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Referendum: Background information on two proposed amendments to the Code of Professional Ethics, October 31, 1969

American Institute of Certified Public Accountants

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Referendum

Background information on two proposed amendments to the Code of Professional Ethics

October 31, 1969



American Institute of Certified Public Accountants
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INTRODUCTION

This booklet provides background on two proposed changes in the Code of Professional Ethics of the American Institute of Certified Public Accountants.

All of the proposals have been approved by the Council of the Institute on the recommendation of the Executive Committee. The Code amendments originated with the committee on professional ethics.

In accordance with the bylaws, the proposals were included in the call to the annual meeting held in Los Angeles, California, on October 6, 1969, for discussion without action.

The bylaws also provide that following the annual meeting, the proposed amendments shall be submitted to all members for a vote by mail ballot, accompanied by a statement prepared by the secretary summarizing the arguments advanced for and against them.

This booklet is issued in conformity with these requirements of the bylaws. The presentation of each proposal is in three parts: an opening statement on the objectives sought by the amendment, the text of the proposed change and a brief summary of the pro and con arguments.

In order to become effective, the proposed amendments must be approved by two-thirds of the members voting. The ballots will be valid and counted only if received by December 30, 1969, as provided in the bylaws. All ballots should also be *signed*; unsigned ballots will not be counted.

John Lawler
Secretary

PROPOSED AMENDMENTS TO CODE OF PROFESSIONAL ETHICS

Both amendments to the Code of Professional Ethics have received wide exposure to the membership through state societies of certified public accountants and *The CPA* as well as in the call to the annual meeting.

Proposal No. 1: Technical Standards— Rule 2. 02(e)

Background

The proposed change in paragraph (e) of Rule 2. 02 gives effect to the recommendations made by a special committee to the Council in 1965 that, after a reasonable period of exposure, the resolution adopted by Council in that year governing disclosure of departures from the Opinions of the Accounting Principles Board should become an integral part of the Code of Professional Ethics.

Text of Proposed Amendment

The language of the proposed amendment would be substituted for the present Rule 2. 02(e) which, with the introduction to the rule, reads as follows:

“2. 02 In expressing an opinion on representations in financial statements which he has examined, a member or associate may be held guilty of an act discreditable to the profession if: . . .

“(e) he fails to direct attention to any material departure from generally accepted accounting principles or to disclose any material omission of generally accepted auditing procedure applicable in the circumstances. (See Opinion Nos. 8 and 18.)”

It is proposed that paragraph (e) of Rule 2.02 be amended to read as follows:

“(e) he fails to disclose in his report, when material in effect:

“(1) the omission of any generally accepted auditing procedure applicable in the circumstances; or

“(2) the use of any accounting principle which departs from generally accepted accounting principles because it lacks substantial authoritative support, in which case he must also either qualify his opinion or give an adverse opinion as appropriate; or

“(3) unless otherwise disclosed in the financial statements, the use of any generally accepted accounting principle which differs from an Opinion of the Accounting Principles Board but which has other substantial authoritative support.

“Disclosure must be made in his report or in the financial statements of the approximate effect of departures under (2) and (3), or a statement made as to the impracticability of determining such effect.”

Discussion—In Favor

Those favoring the proposal to amend Rule 2.02(e) do so, in part, out of a desire to bring to its logical conclusion action on the report submitted to Council in 1965 by the Special Committee to Study the Operations of the Accounting Principles Board. They believe that a reasonable time has been allowed for education and adjustment to the disclosure requirement and see no reason for further delay in strengthening the status of APB

Opinions, the code of ethics and the position of the CPA, by making it a part of the rules.

They are not impressed by the absence of evidence of non-compliance, citing the inability of the profession to police the field adequately. However, if there has been a high degree of compliance, they suggest that the amendment to the code of ethics now can hardly be regarded as a drastic measure.

The proponents believe, further, that the absence of any defiance of the requirement should not be taken as proof that the Council resolution can stand by itself. In fact, they believe it is essential to strengthen support for that resolution and, at the same time, to give added impetus to acceptance of APB pronouncements.

Discussion—Against

Those in opposition to amendment of Rule 2.02(e) oppose it because experience over a period of four years indicates to them that it is not needed.

The proposed amendment, in their opinion, does not bear upon departures from generally accepted accounting principles. Rather, it deals with distinctions among generally accepted accounting principles—those espoused by the Accounting Principles Board and others also having substantial authoritative support. The opponents believe that appraisal of the amendment is impossible in the absence of any concrete illustrations where such distinctions have been drawn. Nor can they document the existence of a problem in these practical terms.

The opposition is convinced that APB Opinions should stand or fall on their own merits and should not be forced into a condition of general acceptability by threat of disciplinary action against members. Far from strengthening the status of APB Opinions, they see the amendment as a "vote of no confidence" in the wisdom of future APB Opinions.

While recognizing that the amendment had been brought before the members as a recommendation in the report of the Special Committee to Council in the spring of 1965, they say that the fears of the committee at that time have not been realized. In their view, the past four years of experience with the disclosure requirement has indicated free and willing compliance by the profession.

In the face of this record, they conclude, no rule of conduct is needed.

Proposal No. 2: Operating Practices— Rule 4. 06

Background

This proposed change would delete the present Rule 4. 06 and would substitute for it one which would permit members to practice in the form of a professional corporation or association. Both the Executive Committee (now Board of Directors) and Council of the Institute approved this change and the accompanying resolution of Council, as amended by the committee on professional ethics, establishes the characteristics of professional corporations or associations approved under the new rule.

Text of Proposed Amendment

The present Rule 4. 06 reads as follows:

“4. 06 A member or associate shall not be an officer, director, stockholder, representative, or agent of any corporation engaged in the practice of public accounting in any state or territory of the United States or the District of Columbia. (See Opinion No. 7.)”

It is proposed that the rule be deleted and the following substituted for it:

“A member or associate may offer services of a type performed by public accountants only in the form of either a proprietorship, or a partnership, or a professional corporation or association whose characteristics conform to resolutions of Council.”

The following resolution of Council was approved at the spring meeting of Council at Colorado Springs on May 6, 1969:

“WHEREAS, if the membership of the Institute approves the proposed amendment of Rule 4. 06 of the Code of Professional Ethics

permitting the practice of public accounting in the form of a professional corporation or association whose characteristics shall be established by the Council, it is hereby

“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 speciality, 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 duly qualified to practice as a certified public accountant in a state or territory of the United States or the District of Columbia. 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 standards 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 recently by the Council, the Executive Committee 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.

Discussion—In Favor

Those who favor amendment of Rule 4.06 point out that forty-seven states have already

enacted legislation permitting corporate practice by professionals and that similar legislation is pending in other jurisdictions.

They note that accounting is the only major profession with a specific rule against incorporation and believe this to be a remnant of the days when such a rule was needed to provide professional stature. They submit that such a rule is now superfluous because CPAs have earned recognition as true professionals from the business community and knowledgeable citizens.

In their opinion, sufficient safeguards for the protection of the public interest have been, or can be, built into the proposed Council resolution setting forth the characteristics of an accounting corporation to effectively offset any hostile or negative public reaction to the change.

In supporting amendment of Rule 4.06, they contend that the major issue before the membership in this ballot is not that of incorporation, per se, but whether a large number of Institute members (who have already expressed interest in corporate practice to their Council members) should be denied the same freedom of choice offered to the other professions as between partnership or corporate practice where state law permits it.

Both proponents and opponents recognize that the mere removal of the current ethical proscription will not immediately assure the claimed benefits of incorporation to members. However, those in favor of the amendment believe that high standards of work can preserve the CPAs favorable public image

and that the legal form in which practices are conducted no longer has any bearing on it.

Discussion—Against

Those opposed to amending Rule 4.06 oppose it on both philosophical and practical grounds. In their opinion, the advantages of professional incorporation most frequently advanced—favored treatment for pension planning and taxation, assurance of continuity, and some measure of relief from the present heavy burden of liability—may prove illusory. In fact, they cite the present 1969 tax reform bill as diminishing, if not entirely eliminating, these tax gains. They ask further that the presumed benefits to be obtained from this action be carefully weighed against the possible damage it may do to the public's trust of the profession. They believe that regardless of how many or how few firms avail themselves of permission to incorporate, repeal of Rule 4.06 will harm accountancy by detracting from its character as a profession. It will, they say, strengthen the mistaken public view that CPAs are businessmen and not professionals, and will not improve the ability of CPAs to serve their clients.

The opposition further argues that the adoption of the corporate form by some practitioners and the retention of the partnership form by others may add a new element of division within the profession.

They also foresee that the necessary legislative efforts to authorize corporate practice could be prolonged and costly—particularly if non-CPAs took advantage of the opportunity to seek or extend recognition for themselves.