or in some cases amplify, the opening paragraph of the bylaws devoted to the purposes of the organization.

- To sustain itself as an organization of distinction by the wide participation of its members, by the intense and creative involvement of the best of the profession in Institute affairs, and by an exceptional quality of staff performance.

- To adopt a form of organization best designed to meet the needs of all its members both in and out of practice.

- To engage a full-time staff of sufficient size and competence and to organize their efforts—both in terms of direct staff work and assistance to committees—so that the organization can move with speed and precision to continually strengthen its service and its leadership.

- To perform in a manner which will persuade all parties at interest —government, financial institutions, the business community, universities, and the public generally—to accept the organization as the authoritative source of principles and procedures in its field.

- To promote improvements in financial reporting by seeking to eliminate variations in reporting practices which are not justified by substantial differences in circumstances.

- To communicate effectively to the public, as well as to all levels of government, in regard to matters of concern to the profession.

- To produce valuable, new knowledge in its field through research and experimentation, analysis and synthesis of experience, and development and adaptation of new techniques.

- To identify those areas in society where the need for the CPA's attest function exists and to assist its members in equipping themselves to perform the attest function wherever a useful social purpose would be served.

- To maintain surveillance over practice in the interest of promoting high standards of performance by the profession and public confidence in its work.

- To promote the adoption of uniform, nationwide standards governing the issuance of CPA certificates, recognition of qualified accountants of other countries, and freedom of movement in interstate and international accounting practice.

- To serve as a constructive force in improving education for the profession and, ultimately, all business education.

- To encourage a continuous restatement of those areas of knowledge and technical competence required by the CPA in his present and prospective professional practice, and a clarification of the responsibilities appropriate to universities, practitioners, and professional societies in the education and training of CPAs.

- To maintain a high level of quality in its publications and in its program of professional development, and thus to aid its members in discharging their commitment as professional men to a lifetime of study and self-improvement.

- To coordinate, on a voluntary basis, the plans, programs, and activities of the state societies and of the Institute, with particular emphasis on the adoption of uniform codes of professional ethics and enforcement procedures.

- To cooperate fully with all organizations of accountants, both at home and abroad, to the end that the entire accounting function can make its maximum contribution to the public good.

- To encourage every eligible CPA, in furtherance of his personal development and in fulfillment of his professional obligations, to become a member of both his state society and the Institute.

- To encourage all CPAs to perform a wide range of services in the broad field of accounting consistent with their professional competence and their ethical responsibilities. *(See BL section 921, "A Description of the Professional Practice of Certified Public Accountants" which was approved by Council in 1966 as an official statement of Institute policy.)*

The next page is 6031.

BL Section 921

A Description of the Professional Practice of Certified Public Accountants

.01 Certified public accountants practice in the broad field of accounting.

.02 Accounting is a discipline which provides financial and other information essential to the efficient conduct and evaluation of the activities of any organization.

.03 The information which accounting provides is essential for (1) effective planning, control, and decision-making by management, and (2) discharging the accountability of organizations to investors, creditors, government agencies, taxing authorities, association members, contributors to welfare institutions, and others.

.04 Accounting includes the development and analysis of data, the testing of their validity and relevance, and the interpretation and communication of the resulting information to intended users. The data may be expressed in monetary or other quantitative terms, or in symbolic or verbal forms.

.05 Some of the data with which accounting is concerned are not precisely measurable, but necessarily involve assumptions and estimates as to the present effect of future events and other uncertainties. Accordingly, accounting requires not only technical knowledge and skill, but even more important, disciplined judgment, perception, and objectivity.

.06 Within this broad field of accounting, certified public accountants are the identified professional accountants. They provide leadership in accounting research and education. In the practice of public accounting CPAs bring competence of professional quality, independence, and a strong concern for the usefulness of the information and advice they provide, but they do not make management decisions.

.07 The professional quality of their services is based upon experience and the requirements for the CPA certificate—education and examination—and upon the ethical and technical standards established and enforced by their profession.

.08 CPAs have a distinctive role in examining financial statements submitted to investors, creditors, and other interested parties, and in expressing independent opinions on the fairness of such statements. This distinctive role has inevitably encouraged a demand for the opinions of CPAs on a wide variety of other representations, such as compliance with rules and regulations of government agencies, sales statistics under lease and royalty agreements, and adherence to covenants in indentures.

.09 The examination of financial statements requires CPAs to review many aspects of an organization's activities and procedures. Consequently they can advise clients of needed improvements in internal control and make constructive suggestions on financial, tax, and other operating matters.

.10 In addition to furnishing advice in conjunction with their independent examinations of financial statements, CPAs are engaged to provide objective advice and consultation on various management problems. Many of these involve information and control systems and techniques, such as budgeting, cost control, profit planning, internal reporting, automatic data processing, and quantitative analysis. CPAs also assist in the development and implementation of programs approved by management.

.11 Among the major management problems depending on the accounting function is compliance with tax requirements. An important part of the practice of CPAs includes tax planning and advice, preparation of tax returns, and representation of clients before government agencies.

.12 CPAs also participate in conferences with government agencies such as the Securities and Exchange Commission, and with other interested parties, such as bankers.

.13 Like other professionals, CPAs are often consulted on business, civic, and other problems on which their judgment, experience, and professional standards permit them to provide helpful advice and assistance.

.14 The complexities of an industrial society encourage a high degree of specialization in all professions. The accounting profession is no exception. Its scope is so wide and varied that many individual CPAs choose to specialize in particular types of service.

.15 Although their activities may be diverse, all CPAs have demonstrated basic competence of professional quality in the discipline of accounting. It is this which unites them as members of one profession, and provides a foundation for extension of their services into new areas.

BL TOPICAL INDEX

References are to BL section and paragraph numbers.

Preface

This division contains the following sections which pertain to the Voluntary Quality Control Review Program for CPA Firms:

- *Voluntary Quality Control Review Program for CPA Firms,* which was approved by Council on October 23, 1976.
- *Scope of the Quality Control Document Review.*
- *Quality Control Policies and Procedures for Participating CPA Firms.*
- *Performing and Reporting on Quality Control Compliance Reviews.*

The Voluntary Quality Control Review Program is designed solely to serve CPA firms which are not members of the AICPA Division for CPA Firms. The standards for peer reviews of members of the division are being promulgated separately by the respective peer review committees of the SEC Practice Section and the Private Companies Practice Section.

Wallace E. Olson
President
May, 1978

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QC Section

VOLUNTARY QUALITY CONTROL REVIEW PROGRAM FOR CPA FIRMS

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QC Section 100

Voluntary Quality Control Review Program for CPA Firms

Introduction

.01 An important part of the profession's system of self-regulation is to see that CPA firms maintain adequate systems of quality control. This is necessary because quality control is a vital element of the profession's assurance to the public that a high level of competence is maintained and that every practicable effort is being made to prevent substandard performance on the part of practitioners.

.02 Toward this end, the American Institute of Certified Public Accountants has established a voluntary program of review of quality control maintained by CPA firms in their audit practices. Standards of quality control have also been promulgated for use in conducting such reviews.

.03 The purpose of the program is educational and preventive in nature and is designed to assist firms in developing and implementing adequate systems of quality control in their audit practices as well as assuring firms with existing systems that their quality control meets, in all material respects, the standards of the profession.

.04 To fulfill its dual purpose, the program includes two types of reviews: consulting reviews and compliance reviews. Consulting reviews are intended to assist firms in developing their systems of quality control and in preparing for participation in the program. Compliance reviews are designed to establish that the quality controls of participating firms meet the standards of the profession.

.05 CPA firms that provide accounting services such as preparation of unaudited financial statements but do not conduct audits also participate in the program. Their participation is based on their procedures for complying with professional standards applicable to unaudited financial statements and on their systems of quality control for audit practice which would be placed in effect should they accept audit engagements.

.06 The program provides direct benefits to the participating firms through the application of objective, outside reviews to their quality control policies and procedures. It is reasonable to expect that these reviews will reduce the number of failures in audit performance that might otherwise occur. However, they cannot provide absolute assurance that all mistakes will be avoided. The basic elements of the program are described in the balance of this document.

Administration of Program

.07 The quality control review program, including both consulting reviews and compliance reviews, is administered by a quality control review committee, which establishes policies for implementation of the program. The committee is also responsible for acquainting the business community and general public with the program and the significance of a CPA firm's participation.

.08 As experience is gained, the committee will modify the program to increase its effectiveness. However, the basic features of the plan can be modified only by Council.

.09 The committee is composed of AICPA members in public practice selected to provide a broad representation of the profession. A qualified staff works under the direction of the committee to assist in carrying out the program.

.10 Two subcommittees operate under the direction of the quality control review committee. One subcommittee is charged with administration of compliance reviews of firms with SEC practices. The other subcommittee administers the consulting reviews and compliance reviews for firms with general audit practices. Some members of the subcommittees are drawn from the quality control review committee.

.11 The possibility exists that a disagreement may arise between a firm and its reviewers. If this occurs and the firm is being reviewed by a review team, the dispute may be submitted to the appropriate subcommittee for resolution. If the firm is being reviewed by another firm, this procedure may be followed with the consent of both firms. If a dispute cannot be resolved by the subcommittee, it will be referred for resolution to an ad hoc review committee appointed by the chairman of the board of the AICPA.

Consulting Reviews

General Description

.12 It is expected that some firms will request assistance in organizing their quality control procedures. The following consultation or educational reviews are provided to assist firms in the conduct of their practices or in their preparation for participation in the quality control review program.

.13 The reviews are conducted on a confidential basis. Except for the quality control document review, no written reports are prepared by the review teams. Neither the Institute nor the reviewed firms will disclose that the reviews have taken place. The reviewed firms pay the reviewers' fees and travel expenses.

Quality Control Document Review

.14 The Institute provides a service whereby a firm preparing for participation may send a description of its quality control system to the Institute for review and comment. This service is not intended to be a regular prelude to a quality control review or to be an alternative for the preliminary quality control procedures review described below. Rather, it is a means for a firm to obtain advice on the adequacy of its quality control document. If more than a nominal amount of time is required for this service, the firm is charged a fee.

Preliminary Quality Control Procedures Review

.15 To assist those firms which might want to have others come to their offices to look at their documented procedures and comment on them, a preliminary quality control procedures review program is provided. As is the case with a quality control review, the reviewers make an objective analysis of the documented procedures in the light of the firm's size, organizational structure, and practice philosophies.

.16 The purpose of the preliminary review is to help a firm prepare for participation in the quality control review program by providing an objective evaluation of the adequacy of its procedures and, if necessary, suggestions for revisions. A review provides a measure of comfort to a firm before it files a letter of intent to participate in the program.

.17 These voluntary reviews are made in the firms' offices on a confidential basis. Since a preliminary review is informal and not complete, it is not a substitute for a full-fledged quality control review.

Technical Standards Review

.18 This program provides an in-house post-issuance review of working papers and reports for audit engagements and unaudited financial statement engagements. Through this program, firms can arrange for confidential objective reviews of their application of technical standards as indicated by their engagement working papers and reports.

.19 Checklists for these technical standards reviews which are updated annually may be purchased from the AICPA to assist firms in meeting professional requirements.

General Description of Compliance Reviews

.20 The quality control review program is voluntary and has the following features:

(1) The program is open to CPA firms with SEC practices or which have a desire to prepare for such practice, to CPA firms with general audit practices, and to those CPA firms that provide accounting services such as preparation of unaudited financial statements.

(2) A quality control review committee composed of members in public practice administers the program.

(3) Participation in the program is initiated by a firm's filing a letter of intent with the Institute. The firm states in the letter that it will comply with the provisions of the program and that it will undergo a review of its documented quality control policies and procedures.

(4) At the inauguration of the program, some months are needed for firms to arrange for their field reviews. Therefore, responses to inquiries regarding the status of participating firms are to be limited to the statement that they have filed a letter of intent, but that no information about completion of field reviews is to be released by the reviewed firms or the Institute until the end of this interim period.

(5) Field reviews are conducted in accordance with standards approved by the auditing standards executive committee. A review is carried out by one of the following methods at the election of the firm to be reviewed:

   a. A review team appointed by the committee.

   b. A CPA firm engaged by the firm under review.

   c. Some other form of independent review satisfactory to the committee, such as an acceptable plan administered by a state society of CPAs.

(6) A review includes examination of audit working papers to the extent necessary to determine whether the firm's quality control policies are in compliance with professional standards. The depth of review of working papers for particular engagements is left to the judgment of the reviewers. The review is directed primarily to the key areas of an audit to determine whether in those areas there were well planned and appropriately executed auditing procedures that were documented in accordance with the firm's policies. If the firm has a significant number of engagements for unaudited financial statements, those engagements are also subject to review.

(7) A firm electing to use a committee-appointed review team agrees to provide qualified personnel for the panel from which reviewers for the reviews of other firms are drawn.

(8) Upon completion of the review, the review team or reviewing firm prepares a short report stating the results of the review. The report is submitted to the reviewed firm which, at its option, submits the report to the Institute. Such reviews are to be conducted at least once every three years for the firm to continue as a participant.

(9) For administrative purposes, the Institute maintains a record of firms filing letters of intent and a record of firms submitting reports on the results of reviews. These records are available to the public upon request.

(10) At its option, a firm may advise its clients of having filed a letter of intent and, subsequently, of the results of the review and that the report of the review is on file at the Institute. Results of reviews are not to be released until the end of an interim period to provide time for the completion of reviews of firms participating in the program at its outset.

(11) To maintain the program on a self-supporting basis, the following fees are charged to firms:

a. An annual participation fee based on the number of the firm's professional personnel. A modest fee covers the administrative cost of the program.

b. Fees for reviews conducted by committee-appointed review teams. These fees are based on the per diem rates for the reviewers and their out-of-pocket expenses. Participating firms electing to be reviewed by other firms make their own fee arrangements.

(12) The committee recognizes that there are differences in the size, structure, and clientele of CPA firms and that quality control procedures will vary according to those characteristics. This program is administered in such a way, however, as to provide a degree of confidence that the participating firms are adhering to applicable professional standards even though they may have varying policies and procedures to achieve such adherence.

(13) The program is not intended as a means for taking disciplinary action since it is directed toward reviewing the systems of quality control of firms for their compliance with professional standards rather than the performance of individual professional staff members. It relies on the firms to maintain a continuing surveillance of the performance of their professional staff members.

However, in the event serious violations of technical standards are encountered as a by-product of the program and the reviewed firm does not take appropriate corrective action, the reviewers are not precluded from referring such information to the Institute's professional ethics division. Such reference would be discretionary and any decision in that regard would be made in light of the circumstances.

General Procedures for Compliance Reviews

Letter of Intent

.21 A firm advises the committee of its decision to participate in the program by filing a letter of intent with the following features:

(1) Advice as to the method of review selected.

(2) The date by which the firm's review will be started and the estimated completion date.

(3) A statement that the firm has documented policies and procedures for the quality control of its audit practice.

.22 A firm may terminate its participation in the program at any time. Also, a firm's participation is terminated if it fails to submit a report on the results of its field review within the time period specified under the program and consistent with the standards of the program. After termination, the firm can no longer refer to itself as a participating firm although it may apply at any time to renew its participation.

Quality Control Policies and Procedures

.23 A firm's quality control policies and procedures affect the quality of work in the firm's audit engagements. While aspects of quality control apply to all firms, the extent to which policies and procedures apply will depend on a variety of factors, such as the size, number of offices, and organizational structure of the firm, and its philosophy and practice as to the degree of operating autonomy appropriate for its people. A participating firm is required to make available to the review team or reviewing firm its policies and procedures for quality control.

[.24] [Superseded by section 200.]

.25 In developing its quality control policies and procedures, a firm must be guided by Statement on Auditing Standards No. 4 [AU section 160], "Quality Control Considerations for a Firm of Independent Auditors." This Statement suggests the following elements of quality control:

(1) *Independence.* Policies and procedures to provide reasonable assurance that persons at all organizational levels maintain independence in fact and in appearance.

(2) *Assigning Personnel to Engagements.* Policies and procedures for assigning personnel to engagements to provide reasonable assurance that audit work will be performed by persons having the degree of technical training and proficiency required in the circumstances.

(3) *Consultation.* Policies and procedures for consultation to provide reasonable assurance that auditors will seek assistance on accounting and auditing questions, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority.

(4) *Supervision.* Policies and procedures for the conduct and supervision of work at all organizational levels to provide reasonable assurance that the work performed meets the firm's standards of quality.

(5) *Hiring.* Policies and procedures for hiring to provide reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently.

(6) *Professional Development.* Policies and procedures for professional development to provide reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned.

(7) *Advancement.* Policies and procedures for advancing professional personnel to provide reasonable assurance that the people selected will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

(8) *Acceptance and Continuance of Clients.* Policies and procedures for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity.

(9) *Inspection.* Policies and procedures for inspection to provide reasonable assurance that the other procedures designed to maintain the quality of the firm's auditing practice are being effectively applied.

Field Reviews

.26 Field reviews are designed to obtain assurance that a firm's quality control policies and procedures conform to professional standards, are adequately documented, and are being complied with. All participating firms are required to undergo a field review at least once every three years to retain their status as participants.

.27 Reviews are conducted at the mutual convenience of the reviewed firm and the reviewers. To accommodate the normal business cycle of the firms, the reviews are conducted during the months of April through December.

.28 Review team members and reviewing firms are expected to have a knowledge of the type of practice of the firm to be reviewed.

.29 It is the responsibility of the review team or reviewing firm to review the quality control policies and procedures to determine that they provide measures reasonable for the particular firm. The firm is advised of apparent deviations, if any, from specified standards. The reviewed firm is given an opportunity to refute or correct such apparent deviations before completion of the review and issuance of the report.

.30 The field reviews are designed, in part, to ascertain that the firm's internal system of quality control is operating as represented. To accomplish this objective, initial attention is directed to a review of documentation in the firm's administrative files, which in the case of multi-office firms is normally located at the executive office. For example, the executive office probably has statistics, correspondence, and other data relative to procedures regarding client acceptance and retention, hiring, training, promotion, independence, and inspection. In addition, the executive office probably has data useful in judging compliance with the firm's policies with respect to supervision and review and consultation.

.31 Client files relating to selected audit engagements, which are normally located in practice offices, are reviewed. The depth of the review of the working papers for particular engagements is decided by the reviewers. The review is directed primarily to the key areas of an audit to determine whether in those areas there were well planned and appropriately executed auditing procedures that were documented in accordance with the firm's policies.

.32 On occasion, an office of a firm may have legitimate reasons for not permitting the files for a selected engagement to be examined. For example, the financial statements of an engagement may be the subject of litigation or investigation by a government authority or the firm may have been advised by the client that it objects to exposure of the working papers to others, such as the review team. If those making the field review are not satisfied as to the legitimacy of the explanation, the matter is reported to the firm's managing partner.

.33 In the case of a multi-office firm, the degree of centralization of the firm's quality control affects the relative amount of time to be spent at the executive or practice offices. Practice offices visited are generally representative of the firm's overall audit practice.

.34 *Committee-Appointed Review Teams.* Review teams appointed by the committee are drawn from the panel of reviewers volunteered by the participating firms. Each team is headed by a team captain who organizes the review according to general guidelines prepared by the committee, supervises the reviewers, and prepares a report on the findings of the review. The firm to be reviewed is advised in advance of the names of the reviewers and their firms.

.35 Participating firms electing to undergo field tests conducted by committee-appointed review teams are required to nominate qualified personnel from their firms for the reviewer panel. Reviews of firms having SEC practices are conducted by audit partners and audit managers knowledgeable about current SEC practice. Reviews of firms with general audit practices are conducted by audit partners and other audit personnel experienced in general audit practice. Managers and other nonpartners are utilized only where subject to the supervision of a partner. A profile is submitted for each nominee indicating the extent of audit experience, SEC experience, participation in his firm's internal quality review programs, present responsibilities, and industry or other special expertise.

.36 The members of a review team are drawn from the reviewer panel. Normally only one partner from a firm is selected for a field test team. In selecting reviewers, consideration is given to their experience with firms and practice units of comparable size and types of practice. Reviewers are required to adhere to all standards applicable to professional engagements, including confidentiality of client relationships. Firms being reviewed by review teams are required to pay the per diem fees of the reviewers and their out-of-pocket travel expenses. The committee sets standard per diem fees for this purpose. The fees are not so large that they might become a reviewer's motive for participating in the program, but reasonably compensate the reviewers' firms for the services of their partners and managers. Reviewers receive fees considerably less than their standard professional fees for services rendered to clients. The team captain receives a slightly higher fee in view of his greater responsibility. These lower fees are justified on the grounds that the program is beneficial not only to the participating firms, but also to the accounting profession as a whole and to the individual reviewers who gain an educational experience from reviewing the procedures of other firms.

.37 The aggregate fee and out-of-pocket travel expenses are paid by the reviewed firm to the Institute for disbursement to the firms of the members of the review team.

.38 A reviewer is not assigned to the review of an executive or practice office in the same geographic area in which he is engaged in public practice. If only one individual is designated by the team captain to visit a practice office, he must be a partner. However, where more than one team member is involved in a visit to either an executive or practice office, the team members are from different firms and a partner is designated to be in charge of the inspection.

.39 For those reviews conducted by a committee-appointed review team, working papers are retained only until such time as the report on the review has been filed with the Institute or the period for filing the report has elapsed, whichever is earlier.

.40 *CPA Firm-Conducted Field Reviews.* A participating firm may elect to have the field review of its procedures conducted by another CPA firm instead of by a committee-appointed review team. The reviewing firm follows applicable standards for the conduct of field reviews. In the cases of reviews of firms with SEC practices, the reviewing firm must be knowledgeable about current SEC practice.

.41 The CPA firm conducting the review is independent of the reviewed firm. For example, reciprocal reviews by firms are not permitted.

.42 As is the case with a committee-appointed review team, the reviewing firm is responsible for determining that the quality control policies and procedures provide measures reasonable for the particular firm and that they are being complied with.

Reports on Field Reviews

.43 Upon completion of the field review, the review team or the reviewing firm reports on the results of the review to the reviewed firm and provides a written short-form report indicating whether or not the firm was complying with the profession's quality control standards.

.44 The reviewed firm, at its option, submits the short-form report to the Institute to maintain the firm's participant status. A copy of the report is maintained in the files of the Institute and is available for public inspection.

.45 Failure to file a report with the Institute within a three-year period causes a firm to be dropped as a participant. Termination of a firm's participation is not publicized.

→ *The next page is 6341.* ←

QC Section 110

*Scope of the Quality Control Document Review**

.01 The quality control document review is a service whereby a CPA firm may send a description of its quality control system (a quality control document) to the Institute for review and comment. This service is one of the consulting reviews provided under the Institute's voluntary quality control review program for CPA firms. The fee charged for this service is $150 for an initial review of a firm's document. If a firm submits a revised version of its reviewed document, the fee charged will be $35 per hour for the additional review.

.02 The review involves a comparison of the document to the policies and procedures presented in *A Guide to Implement the Voluntary Quality Control Review Program for CPA Firms—Quality Control Policies and Procedures for Participating CPA Firms* and is performed by staff of the Institute's quality control review division. The review does not involve a visit to a firm's offices. Accordingly, the review is limited to the description of the firm's accounting and auditing quality control policies and procedures as set forth in the document submitted to the Institute.

.03 This review does not constitute a quality control compliance review or a preliminary quality control procedures review pursuant to the program. In addition, the review is not intended to provide any assurance with regard to the manner in which the firm performs professional services, either in general, or with respect to any specific engagement.

.04 Written comments regarding the document will be offered for the firm's consideration subject to its professional judgment and evaluation in making use of them. Comments expressed by staff performing the review are not official opinions of the Institute or any of its committees. Such comments are the views of the individuals who offer them.

.05 The program stipulates that consulting reviews are conducted on a confidential basis. Accordingly, neither the Institute nor the reviewed firm will disclose that the review has taken place.

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* Issued by the Quality Control Standards Committee, February, 1978.

NOTICE TO READERS

The Special Committee on Proposed Standards for Quality Control Policies and Procedures developed this section to provide guidance in the establishment of quality control policies and procedures by a CPA firm intending to participate in the Voluntary Quality Control Review Program for CPA Firms.

This guide neither interprets nor otherwise modifies Statement on Auditing Standards No. 4, *Quality Control Considerations for a Firm of Independent Auditors*. Practices relating to quality control matters are evolving, and, consequently, the manner in which this guide is applied in practice may be considered in the future to determine whether any guidance concerning the existing authoritative literature is appropriate.

The special committee believes that this guide should be reviewed from time to time by the AICPA to determine whether the material requires modification, update, or amendment in the light of future developments in practice.

Special Committee on Proposed Standards for Quality Control Policies and Procedures

ROBERT W. BURMESTER, *Chairman*
ROBERT S. CAMPBELL
PAUL B. CLARK, JR.
GEORGE J. FREY
JAMES I. KONKEL
ANTHONY P. MANFORTE
NORMAN S. RACHLIN
JOHN L. RICKETTS
JOHN P. SHEA

AICPA Staff:
WILLIAM C. BRUSCHI, *Vice President Review and Regulation*
TED M. FELIX, *Manager Quality Control Review*

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QC Section 200

Quality Control Policies and Procedures for Participating CPA Firms

Introduction

.01 The purpose of this section is to provide guidance for establishment of quality control policies and procedures for CPA firms participating in the Voluntary Quality Control Review Program for CPA Firms (the "program"). This section is not intended to be applicable to CPA firms not participating in the program. As used in this section, the term *participating firm* encompasses those firms that are preparing for involvement in the program as well as participants. A firm is identified as a participant in the program only upon completion of its compliance review and filing with the Institute an acceptable report on that review. The program requires that "in developing its quality control policies and procedures, a firm must be guided by Statement on Auditing Standards No. 4 [AU section 160], *Quality Control Considerations for a Firm of Independent Auditors*." The elements of quality control are identified in SAS No. 4 [AU section 160] and are discussed in this section under the following headings:

1. Independence
2. Assigning Personnel to Engagements
3. Consultation
4. Supervision
5. Hiring
6. Professional Development
7. Advancement
8. Acceptance and Continuance of Clients
9. Inspection

When a firm is participating in the program, the elements of quality control are applicable to segments of its practice wherein the firm is associated with financial statements, including unaudited financial statements. While the elements of quality control and related policies and procedures discussed in this guide may have some significance for other segments of a participating firm's practice, such as providing tax services or management advisory services, other than when associated with financial statements, their relationship to those other segments is not covered by this section.

.02 As used in this section, the term *policies* refers to a participating firm's objectives and goals for effecting the elements of quality control. *Procedures* refer to the steps to be taken to accomplish the policies adopted. Unless the text states otherwise, *personnel* encompasses all the professionals associated with the participating firm's accounting and auditing practice and includes partners, principals, and stockholders or officers of professional corporations.

.03 The purpose of a firm's considering the elements of quality control and adopting quality control policies and procedures is to provide reasonable assurance that it is conforming with generally accepted auditing standards. Participating firms should provide documentation or other evidential matter that will facilitate a subsequent compliance review. The concept of reasonable assurance recognizes that economic considerations affect the conduct of a firm's practice. Therefore, the extent to which quality control policies and procedures are adopted and placed in effect may be influenced by appropriate cost/benefit considerations.

.04 The underlying philosophy and organizational structure of a participating firm provide the framework for its quality control policies and procedures. The extent to which a participating firm should adopt these policies and procedures, and those which are appropriate for a particular firm, depend on a number of factors, such as its size, the degree of operating autonomy appropriately allowed to its people and its practice offices, the nature of its practice, and its administrative controls. Accordingly, it is expected that policies and procedures adopted, and documentation thereof, would normally be more extensive for a larger or multi-office firm than for a smaller or single-office firm.

.05 Each element of quality control is discussed in this guide in a separate section, consisting of an introduction and policies and procedures. It should be recognized, however, that the practice of a firm does not permit clear-cut distinctions among these elements, which ordinarily overlap and are interrelated.

.06 A participating firm should consider establishing policies in the areas identified by numbers under each element of quality control discussed herein to the extent such policies are applicable to its practice. Illustrative examples of procedures designed to implement the policies adopted are also presented. The specific procedures used by a participating firm would not necessarily include all those illustrated or be limited to them.

.07 Since a firm's policies and procedures may require modification in the light of changing conditions, they should be reviewed on a continuing basis and revised when necessary.

.08 Some regulatory agencies have promulgated requirements for compliance with independence or other standards that are applicable to professionals practicing before them. Therefore, a firm should adopt policies and procedures to provide reasonable assurance of compliance with the requirements of regulatory agencies before which it practices.

.09 It is the responsibility of a U. S. firm to establish controls to assure that segments of its engagements performed outside the United States are performed in accordance with U.S. generally accepted auditing standards. While the elements of quality control are applicable to such international practice, local customs and conditions may result in variations in their application. However, it is not intended that the program require that the quality control policies and procedures of a U.S. firm be adopted by its international affiliates. The quality control objectives of a U.S. firm are met when its policies and procedures provide reasonable assurance that portions of its engagements performed outside the United States conform to U.S. standards.

.10 When firms merge or when a firm acquires a practice, the combined firm should give special attention to quality control considerations. The combined firm's quality control policies and procedures should be evaluated to determine that they continue to be applicable in light of the changed circumstances. The firm's quality control policies and procedures, revised to the extent necessary, should be monitored for effectiveness. Similar attention should be given to quality control considerations when a firm is divided.

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.11 On October 23, 1976, Council adopted the Voluntary Quality Control Review Program for CPA Firms. The program requires that a participating firm have documented quality control policies and procedures. A firm participating in the program agrees to undergo periodic compliance reviews to obtain assurance that its quality control policies and procedures conform to professional standards, are adequately documented, and are being complied with. In connection therewith, a participating firm may meet the requirement for documented quality control policies and procedures by preparing either of the following:

1. A quality control document that provides a detailed description of its quality control policies and procedures.
2. A summary statement of its quality control policies and procedures with references to supporting information contained in manuals, memoranda, or other technical literature of the firm.

A quality control document, in addition to discussing the participating firm's quality control policies and procedures, may also contain a description of the firm's organization (including an organization chart), its philosophy of practice, and other descriptive material relating to the firm's operations and the nine elements of quality control.

Independence

.12 The second general standard of generally accepted auditing standards indicates that "in all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors." The *Code of Professional Ethics* of the American Institute of CPAs[1] states that "The public expects a number of character traits in a certified public accountant, but primarily integrity and objectivity and, in the practice of public accounting, independence. . . . Independence has traditionally been defined by the profession as the ability to act with integrity and objectivity."

.13 A participating firm should establish policies and procedures for maintaining independence to provide reasonable assurance that personnel[2] at all organizational levels maintain independence in fact and in appearance where such independence is required by applicable professional standards.[3]

Policies and Procedures

.14 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a

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[1] Some regulatory agencies, including the Securities and Exchange Commission and the United States General Accounting Office, have promulgated rules or regulations regarding independence of accountants practicing before them. Rule 2-01 of the Commission's Regulation S-X, "Qualifications of Accountants," addresses itself in part to the subject of independence: "The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent." Paragraphs (b) and (c) of this rule provide guidance as to its application. Further guidance and examples of situations involving independence are provided by the commission in accounting series releases. The General Accounting Office publication, *Standards for Audit of Governmental Organizations, Programs, Activities & Functions,* treats the subject of independence in chapter 3.

[2] For the purposes of this section on independence, the term *personnel* encompasses all professional persons of the participating firm and is not limited to those in the accounting and auditing practice area.

[3] In instances where a firm is associated with financial statements, and the firm is not independent, see SAS No. 1, section 517 [AU section 517], for reporting requirements.

firm would not necessarily include all the examples or be limited to those illustrated.

1. **Require that personnel at all organizational levels adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, state CPA society, state board of accountancy, state statute, and, if applicable, the Securities and Exchange Commission and other regulatory agencies.[4]**

   a. Designate an individual or group to provide guidance and to resolve questions on independence matters.
      (i) Identify circumstances where documentation as to the resolution of questions would be appropriate.
      (ii) Require consultation with authoritative sources when considered necessary.

2. **Communicate policies and procedures relating to independence to personnel at all organizational levels.**

   a. Inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with these policies and procedures.
   b. Emphasize independence of mental attitude in training programs and in supervision and review of engagements.
   c. Apprise personnel on a timely basis of those entities to which independence policies apply.
      (i) Prepare and maintain for independence purposes a list of the firm's clients and of other entities (client's affiliates, parents, associates, and so forth) to which independence policies apply.
      (ii) Make the list available to personnel (including personnel new to the firm or to an office) who need it to determine their independence.
      (iii) Establish procedures to notify personnel of changes in the list.
   d. Maintain a library or other facility containing professional, regulatory, and firm literature relating to independence matters.

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[4] In some cases, a firm may wish to establish other requirements that it deems appropriate, for example, concerning prohibited transactions or relationships.

3. **Confirm, when acting as principal auditor, the independence of another firm engaged to perform segments of an engagement.**[5]
   a. Inform personnel as to the form and content of an independence representation that is to be obtained from a firm that has been engaged to perform segments of an engagement.
   b. Advise personnel as to the frequency with which a representation should be obtained from an affiliate or associate firm for a repeat engagement.
4. **Monitor compliance with policies and procedures relating to independence.**
   a. Obtain from personnel periodic, written representations, normally on an annual basis, stating that—
      (i) They are familiar with the firm's independence policies and procedures.
      (ii) Prohibited investments are not held and were not held during the period. As an alternative or additional procedure, a firm may obtain listings of investments and securities transactions (numbers of shares or dollar amounts need not be included) from personnel to determine that there are no prohibited holdings.
      (iii) Prohibited relationships do not exist, and transactions prohibited by firm policy have not occurred.
   b. Assign responsibility for resolving exceptions to a person or group with appropriate authority.
   c. Assign responsibility for obtaining representations and reviewing independence compliance files for completeness to a person or group with appropriate authority.
   d. Review periodically accounts receivable from clients to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

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[5] If a firm utilizes the services of a related, affiliated, or associated firm, the principal firm may obtain periodically (frequently annually) a representation from the other firm covering all referred engagements, or may include the representation as part of a continuing agreement.

If a firm other than an affiliate or associate is retained, representation should be received for each engagement.

In the case of an international engagement, the representation from the foreign firm should make reference to U. S. independence standards.

Assigning Personnel to Engagements

.15 Guidance in assigning personnel is found in the first general standard of generally accepted auditing standards which states that "the examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor." A participating firm should establish policies and procedures for assigning personnel to engagements to provide reasonable assurance that engagements will be performed by persons having the degree of technical training and proficiency required in the circumstances.

Policies and Procedures

.16 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Delineate the firm's approach to assigning personnel, including the planning of overall firm and office needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.**
   a. Plan the personnel needs of the firm on an overall basis and for individual practice offices.
   b. Identify on a timely basis the staffing requirements of specific engagements.
   c. Prepare time budgets for engagements to determine manpower requirements and to schedule field work.
   d. Consider the following factors in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:
      (i) Engagement size and complexity.
      (ii) Personnel availability.
      (iii) Special expertise required.
      (iv) Timing of the work to be performed.
      (v) Continuity and periodic rotation of personnel.
      (vi) Opportunities for on-the-job training.

2. **Designate an appropriate person or persons to be responsible for assigning personnel to engagements.**
   a. Consider the following in making assignments of individuals:
      (i) Staffing and timing requirements of the specific engagement.

(ii) Evaluations of the qualifications of personnel as to experience, position, background, and special expertise.
(iii) The planned supervision and involvement by supervisory personnel.
(iv) Projected time availability of individuals assigned.
(v) Situations where possible independence problems and conflicts of interest may exist, such as assignment of personnel to engagements for clients who are former employers or are employers of certain kin.

b. Give appropriate consideration, in assigning personnel, to both continuity and rotation to provide for efficient conduct of the engagement and the perspective of other personnel with different experience and backgrounds.

3. Provide for approval of the scheduling and staffing of the engagement by the person with final responsibility for the engagement.

a. Submit, where necessary, for review and approval the names and qualifications of personnel to be assigned to an engagement.

b. Consider the experience and training of the engagement personnel in relation to the complexity or other requirements of the engagement, and the extent of supervision to be provided.

Consultation

.17 A participating firm should establish policies and procedures for consultation to provide reasonable assurance that personnel will seek assistance on accounting and auditing questions, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority.

Policies and Procedures

.18 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Identify areas and specialized situations where consultation is required and encourage personnel to consult with or use authoritative sources on other complex or unusual matters.

a. Inform personnel of the firm's consultation policies and procedures.

b. Specify areas or specialized situations requiring consultation because of the nature or complexity of the subject matter. Examples include—
   (i) Application of newly issued technical pronouncements.
   (ii) Industries with special accounting, auditing, or reporting requirements.
   (iii) Emerging practice problems.
   (iv) Choices among alternative generally accepted accounting principles when an accounting change is to be made.
   (v) Filing requirements of regulatory agencies.

c. Maintain or provide access to adequate reference libraries and other authoritative sources.
   (i) Establish responsibility for maintaining a reference library in each practice office.
   (ii) Maintain technical manuals and issue technical pronouncements, including those relating to particular industries and other specialties.
   (iii) Maintain consultation arrangements with other firms and individuals where necessary to supplement firm resources.
   (iv) Refer problems to a division or group in the AICPA or state CPA society established to deal with technical inquiries.

d. Maintain a research function to assist personnel with practice problems.

2. **Designate individuals as specialists to serve as authoritative sources and define their authority in consultative situations. Provide procedures for resolving differences of opinion between engagement personnel and specialists.**

   a. Designate individuals as specialists for filings with the Securities and Exchange Commission and other regulatory agencies.

   b. Designate specialists for particular industries.

   c. Advise personnel of the degree of authority to be accorded specialists' opinions and of the procedures to be followed for resolving differences of opinion with specialists.

   d. Require documentation as to the considerations involved in the resolution of differences of opinion.

3. **Specify the extent of documentation to be provided for the results of consultation in those areas and specialized situations where consultation is required. Specify documentation, as appropriate, for other consultations.**

a. Advise personnel as to the extent of documentation to be prepared and the responsibility for its preparation.
b. Indicate where consultation documentation is to be maintained.
c. Maintain subject files containing the results of consultations for reference and research purposes.

Supervision

.19 The first standard of field work of generally accepted auditing standards states that the work is to be adequately planned and assistants, if any, are to be properly supervised. A participating firm should establish policies and procedures for the conduct and supervision of work at all organizational levels to provide reasonable assurance that the work performed meets the firm's standards of quality.

.20 Procedures for supervision are necessary to provide reasonable assurance that appropriate judgments and conclusions can be drawn with respect to the work performed. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of persons performing the work, and the extent of consultation available and used. Additional factors bearing upon the appropriate extent of supervision and review include the degree of authority delegated to assistants on an engagement, performance of personnel assigned to an engagement, and risk factors inherent in the engagement.

Policies and Procedures

.21 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Provide procedures for planning engagements.**
   a. Assign responsibility for planning an engagement. Involve appropriate personnel assigned to the engagement in the planning process.
   b. Develop background information or review information obtained from prior engagements and update for changed circumstances.

c. Describe matters to be included in the engagement planning process, such as the following:
   (i) Development of proposed work programs.
   (ii) Determination of manpower requirements and need for specialized knowledge.
   (iii) Development of estimates of time required to complete the engagement.
   (iv) Consideration of current economic conditions affecting the client or its industry and their potential impact on the conduct of the engagement.

2. **Provide procedures for maintaining the firm's standards of quality for the work performed.**
   a. Provide adequate supervision at all organizational levels, considering the training, ability, and experience of the personnel assigned.
   b. Develop guidelines for the form and content of working papers.
   c. Utilize standardized forms, checklists, and questionnaires to the extent appropriate to assist in the performance of engagements.
   d. Provide procedures for resolving differences of professional judgment among members of an engagement team.

3. **Provide procedures for reviewing engagement working papers and reports.**
   a. Develop guidelines for review of working papers and for documentation of the review process.
      (i) Require that reviewers have appropriate competence and responsibility.
      (ii) Determine that work performed is complete and conforms to professional standards and firm policy.
      (iii) Describe documentation evidencing review of working papers and the reviewer's findings. Documentation may include initialing working papers, completing a reviewer's questionnaire, preparing a reviewer's memorandum, and employing standard forms or checklists.
   b. Develop guidelines for review of the report to be issued for an engagement. Considerations in "a" above would be applicable to this review. In addition, the following matters should be considered for these guidelines:
      (i) Determine that the evidence of work performed and conclusions contained in the working papers support the report.
      (ii) Determine that the report conforms to professional standards and firm policy.

(iii) Provide for review of the report by an appropriate individual having no other responsibility for the engagement.

Hiring

.22 A firm's personnel may well be its most valuable asset. Although the hiring of personnel may be considered partly an administrative function, a firm's policies and procedures with respect to hiring affect the quality of its work. A participating firm should establish policies and procedures for hiring to provide reasonable assurance that those persons employed possess the appropriate characteristics to enable them to perform competently.

Policies and Procedures

.23 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Maintain a program designed to obtain qualified personnel by planning for personnel needs, establishing hiring objectives, and setting qualifications for those involved in the hiring function.**
   a. Plan for the firm's personnel needs at all levels and establish quantified hiring objectives based on current clientele, anticipated growth, personnel turnover, individual advancement, and retirement.
   b. Design a program to achieve hiring objectives which provides for—
      (i) Identification of sources of potential hirees.
      (ii) Methods of contact with potential hirees.
      (iii) Methods of specific identification of potential hirees.
      (iv) Methods of attracting potential hirees and informing them about the firm.
      (v) Methods of evaluating and selecting potential hirees for extension of employment offers.
   c. Inform those persons involved in hiring as to the firm's personnel needs and hiring objectives.
   d. Assign to authorized persons the responsibility for employment decisions.

e. Monitor the effectiveness of the recruiting program.
   (i) Evaluate the recruiting program periodically to determine whether policies and procedures for obtaining qualified personnel are being observed.
   (ii) Review hiring results periodically to determine whether goals and personnel needs are being achieved.

2. **Establish qualifications and guidelines for evaluating potential hirees at each professional level.**

   a. Identify the attributes to be sought in hirees, such as intelligence, integrity, honesty, motivation, and aptitude for the profession.

   b. Identify achievements and experiences desirable for entry-level and experienced personnel. For example,
      (i) Academic background.
      (ii) Personal achievements.
      (iii) Work experience.
      (iv) Personal interests.

   c. Set guidelines to be followed when hiring individuals in atypical situations such as—
      (i) Hiring relatives of personnel or relatives of clients.
      (ii) Rehiring former employees.
      (iii) Hiring client employees.

   d. Obtain background information and documentation of qualifications of applicants by appropriate means, such as—
      (i) Resumes.
      (ii) Application forms.
      (iii) Interviews.
      (iv) College transcripts.
      (v) Personal references.
      (vi) Former employment references.

   e. Evaluate the qualifications of new personnel, including those obtained from other than the usual hiring channels (for example, those joining the firm at supervisory levels or through merger or acquisition), to determine that they meet the firm's requirements and standards.

3. **Inform applicants and new personnel of the firm's policies and procedures relevant to them.**

   a. Use a brochure or another means to so inform applicants and new personnel.

   b. Prepare and maintain a manual describing policies and procedures for distribution to personnel.

   c. Conduct an orientation program for new personnel.

Professional Development

.24 The concept of professional development embodies recognition of the continuing obligation of personnel to maintain their competence during their professional careers. A participating firm should establish policies and procedures for professional development to provide reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Professional development activities enable a firm to provide personnel with the means to acquire the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.

Policies and Procedures

.25 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Establish guidelines and requirements for the firm's professional development program and communicate them to personnel.**
   a. Assign responsibility for the professional development function to a person or group with appropriate authority.
   b. Provide that programs developed by the firm be reviewed by qualified individuals. Programs should contain statements of objectives and education and/or experience prerequisites.
   c. Provide an orientation program relating to the firm and the profession for newly employed personnel.
      (i) Prepare publications and programs designed to inform newly employed personnel of their professional responsibilities and opportunities.
      (ii) Designate responsibility for conducting orientation conferences to explain professional responsibilities and firm policies.
      (iii) Enable newly employed personnel with limited experience to attend the AICPA or other comparable level staff training programs.
   d. Establish continuing professional education requirements for personnel at each level within the firm.
      (i) Consider state mandatory requirements or voluntary guidelines in establishing firm requirements.
      (ii) Encourage participation in external continuing profes-

sional education programs, including college-level and self-study courses.

(iii) Encourage membership in professional organizations. Consider having the firm pay or contribute toward membership dues and expenses.

(iv) Encourage personnel to serve on professional committees, prepare articles, and participate in other professional activities.

e. Monitor continuing professional education programs and maintain appropriate records, both on a firm and an individual basis.

(i) Review periodically the records of participation by personnel to determine compliance with firm requirements.

(ii) Review periodically evaluation reports and other records prepared for continuing education programs to evaluate whether the programs are being presented effectively and are accomplishing firm objectives. Consider the need for new programs and for revision or elimination of ineffective programs.

2. **Make available to personnel information about current developments in professional technical standards and materials containing the firm's technical policies and procedures and encourage personnel to engage in self-development activities.**

a. Provide personnel with professional literature relating to current developments in professional technical standards.

(i) Distribute to personnel material of general interest, such as pronouncements of the Financial Accounting Standards Board and the AICPA Auditing Standards Executive Committee.

(ii) Distribute pronouncements in areas of specific interest, such as those issued by the Securities and Exchange Commission, Internal Revenue Service, and other regulatory agencies to persons who have responsibility in such areas.

(iii) Distribute manuals containing firm policies and procedures on technical matters to personnel. Manuals should be updated for new developments and changing conditions.

b. For training programs presented by the firm, develop or obtain course materials and select and train instructors.

(i) State the program objectives and education and/or experience prerequisites in the training programs.

(ii) Provide that program instructors be qualified as to both program content and teaching methods.

(iii) Have participants evaluate program content and instructors of training sessions.

(iv) Have instructors evaluate program content and participants in training sessions.

(v) Update programs as needed in light of new developments, changing conditions, and evaluation reports.

3. **Provide, to the extent necessary, programs to fill the firm's needs for personnel with expertise in specialized areas and industries.**
   a. Conduct firm programs to develop and maintain expertise in specialized areas and industries, such as regulated industries, computer auditing, and statistical sampling methods.
   b. Encourage attendance at external education programs, meetings, and conferences to acquire technical or industry expertise.
   c. Encourage membership and participation in organizations concerned with specialized areas and industries.
   d. Provide technical literature relating to specialized areas and industries.

4. **Provide for on-the-job training during the performance of engagements.**
   a. Emphasize the importance of on-the-job training as a significant part of an individual's development.
      (i) Discuss with assistants the relationship of the work they are performing to the engagement as a whole.
      (ii) Involve assistants in as many portions of the engagement as practicable.
   b. Emphasize the significance of personnel management skills and include coverage of these subjects in firm training programs.
   c. Encourage personnel to train and develop subordinates.
   d. Monitor assignments to determine that personnel—
      (i) Fulfill, where applicable, the experience requirements of the state board of accountancy.
      (ii) Gain experience in various areas of engagements and varied industries.
      (iii) Work under different supervisory personnel.

Advancement

.26 Advancement is the progression of personnel to positions of greater responsibility within a firm. A participating firm should establish policies and procedures to provide reasonable assurance that personnel selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called upon to assume.

Policies and Procedures

.27 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Establish qualifications deemed necessary for the various levels of responsibility within the firm.**
   a. Prepare guidelines describing responsibilities at each level and expected performance and qualifications necessary for advancement to each level, including—
      (i) Titles and related responsibilities.
      (ii) The amount of experience (which may be expressed as a time period) generally required for advancement to the succeeding level.
   b. Identify criteria which will be considered in evaluating individual performance and expected proficiency, such as—
      (i) Technical knowledge.
      (ii) Analytical and judgmental abilities.
      (iii) Communicative skills.
      (iv) Leadership and training skills.
      (v) Client relations.
      (vi) Personal attitude and professional bearing (character, intelligence, judgment, and motivation).
      (vii) Possession of a CPA certificate for advancement to a supervisory position.
   c. Use a personnel manual or other means to communicate advancement policies and procedures to personnel.
2. **Evaluate performance of personnel and periodically advise personnel of their progress. Maintain personnel files containing documentation relating to the evaluation process.**
   a. Gather and evaluate information on performance of personnel.
      (i) Identify evaluation responsibilities and requirements at each level indicating who will prepare evaluations and when they will be prepared.
      (ii) Instruct personnel on the objectives of personnel evaluation.

(iii) Utilize forms, which may be standardized, for evaluating performance of personnel.
(iv) Review evaluations with the individual being evaluated.
(v) Require that evaluations be reviewed by the evaluator's superior.
(vi) Review evaluations to determine that individuals worked for and were evaluated by different persons.
(vii) Determine that evaluations are completed on a timely basis.

b. Periodically counsel personnel as to their progress and career opportunities.

(i) Review periodically with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include the following:
(a) Performance.
(b) Future objectives of the firm and the individual.
(c) Assignment preferences.
(d) Career opportunities.
(ii) Evaluate partners periodically by means of counseling, peer evaluation, or self appraisal, as appropriate, as to whether they continue to have the qualifications to fulfill their responsibilities.
(iii) Review periodically the system of personnel evaluation and counseling to ascertain that—
(a) Procedures for evaluation and documentation are being followed on a timely basis.
(b) Requirements established for advancement are being achieved.
(c) Personnel decisions are consistent with evaluations.
(d) Recognition is given to outstanding performance.

3. **Assign responsibility for making advancement decisions.**
a. Assign responsibility to designated persons for making advancement and termination decisions, conducting evaluation interviews with persons considered for advancement, documenting the results of the interviews, and maintaining appropriate records.
b. Evaluate data obtained giving appropriate recognition in advancement decisions to the quality of the work performed.
c. Study the firm's advancement experience periodically to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility.

Acceptance and Continuance of Clients

.28 A participating firm should establish policies and procedures for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. The firm does not vouch for the integrity or reliability of a client, nor does it have a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, the firm should consider that the reputation of a client's management could reflect on the reliability of representations and accounting records and on the firm's own reputation. In making decisions to accept or continue a client, a firm should also consider its own independence and its ability to service a client properly with particular reference to industry expertise, size of engagement, and manpower available to staff the engagement.

Policies and Procedures

.29 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Establish procedures for evaluation of prospective clients and for their approval as clients.**
   a. Consider evaluation procedures such as the following before accepting a client:
      (i) Obtain and review available financial information regarding the prospective client, such as annual reports, interim financial statements, registration statements, Forms 10-K, other reports to regulatory agencies, and income tax returns.
      (ii) Inquire of third parties as to any information regarding the prospective client and its management and principals which may have a bearing on evaluating the prospective client. Inquiries may be directed to the prospective client's bankers, legal counsel, investment banker, underwriter, and others in the financial or business community who may have such knowledge. Credit reports may also be useful.
      (iii) Communicate with the predecessor auditor as required by auditing standards. Inquiries should include questions regarding facts that might bear on the integrity of man-

agement, on disagreements with management as to accounting principles, auditing procedures, or other similarly significant matters, and on the predecessor's understanding as to the reasons for the change of auditors.

(iv) Consider circumstances which would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.

(v) Evaluate the firm's independence and ability to service the prospective client. In evaluating the firm's ability, consider needs for technical skills, knowledge of the industry, and personnel.

(vi) Determine that acceptance of the client would not violate applicable regulatory agency requirements and the codes of professional ethics of the AICPA or a state CPA society.

b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained regarding the prospective client and to make the acceptance decision.

(i) Consider types of engagements that the firm would not accept or which would be accepted only under certain conditions.

(ii) Provide for documentation of the conclusion reached.

c. Inform appropriate personnel of the firm's policies and procedures for accepting clients.

d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for acceptance of clients.

2. Evaluate clients at the end of specific periods or upon the occurrence of specified events to determine whether the relationships should be continued.

a. Specify conditions which require evaluation of a client to determine whether the relationship should be continued. Conditions could include—

(i) The expiration of a time period.

(ii) A significant change since the last evaluation, including a major change in one or more of the following:

(a) Management.
(b) Directors.
(c) Ownership.
(d) Legal counsel.
(e) Financial condition.
(f) Litigation status.
(g) Nature of the client's business.
(h) Scope of the engagement.

(iii) The existence of conditions which would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.

b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained and to make continuance decisions.
   (i) Consider types of engagements that the firm would not continue or which would be continued only under certain conditions.
   (ii) Provide for documentation of the conclusion reached.

c. Inform appropriate personnel of the firm's policies and procedures for continuing clients.

d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for continuance of clients.

Inspection

.30 A participating firm should establish policies and procedures for inspection to provide reasonable assurance that the other procedures designed to maintain the quality of the firm's accounting and auditing practice are being effectively applied. A firm's inspection policies and procedures should be related to the nature and extent of controls and monitoring procedures established for the other elements of quality control. While the inspection function is normally performed by the firm's personnel, procedures for inspection may be developed and performed by persons other than the firm's personnel acting on behalf of the firm's management.

Policies and Procedures

.31 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Define the scope and content of the firm's inspection program.**
   a. Determine the inspection procedures necessary to provide reasonable assurance that the firm's other quality control policies and procedures are operating effectively.
      (i) Determine objectives and prepare instructions and review programs for use in conducting inspection activities.

(ii) Provide guidelines for the extent of work at practice units, functions, or departments, and criteria for selection of engagements for review.

(iii) Establish the frequency and timing of inspection activities.

(iv) Establish procedures to resolve disagreements which may arise between reviewers and engagement or management personnel.

b. Establish qualifications for personnel to participate in inspection activities and the method of their selection.

(i) Determine criteria for selecting reviewers, including levels of responsibility in the firm and requirements for specialized knowledge.

(ii) Assign responsibility for selecting inspection personnel.

c. Conduct inspection activities at practice units, functions, or departments.

(i) Review and test compliance with applicable quality control policies and procedures.

(ii) Review selected engagements for compliance with professional standards, including generally accepted auditing standards, generally accepted accounting principles, and with the firm's quality control policies and procedures.

2. **Provide for reporting inspection findings to the appropriate management levels and for monitoring actions taken or planned.**

a. Discuss inspection review findings on engagements reviewed with engagement management personnel.

b. Discuss inspection findings of practice units, functions, or departments reviewed with appropriate management personnel.

c. Report inspection findings and recommendations to firm management together with corrective actions taken or planned.

d. Determine that planned corrective actions were taken.

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NOTICE TO READERS

The Special Committee on Proposed Standards for Quality Control Policies and Procedures developed this section to provide guidance for performing and reporting on quality control compliance reviews under the Voluntary Quality Control Review Program for CPA Firms.

This guide is the second issued by the special committee in implementing the Voluntary Review Program. The first, entitled *Quality Control Policies and Procedures for Participating CPA Firms,* provides guidance in the establishment of quality control policies and procedures by a CPA firm intending to participate in the Voluntary Review Program.

A CPA firm intending to participate in the Voluntary Review Program should consider the objectives of the compliance review as stated in the guide and the nature and extent of procedures that would be performed by a review team conducting a compliance review. The guide also provides guidance on reporting considerations and contains a model form of report acceptable for participation in the Voluntary Review Program.

The special committee believes that this guide should be reviewed from time to time by the AICPA to determine whether the material requires modification, update, or amendment in the light of future developments in practice.

Special Committee on Proposed Standards for Quality Control Policies and Procedures

Robert W. Burmester, *Chairman*
Robert S. Campbell
Paul B. Clark, Jr.
George J. Frey
James I. Konkel
Norman S. Rachlin
John L. Ricketts
John P. Shea

AICPA Staff:
William C. Bruschi, *Vice President Review and Regulation*
Ted M. Felix, *Manager Quality Control Review*

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QC Section 300

Performing and Reporting on Quality Control Compliance Reviews

Introduction

.01 The purpose of this guide is to provide guidance for performing and reporting on quality control compliance reviews in connection with the AICPA Voluntary Quality Control Review Program for CPA Firms (the "program").[1] It should be read in conjunction with other guidance material issued to implement the program.

.02 In order to participate in the program, a CPA firm must undergo a quality control compliance review performed in accordance with the guidelines set forth herein and file an acceptable report (as discussed elsewhere herein) thereon with the AICPA. To continue as a participant, a CPA firm must undergo a compliance review at least once every three years and file an acceptable report thereon with the AICPA.

.03 The purpose of a firm's considering the elements of quality control and adopting quality control policies and procedures for its accounting and auditing practice is to provide the firm with reasonable assurance of conforming with standards of the profession in the conduct of its accounting and auditing practice.[2] For participating firms, an additional purpose is to provide documentation or other evidential matter that will facilitate a subsequent compliance review.[3]

.04 The quality control policies and procedures adopted by a participating firm will depend in part upon the firm's organizational structure, including factors such as its size, the degree of operating autonomy appropriately allowed to its personnel and its practice offices, the nature of its practice, and its administrative controls.

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[1] The terms *compliance reviews* and *field reviews,* as they are used in the program are synonymous and are used interchangeably in this section.

[2] Accounting and auditing practice, as referred to in this section, encompasses all accounting and auditing services for which standards have been established for the profession including accounting services resulting in association of the firm's name with unaudited financial statements.

[3] As used in this section, the term *participating firm* encompasses participants as well as those firms that are preparing for involvement in the program. A firm is identified as a participant in the program only upon completion of its compliance review and filing with the Institute an acceptable report on that review.

.05 A participating firm is required to make available to the review team the documented quality control policies and procedures incorporated in its quality control system.[4] This requirement is met by furnishing one of the following to the review team:

1. A quality control document that provides a detailed description of the firm's quality control policies and procedures.
2. A summary statement of the firm's quality control policies and procedures with references to supporting information contained in manuals, memorandums, or other literature of the firm.

A quality control document or summary, in addition to discussing the firm's quality control policies and procedures, may also contain a description of the firm's organization (including an organization chart), a discussion of its philosophy of practice, and other descriptive material relating to the elements of quality control and the firm's operations.

.06 The guidance included herein is applicable to reviewing entities ("review teams") and to individual reviewers ("review team members") who perform or are involved in performing quality control compliance reviews and who report on such reviews under the program.

Performing Quality Control Compliance Reviews

Objectives of the Compliance Review

.07 Compliance reviews are intended to evaluate whether a reviewed firm's system of quality control for its accounting and auditing practice is appropriately comprehensive and suitably designed for the reviewed firm and whether its quality control policies and procedures are adequately documented, communicated to professional personnel, and are being complied with to provide the firm with reasonable assurance of conforming with the standards of the pro-

[4] The system of quality control maintained by a CPA firm encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of conforming with the standards of the profession in the conduct of the firm's accounting and auditing practice.

fession for firms that are participating in the program.[5]

.08 It is intended that this evaluation be accomplished by—

1. Study and evaluation of a reviewed firm's quality control system.
2. Review for compliance with a reviewed firm's quality control policies and procedures by—
   - Review at each organizational or functional level within the firm.
   - Review of selected engagement working paper files and reports.

.09 Upon completion of a compliance review, the review team communicates its findings to the reviewed firm and prepares a written report in accordance with the guidelines for reporting on quality control compliance reviews.

General Considerations

.10 *Confidentiality.* The compliance review is to be conducted with due regard for requirements of confidentiality of the rules of conduct of the code of professional ethics of the AICPA. Information obtained as a consequence of the review concerning the reviewed firm or any of its clients is confidential and should not be disclosed by review team members to anyone not associated with the review. It is the responsibility of the reviewed firm to take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality. Rule 301 of the AICPA's code of professional ethics contains an exception to the confidentiality requirements so that review of a member's professional practices as part of a voluntary quality review under AICPA authorization is not prohibited. Some state statutes or ethics rules promulgated by state boards of accountancy may, however, not clearly provide a similar exception regarding client confidentiality.[6] Accordingly, a reviewed firm may wish to

[5] As used in this context, *documentation* refers both to the reviewed firm's documented quality control policies and procedures as well as to supporting materials presented to the review team as evidence of compliance with those policies and procedures.

As used in this section, *compliance* means adherence to prescribed policies or procedures in the substantial majority of situations; it does not imply adherence to prescribed policies or procedures in every case.

[6] The AICPA maintains a current listing of states that do not clearly provide an exception to the confidentiality requirements discussed in this section. Such information may be obtained upon request.

consult its legal counsel to determine whether any action is required to permit client engagement files to be made available to the review team.

.11 *Independence.* Independence with respect to the reviewed firm must be maintained by the reviewing firm by review team members, and by their consultants. The AICPA's code of professional ethics does not specifically consider relationships between reviewers, reviewed firms, and clients of reviewed firms. However, the concepts pertaining to independence embodied in the code should be considered for their application.

Reciprocal reviews are not permitted. This prohibition is applicable to a reviewing firm and, for a review conducted by a committee-appointed review team, to the firm with which the review team captain or members of an executive or supervisory committee are associated.

Reviewing firms should consider any family or other relationships between the firms' senior managements at organizational and functional levels in assessing the possibility of an impairment of independence.

Some firms perform engagement correspondent work for other firms. The correspondent firms' fee may be paid by the referring firm or directly by the client. In either situation, if the fees for the correspondent work are material to either the reviewed firm or reviewing firm, independence for purposes of the program is impaired.

Some reviewers or their firms may have continuing arrangements with other firms whereby fees, office facilities, or professional staff are shared. In these situations, independence for purposes of the program is impaired.

.12 *Conflict of Interest.* A reviewing firm or a review team member should not have conflicts of interest with respect to the reviewed firm or to those of its clients that are the subject of engagements reviewed.

The personnel of a reviewing firm and the reviewing firm itself are not precluded from owning securities of clients of the reviewed firm. However, since confidential information may be obtained during the course of a review, a review team member shall not own securities of a reviewed firm's client that is the subject of an engagement reviewed by that member. In addition, the effect of family relationships (close kin, remote kin) and other relationships and the possible resulting conflict of interest must be considered when assigning team members to review individual engagements.

.13 *Competence.* Review teams must have knowledge of the type of practice to be reviewed, including expertise in specialized industries in which the reviewed firm practices. In the case of reviews of firms with SEC practices, review teams must have available reviewers for SEC engagements who are knowledgeable of current SEC rules and regulations.

In determining the composition of a review team, consideration should be given to the areas to be reviewed and the expertise required for various segments of the review.

.14 *Due Care.* Due care is to be exercised by the review team in the performance of the review and in the preparation of the report. Due care for quality control compliance reviews imposes an obligation on each review team member to fulfill assigned responsibilities in a professional manner similar to that of an independent auditor examining financial statements.

Organization of the Review Team

.15 A review team may be (1) appointed by the AICPA Quality Control Standards Committee, (2) formed by a CPA firm engaged by the firm under review, or (3) appointed by another entity which, with the approval of the Quality Control Standards Committee, administers the program for the committee, such as a state society of CPAs.[7]

.16 A review team is headed by a team captain who directs the organization and conduct of the review, supervises other reviewers, and is responsible for preparation of a report on the review. The review team captain is to be a partner currently involved in the audit function.[8] In some larger review engagements, it may be useful for the team captain to designate other partners to serve with the team captain as an executive or supervisory committee for the review and to participate in evaluating the findings of the review team. In the case

[7] On September 17, 1977, the AICPA Council resolved that the form of independent review contemplated by Council in the program can be met by reviews conducted under the auspices of associations of CPA firms so long as the reviews are conducted under criteria for such purpose developed by a special committee and approved by the AICPA Board of Directors. These criteria are set forth in the Report of the Special Committee on Criteria for CPA Firm Association Reviews, which has been approved by the Board of Directors.

[8] As used in this section, *partner* refers to an individual who is at the partner level in a CPA firm, is a partner, a sole practitioner, or is in an equivalent position with a professional corporation.

of a multioffice firm, the reviewers visiting a selected practice office are under the direction at that location of a partner currently involved in the audit function who supervises the conduct of the review and the work performed at that location (subject to the overall direction of the team captain).

.17 The work of review teams at each organizational level of the reviewed firm should be supervised by a partner.

Qualifications for Individuals to Serve as Reviewers

.18 The nature and complexity of a compliance review requires the exercise of professional judgment. Accordingly, individuals serving as reviewers shall be CPAs and shall possess current knowledge of accounting and auditing matters. A reviewer shall be currently active at a supervisory level in the accounting and auditing function with a CPA firm, for example (1) as a partner or manager with a CPA firm, (2) in an equivalent supervisory position with a professional corporation, or (3) as a sole practitioner.

.19 In situations where required by the nature of the reviewed firm's practice, a consultant to the reviewers may be used. Consultants should be individuals with expertise in specialized areas but need not be CPAs. For example, computer specialists, statistical sampling specialists, actuaries, or educators expert in professional development may participate in certain segments of the review.

Qualifications for a Reviewing Firm

.20 When a CPA firm is requested to perform a compliance review engagement, the criteria discussed below should be considered by the firm in determining its capability to perform the compliance review prior to accepting the engagement. Individuals selected by the CPA firm to participate as review team members in a review engagement should possess the requisite qualifications for reviewers or consultants.

.21 *Participating Firm.* A reviewing firm shall be a participant in the program.[9]

[9] The program provides that, since no firm can be a participating firm at the inception of the program or until the expiration of an interim period described in the program, the requirement that a reviewing firm be a participant in the program is not applicable prior to, or during the interim period. During the interim period, however, a reviewing firm shall have filed a letter of intent to participate in the program before issuing a report under the program.

.22 *Capability.* A reviewing firm must determine its capability to perform a compliance review. The reviewing firm must have available to it reviewers with appropriate levels of expertise and experience to perform the review. Prior to accepting an engagement, the reviewing firm should obtain information about the firm to be reviewed, including certain operating statistics pertaining to size and type of practice.

In determining its capability to perform the engagement, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must recognize that the performance of a compliance review may demand substantial commitments of time, especially from its supervisory accounting and auditing personnel. Therefore, a firm should consider carefully the number and availability of supervisory personnel in determining whether it is capable to perform a compliance review of another firm.

In some instances, a reviewing firm may use a correspondent firm to perform a portion of a compliance review engagement. In such cases, the principal reviewing firm must

(1) be satisfied as to the capability of the correspondent (2) assume responsibility for the work performed by the correspondent, (3) adopt appropriate measures to assure the coordination of its activities with the correspondent, and (4) make arrangements to satisfy itself as to the work performed by the correspondent. The report on the review should not make a reference to a correspondent firm's participation in the review. In order to determine its capability to perform its portion of a compliance review, a correspondent firm should also consider the requirements discussed herein prior to accepting an engagement.

The Field Review

.23 The field review should include the following:

1. A study and evaluation of the reviewed firm's quality control system.
2. Review for compliance with a reviewed firm's quality control policies and procedures by—
   - Review at each organizational or functional level within the firm.
   - Review of selected engagement working paper files and reports of the firm.
3. Preparation of a written report on the results of the review.

.24 For a multioffice firm, the review would include visits to the firm's executive office and selected regional and practice offices.

.25 Prior to commencement of the review, the parties to the review may wish to document formally the terms and conditions of the engagement.

.26 *Scope of the Review.* The scope of the review should cover a firm's accounting and auditing practice. (See footnote 2.) Other segments of a firm's practice, such as providing tax services or management advisory services, are not encompassed by the scope of the review except to the extent they are associated with financial statements (for example, reviews of tax provisions and accruals contained in financial statements are included in the scope of the review).

The review should cover a current period (generally one year) to be mutually agreed upon by the reviewed firm and the review team. It is anticipated that quality control policies and procedures may be revised, updated, or amended during the period under review to recognize changing conditions and new professional standards. The scope of the review should encompass the quality control policies and procedures in effect and compliance therewith for the period under review. Client engagements subject to selection for review would be those with years ending during the period under review unless a more recent report has been issued at the time the review team selects engagements.

The review will be directed to the professional aspects of the reviewed firm's accounting and auditing practice; it will not include business aspects of that practice. It may be difficult, however, to distinguish between these aspects of the practice since they may overlap. For example, in evaluating whether the supervision of an engagement was adequate, review team members would consider budgeted and actual time spent for the engagement by various categories or classifications of personnel but would not inquire as to fees billed to the client or the relationship of fees billed to time accumulated at usual or standard billing rates.

Further, when reviewing policies and procedures for advancement, review team members would concern themselves with whether professional personnel were promoted based on demonstrated competence and whether criteria for admission of individuals to the firm give appropriate weight to professional qualifications but would not review compensation of professional personnel.

Review team members will not have contact with, or access to, any client of the reviewed firm in connection with the review.

A reviewed firm may have legitimate reasons for not permitting the working papers for certain engagements to be reviewed. For example, the financial statements of an engagement may be the subject of litigation or investigation by a governmental authority or the firm may have been advised by a client that it will not permit the working papers for its engagement to be reviewed. The review team should satisfy itself as to the reasonableness of the explanation; if the team is not satisfied, the matter should be reported to the reviewed firm's managing partner, and the review team should consider what other action may be appropriate in the circumstances. If the engagements so excluded from the review process are few in number and the review team concludes, by review of additional engagements in a similar area of practice and by review of other work of supervisory personnel who participate in the excluded engagements, that the engagements so excluded do not materially affect the review coverage, then the review team ordinarily would conclude that the scope of the review had not been unduly restricted.

The field review should be concerned with the accounting and auditing engagements performed by the United States offices of the reviewed firm selected for review and supervision and control of work performed on engagements outside the United States. The reviews of engagements should usually be directed toward the accounting and auditing work performed by the practice offices visited and not to a review of work performed by all practice offices of the reviewed firm connected with a particular engagement. Accordingly, in reviewing a selected practice office, the accounting and auditing work performed by that practice office includes work performed for another office of the reviewed firm, for a correspondent firm, or for an affiliated firm.

For those situations in which engagements selected in the practice office reviewed include use of the work of another office, correspondent, or affiliate (domestic or international), the review team would normally limit its review to the portion of the engagement performed by the selected practice office. The review, however, should include instructions for the engagement issued by the reviewed office to another office of the firm, correspondent, or affiliate. In addition, the review should also encompass the procedures by which the reviewed office maintains control over the engagement through supervision (including visits by its supervisory personnel to other locations) and review of work performed by other offices, correspondents, or affiliates.

There may be situations when information available to the review team is insufficient for it to evaluate whether the reviewed firm's quality control policies and procedures have been applied in supervising engagements performed by other offices or firms. In these instances, it will be necessary at least to obtain documentation from such other offices or firms; usually this may be accomplished by forwarding the requested information to the reviewed office.

.27 *Background Information.* The review team should obtain background information from the reviewed firm, some of which will have been obtained before the engagement was accepted. The information is used as a guide for planning purposes (including selection of offices to be visited and engagements to be reviewed) and should relate to the reviewed firm's accounting and auditing practice. The statistical information may be in terms of approximate amounts or estimates. The following are examples of background information that may be obtained from the reviewed firm:

1. Description of the firm's organization (an organization chart may be useful).
2. Firm philosophy including matters such as—
   a. Firm goals or objectives.
   b. Operating practices regarding service to clients and development of personnel.
   c. Policies relating to industry specialization or practice specialists.
   d. Operating autonomy of practice offices (the extent of decentralization of authority).
3. Firm profile. (If the reviewed firm is a multioffice firm, the information should be broken out by individual practice office. Offices that are a part of a larger practice unit may be grouped together.)
   a. Size—accounting and auditing hours. (If such an analysis is not available, the reviewed firm may analyze total billings by function, or make an estimate of the percentage of accounting and auditing work.)
   b. Number of professional accounting and auditing personnel analyzed by level.
   c. Number of accounting and auditing clients classified by "audited" and "unaudited" and by type—publicly held, privately held, or not for profit.
   d. Firm management level personnel analyzed by years with the firm and areas of expertise.

e. Industry concentrations and specialty practice areas, such as SEC or regulated industries.
f. Extent of use of correspondent firms on engagements.
g. Extent of international practice.
h. Description of recent mergers.
i. Newly opened offices.

.28 *Study and Evaluation of the Quality Control System.* After the background information is obtained and studied, the review team should commence its study and evaluation of the reviewed firm's quality control system. The objective of the study is to evaluate whether the quality control policies and procedures are appropriately comprehensive and suitably designed for the reviewed firm, are adequately documented, and the procedures for communicating them to professional personnel are appropriate. This evaluation of comprehensiveness and suitability should be considered further by the review team in the course of the review and may be modified by the review team based on the results of its other review and compliance testing procedures.

The reviewed firm's quality control policies and procedures should be considered in relation to the guidance material contained in *Quality Control Policies and Procedures for Participating CPA Firms.* This process assists the review team in evaluating whether the reviewed firm has given adequate consideraton to, and adopted, appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control to the extent they are applicable to its practice.

If significant apparent deficiencies are identified in the reviewed firm's quality control policies and procedures, the review team should bring them to the attention of the reviewed firm's managing partner or to another appropriate authority in the firm. The reviewed firm would be given an opportunity to refute or correct such apparent deficiencies. If significant corrective actions are required, the review usually will be suspended for a sufficient period of time for the reviewed firm to develop revised policies or procedures and implement them in its practice. The review team should consider communicating such significant deficiencies to the reviewed firm, generally in writing, at the time the review is suspended. The review team would, in resuming the review, evaluate whether the revised policies or procedures correct the deficiencies.

.29 *Extent of Compliance Tests.* Based on its study and evaluation of the reviewed firm's quality control system, the review team should develop programs to test compliance.[10] The programs for compliance tests should be tailored to the practice of the firm under review and should be sufficient to evaluate whether the reviewed firm's quality control policies and procedures have been adequately communicated to professional personnel and are being complied with. The nature and extent of testing should take into account the review team's evaluation of the relative strengths and weaknesses of the reviewed firm's quality control policies and procedures. Some of these compliance tests would be performed at practice offices selected for review, some on a firm-wide basis, and others on an individual engagement basis. These tests may take the form of—

- Inquiries of persons responsible for a function or activity.
- Review of selected administrative and personnel files.
- Interviews with firm professional personnel at various levels.
- Review of the results of the firm's inspection function.
- Review of selected engagement working paper files and reports.
- Review of other evidential matter.

.30 *Location of Documentation*—The review team should determine the work to be accomplished at the reviewed firm regarding compliance with quality control policies and procedures and the location of related documentation, which may be maintained in functional or administrative files. In the case of a multioffice firm, attention should be directed to a review of documentation maintained at the executive office. For example, the executive office probably has statistics, records, and other data relative to procedures regarding client acceptance and continuance, hiring, training, promotion, and independence and may also have data useful in evaluating compliance with the firm's quality control policies and procedures for consultation and inspection.

.31 *Selection of Offices*—The process of office selection is not subject to definitive criteria; visits to practice offices should be sufficient to enable the review team to evaluate whether the reviewed firm's quality control policies and procedures are adequately communicated to professional personnel and are being complied with.

In selecting both the number and location of practice offices to be visited, the review team should consider the reviewed firm's pre-

[10] The AICPA is preparing program guidelines for use by committee-appointed review teams.

viously furnished background information. The practice offices selected should be generally representative of the reviewed firm's accounting and auditing practice and, accordingly, should provide a cross section of offices, giving consideration to their size and geograpic distribution. In addition, consideration should be given to the selection of recently merged or recently opened offices.

The number and location of practice offices to be selected will require the exercise of judgment by the review team. Considerations which may affect the number and location of practice offices selected for review would include (1) degree of centralization of accounting and auditing practice control and supervision, (2) significance of specialized industry practice, and (3) the review team's evaluation of the scope and adequacy of the reviewed firm's inspection program.

Although the foregoing considerations preclude definitive guidelines, Exhibit A has been developed to assist a review team in selecting offices in the review of a multioffice firm.

.32 *Selection of Engagements*—The segment of the firm's accounting and auditing practice reviewed should be sufficient to provide the review team with reasonable assurance for its conclusions regarding the appropriateness or suitability of the reviewed firm's quality control system and compliance therewith.

The review team should select the engagements to be reviewed for each practice office to be visited based on accounting and auditing practice statistics and other data. If not previously obtained, the review team may wish to obtain information such as the names of clients, types of industries, client size (for example, revenues, assets), whether the client is publicly held, privately held or not for profit, the number of engagement hours, and names of the partner and supervisory personnel associated with the engagements.

Engagements selected for review should provide a reasonable cross section of the reviewed office's accounting and auditing practice; however, greater weight should be given to selecting engagements for publicly held clients in view of the public interest in these companies. An effort should be made to include engagements of most of the partners and other supervisory personnel in the reviewed office and to provide a diversity of types of engagements.

The number of engagements to be selected or the percentage of the firm's accounting and auditing hours to be reviewed will be affected by the size and nature of the reviewed firm's practice as well as the method of selection employed by the review team. Although these considerations preclude definitive guidelines, Exhibit B has been developed to assist a review team in determining judgmentally the number of engagements or accounting and auditing hours to be reviewed.

.33 *Extent of Engagement Review.* The objectives of the review of engagements are to evaluate (1) whether there has been compliance by the reviewed firm with its quality control policies and procedures and (2) whether the quality control policies adopted and procedures established by the reviewed firm are appropriately comprehensive and suitably designed for its accounting and auditing practice. To the extent necessary to achieve these objectives, the review of engagements should include review of financial statements, accountants' reports, working papers, and correspondence and should include discussion with professional personnel of the reviewed firm. The depth of review of working papers for particular engagements is left to the judgment of the reviewers; however, the review is directed primarily to the key areas of an engagement to determine whether, in accordance with the reviewed firm's quality control policies and procedures, there were well-planned, appropriately executed, and suitably documented procedures that were performed on the engagement.

In connection with these engagement reviews, the review team may encounter indications of significant failures by the reviewed firm to reach appropriate auditing and reporting conclusions. In such situations, the review team should consider that it has not made an examination of financial statements in accordance with generally accepted auditing standards, nor does it have the benefit of access to client records, discussions with a client, or specific knowledge of a client's business. Therefore, in the absence of compelling evidence to the contrary, the review team should presume that representations concerning facts contained in the working papers are correct. The review team should, however, pursue questions about auditing or reporting matters with the reviewed firm when it believes there may be a significant failure to reach appropriate conclusions in the application of professional standards, which include generally accepted auditing standards and generally accepted accounting principles.

The review team should consider whether significant failures to reach appropriate auditing and reporting conclusions are indicative of significant deficiencies of the reviewed firm in complying with its quality control policies and procedures or of significant inadequacies in those policies and procedures. The pattern, pervasiveness, and significance of the failures noted should be considered by the review team in making its overall evaluation of the reviewed firm's system of quality control and compliance therewith.

Should the review team, during the conduct of the review, believe that the reviewed firm may have issued an inappropriate report on a client's financial statements, the review team captain shall promptly inform an appropriate authority within the reviewed firm. In such circumstances, it is the responsibility of the reviewed firm to determine what action should be taken.[11]

Completion of the Review

.34 Prior to issuance of its report, the review team should communicate its conclusions to the reviewed firm. This communication would ordinarily take place at a meeting attended by the review team captain, the executive or supervisory committee (if applicable) and in-charge or other reviewers, as appropriate, and by appropriate individuals from the reviewed firm. The parties would discuss the review team's conclusions and any resulting impact on the opinion to be issued, recommendations (if any) for improvements in the reviewed firm's quality control policies and procedures, and other relevant matters. The reviewed firm may decide to have recommendations for improvement furnished in writing by the review team captain.

.35 For the review of a multioffice firm, the review team for a practice office would, in addition to the communication described in the preceding paragraph, normally communicate the findings of its review to appropriate individuals at the office reviewed.

Review Team Working Papers

.36 The review team captain should furnish instructions to the review team concerning the manner in which working papers relating to the review are to be prepared during the course of the review to facilitate summarization by the review team captain in completing the review.[12]

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[11] See *Codification of Auditing Standards and Procedures,* SAS No. 1 (New York: AICPA, 1973), sec. 561 [AU section 561].

[12] For reviews conducted by a committee appointed review team under the program, working papers are retained only until such time as the report on the review has been filed with the AICPA or the period for filing the report has elapsed, whichever is earlier.

Reporting on Quality Control Compliance Reviews

The Review Team's Report

.37 The program provides that, upon completion of a quality control compliance review, the review team communicate its findings to the reviewed firm and promptly submit a written report to the reviewed firm. In order for the reviewed firm to become a participating firm in the program or to continue as a participant, a report acceptable for participation in the program (see below) must be submitted by the reviewed firm to the AICPA. Failure to file an acceptable report will result in the reviewed firm's not becoming or not continuing as a participant in the program.

.38 The report should be addressed to the partners, proprietor, stockholders, or officers of the reviewed firm. A report issued by a review team appointed by the Quality Control Standards Committee, or by another entity that administers the program for the committee, should be signed by the review team captain (without reference to the captain's firm) and should contain the name of the review team's originating organization (such as the AICPA or state society of CPAs). A report by a review team formed by a CPA firm should be issued on the reviewing firm's letterhead and signed by the firm. The report should be dated as of the completion of the review.

.39 The reviewed firm may advise its clients and its personnel of the results of the review and indicate that the report is on file at the AICPA. Copies of the report may also be made available by a reviewed firm to its clients, its personnel, and others.

Report Acceptable for Participation in the Program

.40 A report issued by a review team that is acceptable for participation in the program (an "acceptable report") contains a statement of the scope of the review, a description of the general characteristics of a system of quality control, and the opinion (without qualification) of the review team that the reviewed firm's quality control system was appropriately comprehensive and suitably designed for the firm, adequately documented, communicated to professional personnel, and was being complied with to provide the firm with reasonable assurance of conforming with the standards of the profession for firms participating in the program.

.41 An example of an acceptable report is presented as Exhibit C of this section.

Reporting Considerations

.42 The review team's evaluation of whether a reviewed firm's quality control system and compliance therewith conform with the guidelines of the profession requires both an understanding of the elements of quality control and the exercise of professional judgment regarding their application to an accounting and auditing practice. Because of the absence of quantitative measurement criteria, the evaluation of the significance of perceived deficiencies in the system of quality control or compliance therewith may be more difficult than the evaluation of the materiality of exceptions noted in financial reporting matters. In determining whether a review team will issue an acceptable report, the review team should consider factors such as those that follow.

.43 *Deficiencies.* The deficiencies noted should be considered for their significance in relation to the reviewed firm's (1) quality control policies and procedures, (2) organizational structure, and (3) nature of practice.

A deficiency noted in certain quality control policies and procedures may be partially or wholly offset by other policies or procedures. The review team should consider the interrelationships among the elements of quality control and weigh deficiencies against other compensating policies and procedures.

.44 *Compliance.* Compliance, as used in this section, means adherence to a prescribed policy or procedure in the substantial majority of situations; it does not imply adherence to a prescribed policy or procedure in every case. Variance in individual performance and professional interpretation affects the degree of compliance with a firm's prescribed quality control policies and procedures. Adherence to all policies and procedures in every case may not be possible; nevertheless, a high degree of compliance is to be expected. The review team should consider the nature, significance, and frequency of instances of noncompliance noted in the review in evaluating whether the reviewed firm has complied with its quality control policies and procedures in the substantial majority of situations or whether modification of the review team's report is required.

In considering instances of noncompliance with prescribed quality control policies and procedures that could affect the review team's report, the review team should discuss with the reviewed firm whether the quality control policies and procedures in question exceed policies and procedures that would be required in the circumstances to achieve the objectives of a quality control system and participation in the program. In such instances, if the review team concludes that the quality control policies and procedures in question exceed those required for participation in the program, its report should be based on compliance by the reviewed firm with those policies and procedures required to provide the firm with reasonable assurance of conforming with the standards of the profession for firms participating in the program.

Circumstances Resulting in a Report Unacceptable for Participation in the Program

.45 Circumstances that ordinarily would result in an unacceptable report for purposes of participation in the program are as follows:

1. The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary.
2. The review discloses significant deficiencies (see discussion of "deficiencies" above) in the quality control policies and procedures prescribed for the firm's accounting and auditing practice.
3. The review discloses a significant lack of compliance (see discussion of "compliance," above) with the firm's quality control policies and procedures.

.46 In those instances in which the review team determines that an unacceptable report is required, the reasons should be adequately disclosed.

Engagements Discontinued Prior to Completion

.47 In the event that a review is discontinued prior to completion, the review team should consider advising the reviewed firm in writing of the discontinuance. The review team may wish to communicate any major concerns to the reviewed firm.

Disagreement Within Committee-Appointed Review Teams

.48 A disagreement regarding the type of report to be issued may arise among members of an executive committee or supervisory committee (where applicable) or among review team members who have knowledge of the overall findings of the review. When review team members are unable to resolve such a disagreement, the matter should be referred to the Quality Control Standards Committee of the AICPA for resolution.[13]

Exhibits

.49 These guidelines have been developed for guidance to review teams in the initial period of implementation of the program and are subject to review at a subsequent time to determine whether modifications are appropriate in the light of experiences in practice.

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Exhibit A: Guidelines for Selection of Offices

The following guidelines, which should be read in conjunction with guidance on selection of offices included in the accompanying guide, may be considered for reviews of multioffice firms:

Number of offices in reviewed firm	*Approximate number of offices to be selected for review*
2 to 15	Largest office plus 1 to 3 offices
over 15	15% to 25% of the reviewed firm's offices (the selected offices should contain similar percentages of the firm's professional personnel and the firm's accounting and auditing hours)

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Exhibit B: Guidelines for Accounting and Auditing Hours to be Reviewed

The following guidelines may be considered in determining judgmentally the percentage of a reviewed firm's total accounting and auditing hours to be selected for review:

Number of offices in reviewed firm	*Percentage of reviewed firm's total accounting and auditing hours to be reviewed*
1 to 15	5% to 10%
over 15	3% to 6%

[13] The program provides a means for resolving disagreements between a review team and a reviewed firm.

For example, if three offices of a ten-office firm were selected for review, engagements selected for review in those three offices should represent between 5 percent and 10 percent of the reviewed firm's total accounting and auditing hours.

The time required to review selected individual engagements is subject to variation depending on the size, nature, and complexity of the engagement, including engagements in specialized industries. For example, review time for smaller engagements generally may be expected to be proportionally greater than that required for larger engagements in relation to total hours for those engagements.

In performing the engagement review portion of the review, it can be anticipated that the time required by the review team for review of all engagements selected may be expected to vary from 1 percent to 3 percent of the aggregate hours incurred by the reviewed firm to perform these engagements.

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Exhibit C: Report Acceptable for Participation in the Program

To the Partners
Jones, Smith & Co.

We have reviewed the system of quality control for the accounting and auditing practice of Jones, Smith & Co. in effect for the (period) ended June 30, 1978. Our review was conducted in conformity with guidelines for quality control compliance reviews promulgated under the Voluntary Quality Control Review Program for CPA Firms of the American Institute of Certified Public Accountants. We tested compliance with the firm's quality control policies and procedures [at the firm's executive office and at selected practice offices in the United States][1] to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements. [We tested the supervision and control of portions of engagements performed outside the United States.][2]

A firm's system of quality control encompasses its organizational structure and the policies adopted and procedures established to

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[1] To be included, as appropriate, for reviews of multioffice firms.

[2] To be included for reviewed firms with offices, correspondents, or affiliates outside the United States. Appropriately modified wording should be used if the reviewed firm uses correspondents or affiliates domestically, if significant to the scope of the review.

provide the firm with reasonable assurance of conforming with the standards of the profession in the conduct of its accounting and auditing practice. Standards of the profession are expressed in terms of broad concepts and objectives rather than detailed procedures, and their application requires the exercise of professional judgment in a variety of circumstances. The extent of a firm's quality control policies and procedures and the manner in which they are implemented will depend upon a variety of factors such as the size and organizational structure of the firm, the nature of its practice, and its philosophy as to the degree of operating autonomy appropriate for its people. Variance in individual performance and professional interpretation affects the degree of compliance with a firm's prescribed quality control policies and procedures; therefore, adherence to all policies and procedures in every case may not be possible, but compliance does require adherence to prescribed policies or procedures in the substantial majority of situations. In performing our review, we have given due regard to the foregoing conditions.

In our opinion, the system of quality control for the accounting and auditing practice of Jones, Smith & Co. for the (period) ended June 30, 1978, was appropriately comprehensive and suitably designed for the firm, adequately documented, communicated to professional personnel, and was being complied with during the period to provide the firm with reasonable assurance of conforming with the standards of the profession for firms participating in the Voluntary Quality Control Review Program for CPA Firms of the American Institute of Certified Public Accountants.

City, State Date	William Brown Team Captain AICPA Review Team	[for review by AICPA review team]
	Johnson & Co.	[for review by a firm]