A practitioners' guide to the new AICPA Code of Professional Conduct

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Abstract

In June 2014, the American Institute of Certified Public Accountants' (AICPA) Professional Ethics Division adopted a revised version of the AICPA Code of Professional Conduct (AICPA, 2014), that all public firms, businesses, and other members of the AICPA must adopt by December 15th, 2014. With that, there has been much discussion over the validity and application of the new standards. In the following, there will be a brief discussion of the conceptual framework of the new standards, an explanation of the new drafting guidelines, and multiple examples on how to apply the new standards using the new codification.

Keywords: Ethics, AICPA, Professional Conduct, User,

INTRODUCTION

The revised AICPA Code of Professional Conduct

The new AICPA has restructured and now codified the Code of Professional Conduct. According to the AICPA, the reason for the restructuring and codification of the Code "was so that members and other users of the AICPA Code can apply the rules and reach correct conclusions more easily and intuitively". The structure of the new Code is divided into separate parts: a preface that is applicable to all members, including structure, principles, definitions, non-authoritative guidance, and new, revised and pending interpretations of the new code; part one, which are standards applicable to public practice members; part two, which are standards applicable to business members; and Part 3, which are standards applicable to all other members of the AICPA.

The new Code is codified, which means that it is an easy-to-search database of the Professional Code of Conduct. The codification for the Code of Conduct has a numbering convention that appears as, for example, *1.400.010.01*. This numbering convention starts with a single digit, which correlates with the aforementioned parts: 0 – Preface, 1 – Public Practice Members, 2 – Business Members, 3 – Other Members. The second set of digits is the major section, for instance "400" refers to the section entitled "Acts Discreditable". The third set of digits is the topic, for instance, "010" refers to the topic entitled "Discrimination and Harassment in Employment Practices". The last digit is the paragraph pertaining to the section and topic, for instance "01" explains the discreditable act of violating federal, state and municipal antidiscrimination laws.

There are other substantive changes to the code as well. The AICPA expanded the prior definition of "self-review threat" to describe that this self-review threat is also present for "judgments made or work performed by an individual currently with the firm who was previously associated with the client". It is noted within the code that there are no safeguards in place that could eliminate the potential of this self-review threat.

There are also additional discussions of ethical conflicts, definition of attest clients and the term "director", tax power of attorney and prospective clients confidential information, false misleading or deceptive acts, billing for subcontractor services, attest engagement performed with former partner, use of AICPA awarded designation, loans and lending institutions, and blind trusts.

PRINCIPLES OF THE AICPA CODE OF PROFESSIONAL CONDUCT

The principles outlined within the new code are similar to that of the extant code. The principles are: Responsibilities Principle, The Public Interest Principle, The Integrity Principle, Objectivity and Independence Principle, Due Care Principle, and the Scope and Nature of Services Principle.

Responsibilities Principle

This principle states that members, in carrying out their responsibilities, "should exercise sensitive professional and moral judgments in all of their activities". Members of the AICPA must act in a manner that maintains public confidence in the accounting industry, and continually strive to improve the art of accounting, and understand the industries responsibilities of self-governance.

Members should keep in mind that their actions affect many within and outside of the accounting industry.

Public Interest Principle

This principle states that members should proceed with their responsibilities, and keep the public interest in mind in their decisions, and "honor the public trust and demonstrate a commitment to professionalism". The public consists of "clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of *members* to maintain the orderly functioning of commerce". This principle also discusses the pressures that may come from the public, and the fact that members must maintain integrity, objectivity, due professional care, and a genuine interest in serving the public.

Integrity Principle

To have integrity, a member must be "honest and candid with constraints of client confidentiality". When a decision is made, it must be determined that the act is right or just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member needs to make sure that they make sure that their integrity is maintained through the decision.

Objectivity and Independence Principle

A member should maintain objectivity and independence and prevent any conflicts of interest in their practice. To be objective is to be impartial in the professional services offered by the member, and use professional judgement during the engagement with the client. To be independent is to preclude relationships that may hinder the objectivity of the member in the professional services being offered.

Due Care Principle

The due care principle suggests that a member observe the professions ethical and technical standards, continuously improve competence and quality of services, and, to the best of the member's ability, act in a professionally responsible manner. Exercising due care is keeping the best interest of the client in mind as services are performed with diligence and competence.

Scope and Nature of Services Principle

The Code of Professional Conduct should be at the forefront of determining the scope and nature of services. If there is a probability that any of the aforementioned principles will be violated in providing professional services to the client, then it is assumed that violations of the code will exist.

DECISION MAKING USING THE NEW CODE

As with the extant code, there are many instances where the new AICPA Code of Professional Conduct will need to be referenced (www.aicpa.org/InterestAreas/ProfessionalEthics/Community/Pages/ethics-codification-implementation-tools.aspx). There are steps that should be followed using the Conceptual Framework, which are included in Exhibit 1.
[INSERT FIGURE 1 HERE]

Step 1: Identify Threats

Take the scenario that has come up, and understand if there are any threats involved with the scenario. If there are no threats, proceed with the scenario. If there are threats, then proceed to step two of the conceptual framework.

Step 2: Evaluate Threats

Evaluate the threats of the scenario, and determine whether or not the threats are at an acceptable level. If the threats are at an acceptable level, proceed with the scenario, otherwise, proceed to step three of the conceptual framework.

Step 3: Identify Safeguards

Identify the safeguards are in place to protect against any ethical conflicts. These safeguards refer to the internal controls the organization has in place to prevent unethical behaviors. These safeguards can be existing controls, or they may be new safeguards that are required to be developed with new circumstances.

Step 4: Evaluate Safeguards

The safeguards must be evaluated to determine if they eliminate or reduce threats to an acceptable level. Should the safeguards not eliminate or reduce the threats to an acceptable level, then the action should not be taken. If the safeguards do eliminate or reduce the threats to an acceptable level, then the action should be taken.

In the following, some examples will be provided, followed by instructions on how to attain information related to the situation in the new code. The link for the AICPA Code of Professional Conduct codification is: http://pub.aicpa.org/codeofconduct/Ethics.aspx**.** Please follow along with the examples to get hands-on experience in browsing the code.

Example #1: Third-party service providers

Mark Sands, CPA, a member of the AICPA, is contracted with a client to provide professional services. Due to workload restrictions, Sands decides to hire Alex Law, CPA, a third-party service provider, to assist in providing the professional services for this client. The member is concerned that this situation may be a violation of the AICPA Code of Professional Conduct.

Resolution:

Using Figure 1, Step 1, Mark must first identify threats. The threat is that the third-party service provider would now have access to confidential client information. Step 2, Mark must evaluate the threats involved in this decision to seek third-party assistance with the client. Using a third-party service provider may contain threats to the Integrity and Objectivity Principle. Meaning that the third-party provider taking the confidential client information and disclosing it to other parties. In Step 3, Mark must also identify safeguards. Such arrangements should be disclosed to the client prior to the third-party arrangement commencing if confidential client information will be shared to the third-party. However, a member is not required to inform the client if the third party arrangement provides administrative support to the member where no confidential client information is shared.

The member may also want to consult other sections of the Code as well to attain additional interpretations of third-party arrangements. The Code will refer members to such additional guidance, such as Section 1.300 "Use of a Third-Party Service Provider", which expands upon the definition of third-party arrangements, and Section 1.700.04 "Disclosing Information to a Third-Party Service Provider", which discussed the contractual obligations between the member and the third-party.

Example #2: Contingent fees rule

John Black, CPA, a member firm of the AICPA, is in an audit engagement with a client. The client has requested, in addition to the audit engagement, that the member firm provide tax preparation services for the client as well. The member is concerned that this issue may be a violation of the AICPA Code of Professional Conduct.

Resolution:

Following Figure 1, Step 1, John Black must first identify any threats with this situation. Since John Black, CPA, is member of public practice, he would refer to Part 1 of the Code of Professional Conduct. This example has to do with fees and other types of remuneration, therefore, the section 1.500 should be referred. As a subsection, the member would refer to section 1.510.001 "Contingent Fees Rule". This section states that a member in public practice shall not provide services for a fee to the client if the member firm is already in an audit engagement with the client, and may not provide tax preparation services during the financial reporting period to which the audit engagement exists.

Example #3: Member of Organization that Receives Funds from a Fund-Raising Organization

Maxine Clark is a partner of a member firm in public practice. Maxine sits on the Board of Directors of not-for-profit foundation. During the period she is serving on this Board, one of Maxine's attest clients donates money to the not-for-profit foundation. Maxine is unsure if this is a violation of the AICPA Code of Professional Conduct.

Resolution:

Since Maxine is a partner in a firm in public practice, she needs to start her search in Part 1 of the Code. From this point, Maxine must consider which of the principles this could potentially affect. Since this is the receipt of donated fund, this situation may violate the independence principle, which is located at 1.275. From there, Maxine, must determine which section to go to, and the section that relates directly to the situation is *Section 1.275.035* "Member of Organization that Receives Funds from Fund-Raising Organization".

According to this *Section,* "A partner at a member firm serves on the Board of Directors of an organization during the period covered by the *financial statements* or during the *period of the professional engagement* and the organization receives funds from a fund-raising foundation that is an *attest client*, management participation or self-review *threats* to the members compliance with the "Independence Rule" [1.200.001] may exist."

Example #4: Marketing the Firm in a False Manner

Tim Shirk, a member of AICPA, and a member of professional practice, is a partner is Shirk, Kelly and Associates, LLC. In an attempt to attain additional clients, Tim decides to market the services of the organization. Given the competitive nature of the industry in their community, Tim decides that it would be acceptable to stretch the truth of the abilities of the organization to give them a competitive advantage over the competing firms. Tim's partner, Justin Kelly isn't sure that this is allowable with the AICPA Code of Professional Conduct, so he consults the Code.

Resolution:

Since this situation affects a firm in public practice, Justin needs to start his search in Part 1 of the Code. From this point, searching through the codification, it is not immediately clear where rules may be present for marketing the firm. Therefore, Justin enters the term "marketing" in the search field of the codification. Once entered, Justin sees that there are three references to marketing relating to members in public practice: *Acts Discreditable, Advertising and Other Forms of Solicitation, and Confidential Information.* Justin proceeds to read into these three references. Under *Acts Discreditable(1.400.090)*, states that "A member would be in violation of the "Acts Discreditable Rule" if the member promotes or markets the member's abilities to provide professional services or makes claims about the member's experience or qualifications in a manner that is false, misleading, or deceptive". False, misleading or deceptive refers to the claim or representation would most like cause potential clients to be misled or deceived. As a result of this finding, Justin decides to discuss with his partner Tim that his plans for marketing the firm in a false manner is a violation of the AICPA Code of Professional Conduct and the act should not be taken.

Example #5: Taking a Financial Interest in An Attest Client

Matthew Hanahan, an AICPA member, and member of professional practice, is a Partner in a Big Four CPA firm. Matthew is also an active investor, and is always looking for great investing opportunities. A company he has been made aware of through his firm has had record earnings and has planned growth over the next 5 years. The company is an attest client of the firm that Matthew works for. Given the great opportunity, and his motivation to make money investing, wants to invest in this opportunity. However, Matthew is unsure if this is a violation of the AICPA Code of Professional Conduct.

Resolution:

Since this situation affects a firm in public practice, Matthew needs to start his search in Part 1 of the Code. Matthew must also consider which of the principles may be violated if he takes the action of investing in this company. Therefore, Matthew believes that the independence principle will be violated, which falls within 1.200 in the code. Scanning through the independence principle, Matthew sees a section discussing *Financial Interests* in section 1.240. This section states that "if a covered member had or was committed to acquire any direct financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member's compliance with the independence rule", would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Accordingly, independence would be impaired". Considering this may impact his independence, Matthew decides not to take a financial interest in the company and decides to focus his investment interests elsewhere.

<u>*Example #6*</u>

Ted Brady, an AICPA member, and member of professional practice, is a partner in Brady, Butler and Associates, LLC. One of Ted's attest clients offered Ted Super Bowl tickets for "a job well done". Ted, who is a fan of one of the teams playing in this year's Super Bowl, would be very excited to go to the big game, and is considering accepting the tickets. He tells his partner, Brandon Butler, that his client is offering Super Bowl tickets to him. Butler tells him to hold off on it, and tells Ted to go consult the AICPA Code of Professional Conduct.

Resolution

Since this situation affects a firm in public practice, Matthew needs to start his search in Part 1 of the Code. Next, Ted considers what principle might be hindered by accepting the tickets from the attest client. He decides that if he accepts the tickets, his integrity and objectivity might be hindered, therefore, Ted refers to section 1.100 "Integrity and Objectivity". Scanning through the section, Ted come across section 1.20 "Gifts and Entertainment". This section states that "when a member offers to a client or accepts gifts or entertainment from a client, self-interest, familiarity, or undue influence threats to the member's compliance with the "Integrity and Objectivity Rule" may exist. These threats may not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards and the member would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" if: (a) The member offers to a client or accepts gifts or entertainment from a client that violate the member's or client's policies or applicable laws, rules, and regulations; and (2) The member knows of the violation or demonstrates recklessness in not knowing". The member must also be aware of the intent by the client of the gift as this may be a violation of the independence rule as well.

Provided this information, Ted decides to let the client know that since he is an existing client, and that they are presently involved in an attest engagement, he cannot accept the Super Bowl tickets as this may hinder his Integrity and Objectivity, in addition to his Independence in the audit engagement.

CONCLUSION

As we deal with changes in the industry, one must provide themselves with experience with the changes. The new Codification of the AICPA Professional Code of Conduct is a way that organizes the Ethical Standards within the accounting industry in an easy-to-understand format. Making effective decisions is of utmost priority to protect the interest of the AICPA member accountant, clients, and community. Without strict guidelines and adherence to strong ethical standards, adverse effects may occur, causing public trust to diminish.

By following the simple steps of the conceptual framework, members can be assured that the public trust be maintained and continue to lead the profession, and all industries going forward. With the major fraudulent events that have occurred in the past decade, this codified approach to the Code of Conduct will assure that the integrity of the profession is maintained well into the future.

REFERENCES:

"AICPA Code of Professional Conduct", last modified December 15, 2014, http://pub.aicpa.org/codeofconduct/Ethics.aspx

"AICPA Code of Professional Conduct Conceptual Framework", last modified December 15, 2014, (www.aicpa.org/InterestAreas/ProfessionalEthics/Community/Pages/ethics-codification-implementation-tools.aspx)

APPENDIX: FIGURES

Figure 1: Steps in Conceptual Framework