ETHICS FOR MASSACHUSETTS

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CHAPTER 1
ETHICS DEFINED

LEARNING OBJECTIVES:

After studying this chapter you will be able to:

1. Define ethics.
2. Differentiate between amoral and ethical values.
3. List and characterize two systems of ethics.
4. Differentiate between legal versus ethical codes.
5. Discuss the development of law and ethics.
6. List examples of philosophers who contributed to the development of ethics.

Ethics is the "science of morals". A moral is an accepted rule or standard of human behavior. The understanding of "accepted" is "accepted by society", and accepted only insofar as the behavior in question being behavior that affects others in the society, even if only indirectly. The implication of this definition is therefore that private actions that have no impact on others are a matter for personal morality, which is not of business or organizational concern.

However, the distinction between personal morality and business morality may not always be so clearly defined. This is because individuals bring personal values to their jobs and to the real or perceived problems of moral choice that confront them at work. Moral choices sometimes must be made because of tensions within individuals, between individuals, or between individuals and what they believe to be the values that drive their organizations.

Furthermore, business organizations do not operate in a social vacuum. Because of the ways business organizations can and do affect the lives and livelihoods of society at large, some would argue that business organizations are kind of "moral agents" in society. Therefore managers and general public alike often wrestle with defining exactly what constitutes the ethical way of doing business, and what constitutes proper constraints on individual self-interests, and by whom shall these constraints be imposed.

A further complexity results from the fact that businesses are increasingly becoming global in nature. Different countries have or seem to have vastly different customs and values. Understanding and assessing whether and how these different cultural and ethical conflicts should be taken into account is often most difficult.

ATTITUDES TOWARD ETHICS

AMORAL:	Condone any actions that contribute to the corporate aim. Getting away with it is the key. No set of values other than greed.

LEGALISTIC:	Obey the letter of the law but not the spirit of it, especially if it conflicts with profits. Ethics ignored until it becomes **a** problem
RESPONSIVE:	Take the view that there is something to gain from ethical behavior, Using ethics as a tool to attain corporate aim.
EMERGING:	Ethical values becoming part of the culture. Codes of ethics being action documents, and likely to contain statements reflecting core value,
ETHICAL:	Total ethical profile. Everything done is ethical, and the right thing always done by everyone. The ideal.

In general, a key focus of ethics is the concept of integrity (or honesty). Integrity in broad terms will imply that no business-persons in the course of their business functions should be party to the falsification of any facts or information or make any statement which knowingly is misleading, false or deceptive in a material particular.

Another major focus of ethics is professional competence and due care, which implies that business professionals should always perform their functions in accordance with law and regulations. In other words, business transactions and professional functions should not be undertaken unless one possesses the required competence and technical skills.

A more controversial focus is the area of freedom from conflicts of interests. The preferred position of many is that one should always avoid concurrent involvement in any business, occupation or activity, which might result in the compromising of integrity, objectivity and independence of decision making.

ETHICAL SYSTEMS

Utilitarianism (teleological ethics)	The promotion that the best long-term interest of everyone concerned should be the moral standard: one should take those actions that lead to the greatest balance of good versus bad consequences
Deontology (Kantian ethics)	It deals with the concept of duty and the rightness of acts. It emphasizes maxims, duties, rules, and principles that are so important that they should be followed whatever the consequences.

In defining law and ethics and their relationship to each other it is necessary to distinguish between moral and legal rights and duties. Morally, a person's rights consist of claims that he can

justly make to the conditions of well-being; his duties consist of what he can justly contribute to well being. Legal rights and duties - that is, claims and obligations enforceable at law - may or may not be fully in harmony with prevalent moral opinion systems in which law and ethics and religion are closely interwoven. The impact of moral opinion on law varies with the type of political structure and influence of public opinion.

In free societies the ultimate justification of law is that it serves moral ends. But the dependence of law on moral principles must not be taken to imply that there is a set of moral principles which can be lain down for guidance. However, most free societies are coming to be more or less consistent in principles that draw the line between law and morals. The task of ethics becomes two-fold: to bring out what is involved in the notion of a principle or norm of action and to recognize ideals that serve as agencies of guidance and control.

A number of consistent principles recognized in modern society are the individual, responsibility and equity. The end of law is to secure the greatest possible general individual self-assertion. In the Judeo-Christian ethic responsibility is a given: the best ordering of human society in which the individual may come to full manhood and satisfying existence. On the basis of equitable doctrine we can say confidently that morality is inseparable from the legal order; that right and wrong is part of the legal order.

HISTORICAL FOUNDATIONS OF LAW AND ETHICS

The great religions of the world gave birth to several concepts that evolved into structural precepts for society. A commonality of precepts evolved with the passing of tribal customs and tribal belief systems and the rise of the great religions of the world.

"The monotheistic idea of God unifies and coordinates the spiritual goods of the race. The unity of GOD involves the unity of all classes of men. This is a long step toward equality. The sense of sin became part and parcel of the common consciousness. It is a leveler and equalizer." For the good of the tribal society now becomes for the good of the individual. It must come to pass that a given society, if it is to retain the right to exist, must be continually extending the experience of its best things to men who were at one time outside, the pale of the best. The principle of individuality, once established, draws after it the principal of progress." "If it amounts to this, that wherever you find man, you find the eternal goods, and therefore the highest worth. The scale of market prices for the common man is forever disarranged by the discovery in him of something that is above price."

Two of the primary maxims in ethics are the utilitarian rule "Each man is to count for one, nobody for more than one". The second is Kant's--Always treat humanity, whether in yourself or another, as a person, and never as a thing."

"The only ground for counting every body as one, and nobody as more than one is the presence in all men of a something or other which possesses such value that existing social forms and economic accumulations cannot bid against it."

"The social question is the moral question, first, because its ultimate root is a choice between divergent ideals of the state, that , between different ways of viewing and organizing the total human life in time and space; and secondly, because, as a consequence, the question concerning the worth of the labor turns into the question concerning the worth of the laborer". The history of conscience is the history of the individual where 'conscience' means knowing along with " ...nothing can be good for one man that is not law for all men."

SELECT DEVELOPMENT OF LAW AND ETHIC

This section will review the historical evolution of law and ethics through select excerpts of legal philosophy from Plato to Hegel.

PLATO: Plato maintained that all wrong doing is involuntary and arises from ignorance since right conduct is happiness, and wrong conduct is unhappiness, and no one therefore would willingly choose wrong conduct which would lead to unhappiness. Plato's resolution was to make a distinction between acts which were remediable in damages and acts which require punishment between injury and wrongdoing. If there had been a wrongdoing, the guilty person must not only pay for the injury, but must also be punished,...the court must teach him virtue.

Plato endeavored to extend his ideas of code making from the civil to the criminal field, and to devise a penal code based upon rational principles. In the history of jurisprudence, no one has been more fully aware of the necessity of the reign of law for any state which desires to realize the ultimate values of happiness and well-being for its citizens.

ARISTOTLE: Aristotle assigned to jurisprudence what must always be its main task, the establishment of a rational legal order for a given society. "Every art and every inquiry and similarly every action and pursuit, is thought to aim at some good; and for this reason the good has rightly been declared to be that at which all things aim." Law may also be a means in the inculcation of established ethical ideals and the promotion of new ones. The precepts of the law are to live honorably, not to hurt another, to give each man his due." He further maintained that the state must train and educate its citizen in the spirit of the law - for there is no merit in the most valuable laws if citizens are not trained and educated early. "If a man is to lead the good life he must practice it a long time."

Aristotle left a powerful legacy on the law of property, contract, inheritance, possession, crime and punishment and tort.

CICERO: Cicero established a bridgehead between ancient and modern legal thought that was to be dominant in Western thinking. Justice is one; it binds all human society, and is based on one law, which is right reason applied to command and prohibition. Cicero's jurisprudence embraced a humanitarian ideal....that what people have always sought is equality of rights before the law. Laws were invented to speak to all men at all times in one and the same voice. He paved the way for identification of law and morality.

ST. THOMAS AQUINAS: "Law is defined by St. Thomas as an ordinance of reason for the common good, made by him who has care of the community, promulgated." His definition is an attempt to embrace all the law, the eternal, the natural as well as the human; there is an effort to include what is regarded as ethically necessary. Law is a rule or measure of Acts whereby one is induced to act or restrained from acting . The elements of law...insist that it is a form of reason, holds that it must be made for the common good, by the guardian of the community, and to teach men to lead the good life.

St. Thomas stated several principles that are inherent in the law: Law binds one to Act. Therefore, the first principle of human acts is the reason-modern substitutes for reasons have become utility, authority, experience. A second principle for common law asserts that choice between alternative rules of law shall rest on a deliberate balancing of possible ends and means. Third, the law must be for the common good. It rests on the ethical ideas that laws are rules of conduct which have as their final end the realization of happiness. Since, there are no limits to the good at which law aims, it is not restricted to the good of a particular person but always directed to the common good. Finally laws must be promulgated or made known to the people. Man should be informed of the laws he was expected to obey.

St. Thomas' argument for law as a necessity of human society is entirely an ethical one. The approach today attempts to show law in some sense as an essential constituent of society, generally, altogether apart from its function as an instrument in the promotion of ethical conduct. When the observance of the letter of the law is against the equality of justice and public good it is equitable to disregard it.

FRANCIS BACON: For Francis Bacon, there was only one end of law and that was the happiness of the citizens. He asserted that private rights were dependent ultimately for their security upon the preservation of public law extended to everything that affected the well being of the state. In Rome private law was that part which looked to the interests of individuals.

Bacon's ultimate achievement or ideal was that certainty was the primary necessity of law. The best law leaves the least to the discretion of the judge, and this can come about only if the laws are certain. Bacon's first remedy to achieve certainty is the basis of the theory of precedents and is therefore the root of the common law system of case law.

HOBBES: Hobbes distinguished law and right as complete opposites to each other. Right is the liberty which the laws leave us. The laws are the restraints by which we agree mutually to abridge one another's liberty. Hobbes emphasized the idea that morality was based on instructed prudence. In thinking of law he thus took his departure from neither the ethical nor the rational - his idea culminated in the doctrine that no positive law can be unjust. He admitted of the validity of ethical rules and conceded that they were anterior to the establishment of the state. Hobbes' idea became one of the most powerful weapons for the analysis of legal phenomena ever devised.

SPINOZA: His views contributed to the welfare of our social existence in that they taught social cooperation and contentment . He felt the attainment of virtuous habits is something for each man to achieve for himself if he can. Morality is not the business of the state--which is concerned solely

with security. The roots of law in Spinoza's system is uniformity. He stated that " the moral judgment is determined by what a man would do if he were free to do it," and hence it is only necessary that he should think himself to be free in order to justify moral responsibility. Moral responsibility rests solely on the attitude displayed in so-called "choice".

LEIBNIZ: His central idea was that law should be taught both as a science and as a practical discipline. He insisted upon the necessity of a liberal education for the lawyer. When we train students in the law we are instructing them in one of the most vital functions of a culture – "the maintenance and development of a dominant order of society". For Leibniz God is the foundation of all-natural Right, God's existence serves as sufficient guarantee of the highest possible legal and moral condition in the universe. His philosophy was to exalt enlightenment , education and learning. He conceived justice as a communal virtue, that is a virtue which preserves the community. Leibniz defined six types of communities: the marital community, the family community of master and servant, the community of the household, the civil community comprising the city, province and the state and finally the community of God - the church. The aim of the community was to attain happiness. For Leibinz the end of the law emphasized two tasks—one, a proper consideration of the human being and second, the attainment of the common end as the measure of social values.

LOCKE: Locke believed he could, through reason, frame a set of moral rules which would be universally applicable. He took the position that human reason needed the assistance of religion in order to work out a system of ethics. At the heart of Locke's theory of civil society was the idea of the law. The great and chief end of men uniting into commonwealths, and putting themselves under government, is the preservation of their property. Law to Locke was a branch of ethics, and laws in their essence were moral rules. He did not think of law as a command but as that which is set up by authority as a rule for the measure of conduct. In Locke's system the capacity of Supreme Power is fiduciary - it establishes a pattern to which behavior should conform--which associates rewards and penalties for conformity or infractions.....the end of law is not to abolish or restrain, but to preserve and enlarge freedom. Where there is no law there is no freedom.

HUME: Hume based his studies on human nature. In his system justice serves both an ethical and a sociological function. In ethics ...what is approved is pleasant or promotes human happiness. A legal system to be socially useful must adhere strictly to its rules even at the expense of injustice in individual cases. Hume advanced the contention that public utility is the sole origin of legal justice and the sole foundation of its merit. For example a criminal has fewer rights than an innocent man but he is nevertheless accorded some measure of protection by law. Hume distinguished many of the separate ideas which jurists now find in the concept "LAW". Property in the broad sense employed by Hume embraced the individual's rights to life, liberty and health. Hume's solution of why men obey law is essentially a sociological and not an ethical one. He attempted to show that morality was founded on feeling and not reason. Justice can be understood only on the basis of sympathy for the welfare of human life.

KANT: Kant developed his system of law on principles that originate in reason. The Kantian rule became the celebrated injunction: "Every man is free to do that which he wills provided he infringes not the equal liberty of any other man." (Herbert Spencer). Kant's conception of right

became what he termed Universal Law of Right: Every action is right which in itself or in the maxim on which it proceeds, is such that it can exist along with the freedom of the will of each and all in action. Kant made a sharp distinction between ethics and law. Ethics as distinguished from law, does not impose upon me the obligation to make the fulfillment of rights a maxim of my conduct. Kant assigned possession two meanings, physical possession and rational or juridical possession. He stated anyone who would assert the right to a thing as his, must be in possession of it as an object. "The property right is essentially a guarantee of the exclusion of other persons from the use of handling the thing. To enforce this right the holder must be able to assert his right." Kant defines moveable property as everything that can be destroyed. Kant limits the right of taking possession of the soil to the extent of the capacity to defend it. Kant's important contribution is his idea that right is a thing that presupposes a collective will of all united in a relation of common possession. One of his most influential ideas is his theory of contract. Kant calls the transference of property to another its "alienation", and the act of united wills of two persons, by which what belongs to one passes to another, he terms "contract".

Kant held that four juridical acts are involved in every contract--two preparatory; an offer followed by an indication that the offer will be accepted; these two are followed by a promise and an acceptance. In civil law Kant's separation of offer and promise still prevail. By contract, Kant held, "I acquire the promise of another, as distinguished from the thing promised." His concept of the Criminal law turns on the idea of retributive justice. He defined crime as any transgression of the public law which makes him who commits it incapable of being a citizen.

FICHTE: For Fichte the basis of law is the idea of the legal relation. The conception of law is the conception of a relation between human beings. He defines this relationship as the compulsion upon each individual to restrict his freedom in recognition of the possibility of the freedom of others. He calls this the "relation of legality". In no sense is jurisprudence to be connected with morality. Jurisprudence is not a branch of ethics. Law merely permits but morality commands. Fichte's law is a law of freedom.

Individuals are free to accept or reject it. The end of law is a community of free beings. All positive laws follow the principle of right. They cannot be arbitrary and they must be such as every rational being would make them. Fichte reached the conclusion that natural law, or a legal relation between men, is not possible except in a commonwealth and under positive law. He asserted to supporting propositions: "all law is purely the law of reason", and "all law is the law of the state". Man separates himself from his citizenship in order to elevate himself with absolute freedom to morality; but in order to do so he becomes a citizen.

HEGEL: Hegel emphasized two ideas--will and personality. "Be a person and respect others as persons." From the ideas of will and personality he developed three categories of right -- possession of property, contract and wrongdoing and crime. Hegel's system is based upon a principle of knowledge, reason, which acts universally. The ethical rules which are to guide individuals must be given a universal form.

CONCLUSIONS

In the historical development of law there are many different points of view. It is for this reason

that the law is unable to accept without modification many of the results of ethical inquiry. In modern terminology law creates a duty "...there are no properties of goodness and badness that states of affairs an inherently possess, and no properties of rightness or wrongness that inhere in actions."

Value judgment in a broad sense compares contrasted ways of life; rationality, prudence and stability, (one of pleasure and happiness) versus the state of anxiety, confusion, inner turmoil and impulsive rashness. The first is a "good" way of life; the other is a "bad" way in terms of value. The best way of life involves the guidance of reason, and also the way of knowledge, of understanding, of relative freedom from error.

Moral responsibility rests solely on the attitude displayed in so-called "choice". The act of choosing is essentially a proper and stringent expression of the ethical. Whenever in a stricter sense there is a question of an either/or one can always be sure that the ethical is involved.

An ethic must first decide upon the kind of social effects which it desires to achieve and the kind which it desires to avoid. It must then decide, as far as our knowledge permits, what acts will promote the desired consequences; these acts it will praise, while those having a contrary tendency it will condemn. To the extent to which man has freedom, he needs a personal morality to guide his conduct. "Good and evil grow up together and are bound in an equilibrium that cannot be surrendered. The most we can do is try to tilt the equilibrium toward the good." The least we can do is be aware of our standards of conduct least "....the habit of being amoral should make the immoral come to seem right."

CHAPTER 2
AICPA ETHICS

LEARNING OBJECTIVES:

After studying this chapter you will be able to:

1. Differentiate between rulings and principles of the AICPA' Code of Professional Conduct.
2. Briefly describe the six principles.
3. List the eleven rules.
4. Outline ethics rulings on independence.
5. List consulting services prohibited by the Sarbanes-Oxley (SOX) Act of 2002..
6. Outline the standards for tax services
7. Explain disciplinary mechanisms within the profession.
8. List the key features of corporate responsibility law (Sarbanes-Oxley act).

This chapter covers the AICPA's *Code* of *Professional Conduct,* Statements on Standards for Consulting Services, and the disciplinary systems within the accounting profession. This chapter has six subunits. The first section is a condensed but comprehensive summary of the AICPA Code of Conduct. The second section contains summaries of AICPA Ethics Interpretations and Professional Ethics Rulings under the 11 Rules of Conduct. The third section addresses Statements on Standards for Tax Services. The fourth section lists some of the consulting services prohibited by the Sarbanes-Oxley (SOX) Act of 2002. The fifth section covers disciplinary systems within the profession. The final section outlines the key features of the SOX.

AICPA's CODE OF PROFESSIONAL CONDUCT

It consists of two sections: Principles and Rules. The six principles, which provide the framework for the rules, are goal-oriented and aspirational but nonbinding.

Synopses of the Six Principles

1. *Responsibilities.* Members should exercise sensitive professional and moral judgments when carrying out their professional responsibilities. Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism. A distinguishing mark of a profession is acceptance of its responsibility to the public.

2. *The Public Interest.* Members should act to benefit the public interest, honor the public trust, and demonstrate commitment to professionalism. The AICPA adopted the ethical standards because a distinguishing mark of a profession is an acceptance of responsibility to the public.

3. *Integrity.* Members should perform all professional responsibilities with the highest sense of integrity to maintain public confidence.

4. *Objectivity and Independence.* A member should maintain objectivity and be free of conflicts of interest. A member in public practice should be independent in fact and appearance when providing attestation services. Objectivity is a state of mind, a quality that lends itself to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

5. *Due Care.* A member should follow the profession's technical and ethical standards, strive for improved competence and quality services, and discharge professional responsibility to the best of the member's ability. Members must adequately plan and supervise any activity for which they are responsible.

6. *Scope and Nature of Services.* A member in public practice should follow the Principles of the *Code of Professional Conduct* in determining the nature and scope of services.

Synopses of the Eleven Rules

Rule 101 — *Independence.* A member in public practice should be independent when performing professional services as required by standards-setting bodies.

(1) In this context, rules of the state boards of accountancy, state CPA societies, the Independence Standards Board, the SEC, the General Accounting Office, and other bodies may be relevant.

(2) Relevant AICPA standards-setting bodies are the Auditing Standards Board (ASB), Accounting and Review Services Committee, and Management Consulting Services Executive Committee. The foregoing bodies are all authorized to promulgate attestation standards.

(3) The ASB issues Statements on Auditing Standards. Thus, SAS 1 is consistent with the requirement for auditors to maintain independence in mental attitude. To inspire public confidence, an auditor must not only be independent (intellectually honest) but also be recognized as independent (free of any obligation to, or interest in, the client).

(4) The fourth general attestation standard likewise requires practitioners to maintain independence in mental attitude when performing attest engagements.

(5) Under Statements on Standards for Accounting and Review Services, an accountant may not report on a review of the financial statements of a nonpublic entity if (s)he is not independent.

(6) According to the AICPA's Statements on Standards for Attestation Engagements, a practitioner must also be independent to examine or apply agreed-upon procedures to prospective financial statements.

(7) SEC independence regulations were revised in accordance with the Sarbanes-Oxley Act of 2002.

(a) Audit committees must preapprove the services performed by accountants (permissible nonaudit services and all audit, review, and attest engagements). Approval must be either explicit or in accordance with detailed policies and procedures. If approval is by the latter, the audit committee must be informed, and no delegation of its authority to management is allowed. However, preapproval is not needed for nonaudit services representing less than 5% of the annual amount paid to the accountant if (1) the services were not recognized as nonaudit at the time of the engagement, and (2) the audit committee approves prior to completion of the audit.

(b) An issuer must disclose in its proxy statement or annual filing fees paid to the accountant segregated into four categories: (1) audit, (2) audit-related, (3) tax, and (4) all other. The disclosure is for the two most recent years and must describe the services in (2)-(4).

(c) The lead and concurring (reviewing) audit partners must rotate every 5 years, with a 5-year time-out period. Other audit partners must rotate every 7 years, with a 2-year time-out.

(d) An accountant is not independent if, during the audit and the period of the professional engagement, any audit partner (excluding specialty partners such as tax partners) earns or receives compensation for selling services (excluding audit, review, or attest services) to the audit client.

(e) Conflicts of interest. An accounting firm is not independent with respect to an audit client if a former partner, principal, shareholder, or professional employee accepts employment with a client if (s)he has a continuing financial interest in the firm or is in a position to influence the firm's operations or financial policies. Moreover, an accounting firm is not independent if a CEO, CFO, controller, or person in an equivalent position for an issuer was employed by that firm and participated in any capacity in the audit of that issuer during the year before the beginning of the audit.

(f) Communications with the audit committee by the accounting firm must include (1) all critical accounting policies and practices; (2) all material alternative accounting policies and practices within GAAP that were discussed with management; and (3) other material written communications with management, such as management representations and schedules of unadjusted audit

differences. These communications must be prior to filing the audit report with the SEC.

Rule 102 — *Integrity and Objectivity.* A member shall maintain objectivity and integrity, be free of conflicts of interest, not knowingly misrepresent facts, and not subordinate his/her judgment to others when performing professional services.

Rule 201 — *General Standards.* A member shall comply with the following:

(1) Undertake only those services that the member can reasonably expect to complete with professional competence.

(2) Exercise due professional care when performing professional services.

(3) Adequately plan and supervise performance of professional services.

(4) Obtain sufficient relevant data to provide a reasonable basis for conclusions in relation to any professional service.

(a) Proficiency. Auditors must have adequate technical training and proficiency. According to SAS 1, both education and experience, as well as proper supervision, are necessary. Objectivity and independent judgment are necessary in the preparation of the audit opinion. An auditor must have experience and seasoned judgment to accept final responsibility for an audit opinion.

(b) Due professional care must be exercised in the planning and performance of the audit and the preparation of the report. According to SAS 1, an auditor should have the degree of skill commonly possessed by other auditors and must exercise it with reasonable care and diligence. An auditor should also exercise professional skepticism. The exercise of due professional care allows the auditor to obtain reasonable assurance. Absolute assurance is impracticable due to characteristics of fraud such as concealment by collusion, withheld or falsified documentation, or management override of controls.

Rule 202 — *Compliance with Standards.* A member who performs professional services must comply with promulgated standards.

Rule 203 — *Accounting Principles.* A member shall not express an opinion or make an affirmative statement about conformity with GAAP or state that (s)he is not aware of any material modifications that should be made to achieve conformity with GAAP, given any departure from an accounting principle promulgated by bodies designated by the AICPA Council to establish such principles that has a material effect on the financial statements or data taken as a whole. However, if the member can demonstrate that, due to unusual circumstances, the financial statements or data would have been misleading without a departure from GAAP, the member can comply with the rule by describing the departure, its approximate effects, if

practicable, and the reasons compliance with the principle would be misleading.

Rule 301 — *Confidential Client Information.* A member in public practice cannot disclose confidential client information without the client's consent. However, this Rule does not affect a CPA's obligations

(1) To comply with a validly issued and enforceable subpoena or summons or with applicable laws and regulations

(2) To discharge his/her professional obligations properly under Conduct Rules 202 and 203

(3) To cooperate in a review of the CPA's professional practice under AICPA or state CPA society or board of accountancy authorization

(4) To initiate a complaint with or respond to any inquiry made by the professional ethics division, trial board of the AICPA, or an investigative or disciplinary body of a state society or board of accountancy

Rule 302 — *Contingent Fees.* A contingent fee is established as part of an agreement under which the amount of the fee is dependent upon the finding or result.

(1) The receipt of contingent fees by a member is prohibited when the member performs an audit, a review, a compilation when the report will be used by third parties and the report does not disclose the CPA's lack of independence, or an examination of prospective financial information.

(2) A contingent fee is not permitted for preparing an original or amended tax return or claim.

(3) Fees are not deemed to be contingent if fixed by courts or other public authorities, or in tax matters, if they are based on the results of judicial proceedings or the findings of governmental agencies.

Rule 501 — *Acts Discreditable.* A member shall not commit an act that is discreditable to the profession. Withholding as a result of nonpayment of fees for a completed engagement certain information contained in the client's books would not be considered such an act. The member's duty to return client records is absolute. However, the duty to return other information not related to the client's books and records is not absolute. Although the client's financial information may be incomplete as a result, if fees for a completed engagement have not been paid, such other information may be withheld. Thus, the duty to return is conditional upon payment of fees with respect to information such as adjusting, closing, combining, or consolidating entries and information normally found in books of original entry and general or subsidiary ledgers.

Rule 502 — *Advertising and Other Forms of Solicitation.* A member in public practice shall not

seek to obtain clients by advertising or other forms of solicitation done in a false, misleading, or deceptive manner. Solicitation through coercion, overreaching, or harassing conduct is prohibited.

Rule 503 — *Commissions and Referral Fees.* A member in public practice shall not accept a commission for recommending or referring to a client any product or service, or for recommending or referring any product or service to be supplied by a client, if the member performs for that client an audit, a review, a compilation when a third party will use the financial statement and the report does not disclose the CPA's lack of independence, or an examination of prospective financial information.

(1) Permitted commissions must be disclosed to any person or entity to whom the member recommends a product or service.

(2) A member who accepts a referral fee for recommending services of a CPA or who pays a referral fee to obtain a client must disclose the arrangement to the client. A referral fee is compensation for recommending or referring any service of a CPA to any person. Referral fees are not considered commissions.

Rule 505 — *Form of Organization and Name.* A member may practice public accounting only in a form of organization allowed by law or regulation that conforms with resolutions of the AICPA Council.

1) The firm name must not be misleading.

2) Names of past owners may be included in the name of the successor organization.

3) A firm cannot designate itself as "members of the AICPA" unless all CPA owners are members.

Definitions. The following are summaries of selected ethics definitions.

- *Attest engagement* — One that requires independence.

- *Attest engagement team* — Participants in the engagement, including partners who perform concurring or second reviews and all employees and contractors retained by the firm, but excluding specialists.

- *Close relatives* — Parents, siblings, or nondependent children.

- *Covered member* — (1) An individual on the attest engagement team or who is able to influence the engagement, (2) a partner or manager who provides at least 10 hours of nonattest services to a client, (3) a partner in the office where the lead engagement partner primarily practices in relation to the engagement, (4) the firm (including its

benefit plans), and (5) an entity that can be controlled by the foregoing parties.

- *Financial institution* — An entity that normally makes loans to the public.

- *Firm* — A form of organization permitted by law or regulation that is consistent with the resolutions of the AICPA's Council and practices public accounting. The term "firm" includes partners except for the purposes of Rule 101.

- *Immediate family* — A covered member's spouse, equivalent of a spouse, or dependents.

- *Individual in a position to influence the attest engagement* — One who (1) evaluates the attest engagement partner or recommends his/her compensation; (2) directly supervises or manages that partner, including all levels above such supervisor or manager; (3) consults with the engagement team about technical or industry-related issues; or (4) participates in or oversees quality control for the engagement, including all senior levels.

- *Joint closely held investment* — An investment in any entity or property by the member and (1) the client, (2) the client's officers or directors, or (3) an owner who can exercise significant influence if the investment permits such parties to control the entity or property.

- *Key position* — One in which an individual is primarily responsible for (1) significant accounting functions supporting material financial statement components, or (2) for the preparation of the statements. A key position is also one able to influence financial statement content, for example, director, CEO, CFO, general counsel, chief accountant, director of internal audit, or treasurer.

- *Normal lending procedures, terms, and requirements* — Those reasonably comparable with those for similar loans to others from the financial institution in the period when a commitment was made for a loan to a covered member.

- *Period of the professional engagement* — This period starts at the earlier of when the member signs an initial engagement letter to perform attest services or begins to perform. It continues for the entire professional relationship and does not end with the issuance of a report and start again with the next year's engagement. It ends with the later of notification by the member or client or by issuance of a report.

Note: Common law does not recognize privileged communication between a CPA and client. In some states and in some federal tax matters, however, the auditor may be protected by a privilege created by statute.

INTERPRETATIONS AND RULINGS

Interpretations and rulings are presented for each of the eleven Rules. The Interpretations are in outline format followed by brief summaries of the Rulings.

Rule 101 — *Independence.*

A. Interpretation 101-1 (Interpretation of Rule 101)

1. Independence is impaired if, during the period of the professional engagement, a covered member

1) Had a direct financial interest or a material indirect financial interest in the client.
2) Was a trustee of any trust or executor of any estate that had a direct or material indirect financial interest in the client AND (1) the covered member's position conferred investment authority, (2) the trust/estate owned more than 10% of the client, or (3) the interest of the trust/estate was more than 10% of its total assets.
3) Had any joint, closely held investment that was material to the covered member.
4) Had a loan to or from a client, any of its officers or directors, or an individual owning at least 10% of the client. Exceptions are grandfathered loans and certain other permitted loans.

2. Independence is impaired if, during the period of the professional engagement, a firm partner or professional employee, such individual's immediate family, or a group of these individuals acting together owned more than 5% of the client.

3. Independence is impaired if, during the period covered by the financial statements or during the period of the professional engagement, a firm, or partner or professional employee of the firm, was

1) Also associated with the client as an officer, director, employee, promoter, underwriter, or voting trustee, or in a management capacity.
2) A trustee for any pension or profit-sharing trust of the client.

4. An individual may have been employed by the client or associated with the client in a capacity listed in Interpretation 101-3. Independence is impaired if (1) the employment or association overlapped the engagement, and (2) the individual participated in the engagement or was able to influence it. Independence is also impaired if the individual was otherwise a covered member relative to the client unless the individual dissociates from the client by

1) Ending any relationship described in Interpretation 101-3.
2) Disposing of any direct or material indirect financial interest in the client,
3) Collecting or repaying any loans to or from the client (except as permitted under the rules for grandfathered loans),
4) Ceasing participation in any client-sponsored employee benefit plan (unless the

client is legally required to allow participation and the individual pays the full cost), and

5) Liquidating or transferring any vested benefits in a client plan as soon as legally permitted. This is not required if a large penalty would result.

5. A covered member's immediate family is subject to Rule 101. However, independence is not impaired solely because

1) An immediate family member was employed by the client in a non-key position.
2) As part of his or her employment, an immediate family member of one of the following participated in a benefit plan that is a client, is sponsored by a client, or invests in a client if the plan is offered to all similarly situated employees:
   a) A partner or manager who provided at least 10 hours of nonattest services to the client
   b) Any partner in the office where the lead engagement partner primarily practiced in relation to the engagement

6. Independence is impaired if an individual who is participating on the engagement team, who can influence the engagement, or who is a partner in the office where the lead engagement partner primarily practices, has a close relative who

1) Occupied a key position with the client,
2) Held a material financial interest in the client that was known to the individual, or
3) Held a financial interest that permitted significant influence over the client.

7. Because listing all situations in which an appearance of a lack of independence might arise is not feasible, members also should consider whether a relationship between the member and the client or an associate of the client might lead to a reasonable conclusion that independence is lacking.

8. Under Rule 101, materiality is determined by aggregating the interests of the covered member and his/her immediate family.

B. Interpretation 101-2 (Employment or association with attest clients)

A former partner or professional employee (POPE) of the firm who is employed by or associated with an attest client in a key position impairs the firm's independence unless

(1) Amounts due to the former POPE are not material to the firm, and the payment formula is fixed during the payout period. Retirement benefits may also be adjusted for inflation, and interest may be paid.

(2) The former POPE cannot influence the firm's operations or financial policies.

(3) Once employed or associated with the client, the former POPE does not participate or appear to participate in, and is not associated with, the firm, regardless of compensation, for example, by consulting, use of an office, or inclusion in membership lists.

(4) The engagement team considers the risk that the POPE's knowledge of the audit plan will reduce audit effectiveness.

(5) The firm assesses when team members can effectively deal with the POPE.

(6) The engagement is reviewed to determine whether team members maintained professional skepticism in dealings with the POPE.

A team member's consideration of employment or association with the client impairs independence absent prompt reporting to the firm and removal from the team.

C. Interpretation 101-3 (Performance of nonattest services)

1) Before a member and his or her firm performs nonattest services (such as tax or consulting services) for an attest client, (s)he must comply with Interpretation 101-3 to avoid impairment of independence. If the applicable independence rules of an authoritative body (e.g., the SEC or a state board of accountancy) are more restrictive, the member must comply with them.

2) General Requirements. Performing management functions or making management decisions impairs independence, but providing advice, research, and recommendations does not.

   a) The member should be satisfied that the client will make an informed judgment about the results of nonattest services and be able to designate a competent employee (preferably a senior manager) to oversee the services; evaluate their adequacy and results; make management decisions and perform management functions; accept responsibility for results; and establish and maintain internal controls.

   b) The member and client should agree about the objectives and limitations of the engagement, the services to be performed, and mutual responsibilities. The understanding should be documented in writing. This requirement does not apply to routine services, those provided before the client became an attest client, and those performed before 2005.

3) General activities that impair independence include

   a) Exercise or possession of authority over transactions on a client's behalf
   b) Preparing source documents evidencing transactions

c) Custody of client assets
d) Supervision of client employees in normal activities
e) Determining member recommendations to be implemented
f) Reporting to the board on behalf of management
g) Service as a stock transfer or escrow agent, registrar, or general counsel

4) Examples of nonattest services that may not impair independence if the general requirements are met include bookkeeping, disbursement, benefit plan administration (e.g., preparing participant account valuations and statements), investment advisory, finance, executive search, business risk consulting, and IT (but designing a system or operating a network impairs independence).

5) An appraisal, valuation, or actuarial service impairs independence if the results are material to the financial statements and significant subjectivity is involved. For example, a valuation for a business combination, but not an actuarial valuation for a pension liability, usually involves significant subjectivity. Furthermore, appraisal, valuation, and actuarial services not performed for financial statement purposes do not impair independence if the other requirements of Interpretation 101-3 are satisfied.

6) Internal audit assistance services impair independence unless the member ensures that the client understands its responsibility for internal control and managing the internal audit function. Accordingly, the member must ensure that the client designates a competent individual to oversee internal audit; determines the scope, risk, and frequency of its activities; evaluates its findings; and evaluates the adequacy of its procedures.

a) The member should be satisfied that the client's governing body is informed about his/her role so that it can develop proper guidelines.
b) The member may assist in preliminary risk assessment, preparation of the audit plan, and recommendation of priorities.
c) Independence is impaired if the member, among other things, performs an ongoing monitoring or control function, determines which control recommendations are adopted, reports to the board on behalf of management, approves or is responsible for the overall audit work plan, or is a client employee or manager (or the equivalent).
d) Services that are normal extensions of the external audit scope (e.g., confirming receivables or analyzing balances) and engagements under the attestation standards do not impair independence.

7) SEC regulations promulgated under the Sarbanes-Oxley Act of 2002 prohibit auditors of public companies from performing certain nonaudit services:

a) Appraisal and other valuation services.
b) Designing and implementing financial information systems.

c) Internal auditing or actuarial functions unless the firm reasonably concludes it will not examine such work during the financial statement audit.
d) Management services.
e) Human resource services.
f) Bookkeeping if the firm also conducts an audit.
g) Expert services not pertaining to the audit.
h) Investment banking or advisory services.
i) Broker-dealer services.

D. Interpretation 101-4 (Honorary directorships and trusteeships of non-for-profit organizations)

A member in an honorary position will not impair independence if (s)he is associated with the financial statements of a not-for-profit organization that (s)he allows to use his/her name on letterheads and circulated materials to lend prestige to the organization. However, the member should not be able to vote or participate in board or management decisions and should be identified as an honorary director or trustee.

E Interpretation 101-5 (Loans from financial institution clients)

1) Grandfathered loans. Independence is not impaired by (a) unsecured loans that are not material to the covered member's net worth or (b) secured loans (including home mortgages) provided that the loans were obtained from a financial institution under its normal lending procedures, terms, and requirements. However, loans are grandfathered only if

   a) They were kept fully current at all times after the borrower became a covered member, and the terms did not change in a way not allowed in the original agreement.
   b) They were obtained
      i) From a financial institution before it became a client requiring independence;
      ii) From a client not requiring independence and were sold to one requiring independence;
      iii) Prior to February 5, 2001 and satisfied the requirements of the Interpretation then effective;
      iv) During the period from February 5, 2001 through May 31, 2002, and the covered member complied with SEC regulations then effective; or
      v) After May 31, 2002 from a client requiring independence before the borrower became a covered member relative to the client.

2) The date a grandfathered loan is obtained is the date a loan commitment or line of

credit was granted.

3) The collateral for a secured grandfathered loan must equal or exceed the remaining balance of the loan during its term. If the loan exceeds the value of collateral, this excess must not be material to the covered member's net worth.

4) In the case of a limited partnership in which covered members have a combined interest exceeding 50% or a general partnership in which covered members control the partnership, the loan is ascribed to each covered member based on his/her legal liability as a limited or general partner. Even if this amount is zero, renegotiating the loan or entering into a new loan that is not an "other permitted loan" is deemed to impair independence.

5) Other permitted loans. The following loans are permitted even if the client is one for which independence is required, provided that they are obtained under normal lending procedures, terms, and requirements and are always kept current:

   a) Automobile loans and leases collateralized by the automobile
   b) Loans fully collateralized by the cash surrender value of insurance
   c) Loans fully collateralized by cash deposits
   d) Credit cards and overdraft reserve accounts with an aggregate outstanding balance of $10,000 or less on a current basis by the payment due date

F. Interpretation 101-6 (Effect of actual or threatened litigation)

1) Litigation between client and member
   a) Independence is impaired when litigation is begun by
      i) The present management alleging deficiencies in audit work
      ii) The member alleging management fraud or deceit
   b) An expressed intention by the management to litigate against the member for alleged deficiencies in audit work will impair independence if it is probable that the claim will be filed.
   c) Independence is not impaired when the threatened or actual litigation is not related to the audit and the amount is not material. Examples include disputes over billings for services and results of tax advice.

2) Litigation by security holders (primary litigation)

   a) Shareholders may bring a class action against the client company or its management without impairing independence. Often the member and the client are both defendants, but if cross-claims are filed, adverse interests may arise and independence may be impaired.
   b) Cross-claims filed by the client to protect a right to legal redress in the event of a future adverse decision do not impair independence in the

absence of a significant risk of a material settlement.

c) Cross-claims against the member by an underwriter do not impair independence if no similar claims are made by the client.

d) Cross-claims filed against the member by persons who are also officers or directors of other clients do not usually impair independence with respect to the other clients.

3) Other third-party litigation

a) Litigation may be commenced against the member by a creditor or insurer that alleges reliance on financial statements of the client. This litigation does not affect independence if the client is not the plaintiff or is a nominal plaintiff. Independence may be impaired if the third party (e.g., an insurance company) is also a client of the member and there is a significant risk of a material settlement.

4) If a reasonable person would conclude that litigation poses an unacceptable risk of impairment of independence, the member should disengage or disclaim an opinion for lack of independence.

G. Interpretation 101-8 (Financial interests in nonclients having investor or investee relationships with the client)

1) Independence is impaired when

a) A member has a direct or material indirect financial interest in the nonclient if the investee is material to the investor.

b) A member has a material interest in a nonclient who is an immaterial investee of the client investor.

c) A member can exercise significant influence over a nonclient investor who has an immaterial interest in the client investee.

2) Independence is not impaired if a member did not know about the financial interests described above.

H. Interpretation 101-10 (Effect on independence of relationships with entities included in governmental financial statements)

1) A financial reporting entity's basic financial statements (BFS) issued in accordance with U.S. GAAP include the government-wide statements (reporting governmental activities, business-type activities, and discretely presented component units), fund financial statements (reporting major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds), and other entities disclosed in the notes of the BFS. Disclosures should be made in the

notes to the BFS about related organizations, joint ventures, jointly governed organizations, etc.

2) An auditor of the BFS of the entity must be independent of it. Nevertheless, a primary auditor need not be independent with respect to any fund, component unit, or disclosed entity if (s)he explicitly relies on reports by other auditors on such fund, etc. Moreover, (s)he need not be independent of a disclosed entity if the reporting entity is not financially accountable for it and the required disclosure does not include financial information.

a) Neither the covered member nor a member of his/her immediate family should occupy a key position with a fund, component unit, or disclosed entity.

3) An auditor of the statements of a fund, component unit, or disclosed entity who is not auditing the primary government must be independent only of the statements reported on. Nevertheless, the covered member or a member of his/her immediate family may not occupy a key position with the primary government.

I. Interpretation 101-11 (Independence and attest engagements)

1) This interpretation applies only to engagements, other than examinations and reviews, covered by SSAEs when the use of the report is restricted.

2) The following covered members and their immediate families must be independent in relation to the responsible party:

a) An individual on the attest engagement team.

b) An individual who directly supervises or manages the attest engagement partner.

c) Individuals who consult with the attest engagement team about technical or industry-related matters specific to the engagement.

3) Independence is impaired if the firm had a material relationship with the responsible party prohibited under Rule 101.

4) A firm may provide nonattest services to the responsible party that are prohibited due to an association as an employer, director, officer, promoter, voting trustee, or pension trustee. However, if they do not relate directly to the subject matter of the attest engagement, independence is not impaired.

5) When the party that engages the firm is not the responsible party or associated

therewith, individuals on the attest engagement need not be independent of the party that engaged the firm. However, they should consider their responsibilities regarding conflicts of interest.

J. Interpretation 101-12 (Independence and cooperative arrangements with clients)

1) Independence is impaired if, during the engagement or at the time of expressing an opinion, a member's firm had any material cooperative arrangement with the client.

   a) A cooperative arrangement means joint participation in a business activity.

K. Interpretation 101-14 (Effect of APSs on independence rules)

1) The independence rules for an alternative practice structure (APS) apply to all structures in which "the 'traditional firm' engaged in attest services is closely aligned with another organization, public or private, that performs other professional services." For example, a CPA firm may be sold to another entity having subsidiaries or divisions such as a bank, an insurance company, a broker-dealer, and entities providing nonattest services (tax, management consulting, etc.). The owners and employees of the CPA firm become employees of one of the parent's subsidiaries or divisions and may offer nonattest services. Moreover, the original owners of the acquired CPA firm create a new CPA firm to offer attest services. The majority ownership of the new firm must be held by CPAs, but it leases employees, offices, and equipment from the parent, which may also provide advertising and perform back office functions. The owners of the new CPA firm pay a negotiated amount for such services.

2) In the example above, the term "member or a member's firm" includes the new CPA firm (the firm) and any leased or employed person or entity.

3) When two or more new CPA firms are "closely aligned" with another organization, issues arise as to whether owners of one perform services or have significant economic interests in another. Thus, if an owner of one performs services for another, (s)he is deemed to be an owner of both. Similar issues arise regarding managers (leased or otherwise).

4) In an APS, persons and entities included in "member or a member's firm" are closely aligned with other persons and entities. The latter include direct superiors who can directly control the activities of an owner or manager. A

direct superior is an immediate superior who can direct the activities of an owner or manager so as to be able to directly or indirectly derive a benefit. Direct superiors are subject to the same independence rules as persons included in "member or a member's firm."

5) An indirect superior (defined to include a spouse, cohabitant, or dependents of an indirect superior) is one or more levels above a direct superior and does not have a direct reporting relationship with the new CPA firm's owners and managers. Less restrictive standards apply to indirect superiors and to other entities in the consolidated group.

a) These parties may not have a relationship involving a direct financial interest or an indirect material financial interest with an attest client of the new CPA firm that is material.

b) These parties also should not exercise significant influence over the attest client.

c) Other entities in the consolidated group and their employees may not be promoters, underwriters, directors, officers, or voting trustees of an attest client. However, with the foregoing exceptions, indirect superiors and other consolidated entities may provide services to an attest client that a member could not without impairing independence.

6) The new CPA firm may not perform a service requiring independence for any entity in the consolidated group.

7) Independence is impaired with regard to an attest client who exercises significant influence over, or has a material investment in, the parent.

8) Referrals within the consolidated group are subject to the provisions regarding conflicts of interest.

Ethics Rulings on Independence — Rule 101.

Independence Not Impaired

1. Membership in a client trade association provided the member is not an officer or a director, or in a position equivalent to management.

2. The member provides advisory services for a client.

3. A member is designated to serve as an executor of an individual's estate that owns the majority of the stock of a corporation. Independence with respect to the corporation is not

impaired unless the member serves as executor.

4. A CPA is a director of a federated fund-raising organization, e.g., United Way, and audits local charities receiving funds. Independence with respect to the charities is not impaired unless the organization exercises managerial control over them.

5. A CPA has a pro rata share of securities in a social club, unless (s)he is on the governing board or takes part in management.

6. A member serves on a citizens' committee advising a county and on another committee advising the state where the county is located.

7. A CPA's ownership of shares in a mutual fund that holds some of a client's shares. Independence becomes impaired if the indirect interest becomes material or the CPA has significant influence over the mutual fund.

8. A member and a client bank serve in a co-fiduciary capacity with respect to an estate, provided the estate assets are not material.

9. A client financial services company has custody of a covered member's assets (not in depository accounts); services are provided under its normal procedures, terms, and requirements; and any assets subject to risk of loss are immaterial to the member's net worth.

10. Independence is not impaired if a member audits an employee benefit plan unless a partner or professional employee of the firm had significant influence over the employer(s); was in a key position with the employer; or was associated with the employer as a promoter, underwriter, or voting trustee.

11. The mere servicing of a member's loan by a client financial institution.

12. When a covered member has a checking or savings account, certificate of deposit, or money market account in a client financial institution, provided the amounts are fully insured. Uninsured amounts do not impair independence if they are immaterial or if they are reduced to an immaterial balance within 30 days. A firm's independence is not impaired if the probability is remote that the depository institution will have financial difficulty.

13. Membership in a client credit union if all the following are met:

    1. Each member qualifies to join the credit union without regard to the professional services.

    2. The member's vote must not have significant influence over policies.

    3. Loans must be limited to grandfathered and other permitted loans made under normal procedures, terms, and requirements.
    4. Any deposits with the credit union must meet the conditions in number 12.

14. A member's service as treasurer of a mayoral campaign organization. Independence is impaired with respect to the organization itself, but not the political party of the candidate or

the city.

15. If a member leases property to or from a client under an operating lease with terms comparable to those of similar leases, and all amounts are paid in accordance with the lease. If, however, the lease is a capital lease, independence would be impaired unless the lease is tantamount to a permitted loan.

16. Inclusion of a clause in an engagement letter providing for member indemnification by the client.

17. A predispute agreement with a client to use alternative dispute resolution (ADR) techniques.

18. Commencement of an ADR proceeding. However, Interpretation 101-6 applies, and independence may be impaired if the proceeding is sufficiently similar to litigation because the parties have material adverse interests, e.g., in binding arbitration.

19. Performing extended audit services regarding reporting on internal control if management assumes responsibility for control, and management does not rely on the member's work as the primary basis for its assertion.

Independence Impaired

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1. Acceptance of more than a token gift from a client.

2. The member signs or cosigns checks or purchase orders or exercises general supervision to ensure compliance as a representative of a creditors' committee in control of a debtor corporation.

3. The member serves as an elected legislator in a municipal body at the same time as (s)he is performing an audit of that body.

4. With respect to a foundation and an estate if the member is a trustee of the foundation that is the beneficiary of the estate.

5. A CPA serves on the board of directors of a client nonprofit social club.

6. A CPA is on a client's committee that administers the deferred compensation program.

7. A CPA is a director of a company and an auditor of the profit sharing and retirement trust.

8. A CPA owns an immaterial amount of bonds in a municipal authority (considered a loan).

9. With respect to a common interest realty association (CIRA) as a result of owning or leasing realty. But no impairment occurs if the CIRA has governmental functions, the CPA's annual assessment is immaterial, sale of the CIRA or common assets does not result in a distribution to the member, CIRA creditors have no recourse to the member, and the CPA is not a manager or employee of the C IRA.

10. A CPA owns an investment club that holds a client's shares (a direct financial interest).

11. A member of a university's faculty audits the student senate fund (the member will audit functions performed by the university, which is his/her employer).

12. If billed or unbilled fees, or a note arising from the fees, for client services rendered more than 1 year before the current year's report date remain unpaid. Not applicable if the client is in bankruptcy.

13. When a CPA is on the board of directors of a fund-raising organization; unless the position is honorary.

14. If a member's retirement or savings plan has a direct or material indirect financial interest in a client.

15. A direct financial interest in a client whether or not the interest is placed in a blind trust.

16. For both partnerships, when two limited partnerships have the same general partner and a member has a material interest in one of the partnerships.

17. The use of partners, shareholders, and professional employees from another firm that is not independent of the client. Their work can be used in the same manner as that of internal auditors.

18. A CPA's service on a client's advisory board unless it

    a. Is in fact advisory.
    b. Has no authority to make management decisions, and
    c. Is distinct from the board of directors with few common members.

19. A CPA who is not independent may not express an audit opinion or issue a review report, but (s)he may issue a compilation report disclosing the lack of independence.

20. A member who is a general partner in a partnership that invests in a client. If the member is a limited partner, independence would not be impaired unless the interest in the client is material.

21. If a member is a limited partner in a limited partnership (LP) and the client is a general partner, the member lacks independence with respect to the LP, the client if the client has a material interest in the LP, and a subsidiary of the LP if the member's interest is material.

22. A member's joint interest in a vacation home with a principal shareholder of a client will be considered a "joint closely held business investment' (even if it is only intended for personal use) if the interest is material.

23. Unless a loan from a nonclient subsidiary of a client parent is "grandfathered" or "permitted" under Interpretation 101-5, it impairs independence with respect to the parent. However, a loan from a nonclient parent does not impair independence with respect to a client subsidiary

if the subsidiary is not material to the parent.

24. If a report was issued when a member was independent, (s)he may reissue it or consent to its use when his/her independence is impaired provided (s)he did not do any post-audit work (not including reading subsequent statements or inquiries of subsequent auditors) while not independent.

25. Agreeing to indemnify a client for losses arising from lawsuits, etc., that relate directly or indirectly to client acts impairs independence.

26. When a member has significant influence over an entity with significant influence over a client.

27. Independence is impaired with respect to the client and the plan if a member participates in a client's health and welfare plan. But, if participation arises from permitted employment of the immediate family of the covered member, no impairment occurs provided the plan is offered to all employees in equivalent positions.

28. When investment contributions by a member are invested or managed by a nonclient firm that offers financial services products (FSP5) that allow the member to direct his/her investment, independence is impaired if the FSP is invested in that client, whether or not the member directs the investment (a direct interest). If the member does not have authority to direct the investment, and the FSP invests in the client, an indirect interest results. If it is material to the member, independence is impaired. If the FSP invests only in the member's clients, the interest is direct, and independence is impaired.

29. A member's performing investment management or custodial services for an employee benefit plan sponsored by a client impairs independence regarding the plan. Independence is also impaired regarding the client-sponsor of a defined benefit plan if the assets involved are material to the plan or sponsor. Independence is not impaired regarding a client-sponsor of a defined contribution plan if the member performs no management functions and does not have custody of the assets.

Rule 102— *Integrity and Objectivity.*

a. Interpretation 102-1. Knowing misrepresentations of facts include knowingly making materially false and misleading entries in financial statements or records, failing to make corrections in materially false or misleading statements or records when the member has such authority, or signing a document with materially false and misleading information.

b. Interpretation 102-2. If a conflict of interest arises that could impair objectivity When a member performs a professional service, Rule 102 will not prohibit the service if disclosure is made to and permission is obtained from the appropriate parties. However, an independence objection cannot be overcome by disclosure and consent. The following are examples of situations in which

objectivity may be impaired:

1) Performing litigation services for the plaintiff when the defendant is a client

2) Providing tax or personal financial planning (PFP) services to both parties to a divorce

3) Suggesting that a PFP client invest in a business in which the member has an interest

4) Providing tax or PFP services to family members with conflicting interests

5) Performing consulting services for a client that is a major competitor of a company in which the member has a significant financial interest, occupies a management position, or exercises influence

6) Serving on a board of tax appeals that hears matters involving clients

7) Providing services in connection with a real estate purchase from a client

8) Referring a tax or PFP client to a service provider that refers clients to the member under an exclusive arrangement

9) Referring a client to a service bureau in which the member or a partner in the member's firm has a material interest

c. Interpretation 102-3. In dealings with an employer's external accountant, a member must be candid and not knowingly misrepresent facts or fail to disclose material facts.

d. Interpretation 102-4. If a member and his/her supervisor have a dispute about statement preparation or recording of transactions, the member should do nothing if the supervisor's position is an acceptable alternative and does not materially misrepresent the facts.

1) If the member concludes that a material misstatement would result, (s)he should consult the appropriate higher level(s) of management and should consider documenting relevant matters.

2) If, after such discussions, the member concludes that action was not taken, (s)he should consider the continuing relationship with the employer, the obligation to communicate with third parties, and the desirability of consulting legal counsel.

e. Interpretation 102-5. Educational services, e.g., teaching and research, are professional services subject to Rule 102.

f. Interpretation 102-6. Professional services involving client advocacy are governed by the Code, e.g., Rules 201, 202, 203, and 102. If independence is required for a service, Rule 101 also applies.

1) If the service stretches the bounds of performance standards, exceeds sound and reasonable professional practice, or compromises credibility, and therefore poses an unacceptable risk of injury to the member's or the firm's reputation, the propriety of accepting the engagement should be considered.

Ethics Rulings on Integrity and Objectivity — Rule 102.

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1. A member in public practice should not ordinarily serve as a director of a bank if it engages in significant transactions with his/her clients. The rules on confidential client information and conflict of interest may be violated.

2. The use of the CPA designation by a member not in public practice if it implies the member is independent of his/her employer is an intentional misrepresentation. The member should clearly indicate the employment title in any transmittal in which (s)he uses the CPA designation. If the member states that a financial statement conforms with GAAP, Rule 203 applies.

3. A member is a director of a federated fund-raising organization from which local charities that are clients (with significant relationships with the member) receive funds. If the significant relationship is disclosed and consent is received from the appropriate parties, performance of services not requiring independence is allowed.

4. A company approaches a member to provide PFP or tax services for its executives, who consent to the arrangement and are aware of any relationship the member has with the company. The result of the services could be recommendations adverse to company interests. Rule 102 and Rule 301 do not prohibit acceptance of the engagement if the member believes (s)he can perform objectively. The member should consider informing all parties of possible results. The member should also consider responsibilities to the company and to the executives under Rule 301.

5. Service as an expert witness does not constitute client advocacy.

6. If a member is an officer, director, or principal shareholder of an entity having a loan to or from a client, independence is impaired with respect to that client if the member controls the entity, unless the loan is specifically permitted. If the member does not control the entity, the guidance in the interpretations should be considered. Disclosure and consent may therefore overcome the conflict-of-interest objection and permit the performance of the professional service for the client, provided the member believes it can be done with objectivity.

Rule 201 — *General Standards.*

a. Interpretation 201-1. A member should have the competence to complete professional services according to professional standards and with reasonable care and diligence.

1) Competence involves technical qualifications and the ability to supervise and evaluate the work. It relates to knowledge of standards, techniques, and technical subject matter and to the ability to exercise sound judgment.

2) In some cases, additional research and consultation is a normal part of performing services. However, if a member cannot gain sufficient competence, (s)he should suggest the engagement of someone competent.

Rule 202 — *Compliance with Standards.* No interpretations.

Rule 203 — *Accounting Principles.*

a. Interpretation 203-1. Professional judgment should be used in determining what constitutes unusual circumstances requiring a departure from established principles to prevent the financial statements or data from being misleading. Events that may justify such departures are new legislation or evolution of a new form of business transaction. An unusual degree of materiality or conflicting industry practices ordinarily do not justify departures.

b. Interpretation 203-2. The body designated to establish accounting principles for nongovernmental entities is the FASB. Unsuperseded SFASs, ARB5, and APB Opinions are accounting principles within the meaning of Rule 203. The GASB, with respect to Statements of Governmental Accounting Standards, is the designated body for state and local governments. The Federal Accounting Standards Advisory Board (FASAB), with respect to its Statements of Federal Accounting Standards adopted and issued beginning in March 1993, is the designated body for federal governmental entities.

c. Interpretation 203-4. Rule 203 applies to all members regarding any affirmative statement about GAAP conformity.

1) Thus, Rule 203 applies to members who sign client reports to regulatory agencies, creditors, or auditors that contain such representations.

Ethics Rulings on General and Technical Standards — Rules 201, 202, 203.

1. The member has a responsibility to make sure that a subcontractor (s)he has selected has the professional qualifications and skills needed.

2. A member is not required to be able to perform all the services of a newly hired systems analyst. But the member must be qualified to supervise and evaluate the specialist's work.

3. If a member submits financial statements in his/her capacity as an officer, shareholder, partner, director, or employee to a third party, the member's relationship to the entity should be clearly communicated. No implication of independence should be made. Rule 203 applies if the communication states that the financial statements conform with GAAP. If the member acts as a public practitioner or submits the statements on his/her public practitioner's letterhead, (s)he should comply with applicable standards, including disclosure of lack of independence.

4. Rule 203 applies to members who perform litigation support services.

Rule 301 — *Confidential Client Information*

a. Interpretation 301-3. The rule against disclosure of confidential information does not prohibit the review of a member's professional practice pursuant to a purchase, sale, or merger of the practice. However, appropriate precautions (e.g., a written confidentiality agreement) should be taken so that the prospective buyer does not disclose any confidential client information.

Rule 302 — *Contingent Fees.*

a. Interpretation 302-1. An example of circumstances in which a contingent fee is not allowed is the preparation of an amended income tax return for a client claiming a refund of taxes because of an inadvertent omission of a proper deduction.

1) Examples of circumstances in which a contingent fee is allowed include

a) Representation of a client in an examination by a revenue agent
b) Representation of a client who is obtaining a private letter ruling
c) Filing an amended tax return claiming a refund based on a tax issue that is the subject of a test case involving a different taxpayer

Ethics Rulings on Responsibilities to Clients — Rules 301 and 302.

1. A member may use an outside service to process tax returns provided (s)he takes all necessary precautions to prevent the release of confidential information.

2. A member may give a client's profit and loss percentages to a trade association provided the member has permission from the client.

3. A member who withdrew from an engagement because of fraud on a client's tax return should suggest that the successor obtain permission from the client to reveal the reasons for leaving.

4. A member may use a records-retention agency to store client records, but the responsibility for confidentiality still lies with the member.

5. A member may work for a municipality in verifying that proper amounts of taxes have been paid by the area businesses. Members are prohibited from releasing any confidential information obtained in their professional capacity.

6. A member may reveal a client's name without permission unless disclosure would constitute release of confidential information.

7. A member performing a consulting service must maintain the confidentiality of nonclient outside sources. If the client does not agree to this arrangement, the member should withdraw.

8. Knowledge and expertise obtained from a prior engagement may be used on behalf of a current client provided that the details of the other engagement are not revealed without permission.

9. A member who prepares a joint tax return should consider both spouses to be clients. After the spouses have divorced, the member will not violate Rule 301 if (s)he releases information to either spouse. But the legal implications should be discussed with an attorney.

10. A contingent fee or commission is considered to be received when the performance of related services is complete and the fee or commission is determined.

11. Rule 301 does not prohibit a member from releasing confidential client information to the member's liability insurance carrier solely to assist the defense against a claim against the member.

12. A member may make disclosures necessary to initiate, pursue, or defend legal or alternative dispute resolution proceedings. Rule 301 does not prohibit compliance with laws or regulations.

13. A member who provides investment advisory services for an attest client for a percentage of the investment portfolio violates Rule 302 unless the fee is a specified percentage of the portfolio, the dollar amount of the portfolio is determined at the beginning of each quarterly (or longer) period and is adjusted only for the client's additions or withdrawals, and the fee arrangement is not renewed more often than quarterly.

14. Providing investment advisory services to the owners, officers, or employees of an attest

client or to a nonattest client employee benefit plan sponsored by an attest client for a contingent fee does not violate Rule 302. Referring for commission the products or services of a nonclient or a nonattest client to the foregoing parties does not violate Rule 503 if the commission is disclosed to them. However, the member should consider the possible conflict of interest and also Rule 301.

15. See Ethics Ruling 25 under Rule 503.

Rule 501 — *Acts Discreditable*

a. Interpretation 501-1. Client records must be returned after a client demands them even if fees have not been paid. This ethical standard applies even if the state in which the member practices grants a lien on certain records in his/her possession.

1) Client records are defined as "any accounting or other records belonging to the client that were provided to the member by or on behalf of the client."

2) However, "a member's workpapers — including, but not limited to, analyses and schedules prepared by the client at the request of the member — are the member's property, not client records, and need not be made available."

3) Moreover, the duty to return is not absolute regarding certain other information. Examples include adjusting, closing, combining, and consolidating entries; information usually found in the journals and ledgers; and tax and depreciation carryforward information. When the engagement is complete, this information should be made available upon request in the medium in which it is requested if it exists in that medium. But information need not be converted from a nonelectronic format to an electronic one. Furthermore, the information need not be provided if all fees due the member have not been paid.

b. Interpretation 501-2. When a court or administrative agency has made a final determination that a member has violated an antidiscrimination law, (s)he is deemed to have committed an act discreditable.

c. Interpretation 501-3. In a governmental audit, failure to adhere to applicable audit standards, guides, procedures, statutes, rules, and regulations is an act discreditable to the profession unless the report discloses the failure and the reasons therefore.

d. Interpretation 501-4. Negligently making, or permitting or directing another to make, materially false and misleading entries in the financial statements or

records; negligently failing to correct materially false and misleading statements when the member has such authority; or negligently signing, or permitting or directing another to sign, a document with materially false and misleading information is an act discreditable.

e. Interpretation 501-5. A member must follow GAAP and the requirements of governing bodies, commissions, or regulatory agencies when preparing financial statements or related information or in performing attest services for entities subject to their jurisdiction. A material departure from the requirements is an act discreditable unless the member discloses the reasons.

f. Interpretation 501-6. Solicitation or knowing disclosure of May 1996 or later CPA examination questions or answers is an act discreditable.

g. Interpretation 501-7. Failing to comply with laws regarding timely filing of personal or firm tax returns or timely remittance of taxes collected for others is an act discreditable.

Rule 502 — *Advertising and Other Forms of Solicitation.*

a. Interpretation 502-2. False, misleading, or deceptive acts are prohibited because they are against public interest. These prohibited activities include

1) Creating false expectations of favorable results
2) Implying the ability to influence any court, regulatory agency, or similar body
3) Representing that specific services will be performed for a stated fee when it is likely at the time of the representation that the fees will be substantially increased and the client is not advised of the possibility
4) Other representations that would cause a reasonable person to misunderstand or be deceived

b. Interpretation 502-5. Members are permitted to render services to clients of third parties. If the third party obtained its clients through advertising, the members must ascertain that all promotional efforts were within the Rules of Conduct. Members must not do through others what they are prohibited from doing themselves.

Rule 503 — *Commissions and Referral Fees.* No interpretations.

Rule 505 — *Form of Organization and Name.*

a. According to the relevant AICPA Council Resolution, a member may practice

public accounting only in a firm or organization with certain characteristics.

1) If such an entity performs any audit under the SASs, a review under the SSARSs, or an examination of prospective information under the SSAEs or holds itself out as a firm of CPAs, an entity must have the following attributes:

   a) CPAs must own a majority of the firm in terms of financial interests and voting rights.

   b) A non-CPA owner, including an investor or commercial enterprise, must be actively engaged in providing services to clients as his/her/its principal occupation.

   c) A CPA must have ultimate responsibility for all services provided.

   d) A non-CPA owner must have a baccalaureate degree.

   e) Non-CPA owners cannot hold themselves out to be CPAs, must abide by the Code, must complete the work-related CPE requirements, and are ineligible for AICPA membership.

   f) Owners must own their equity in their own right.

   g) Ownership must be transferred to the firm or to other qualified owners within a reasonable time if the owner ceases to be actively engaged in the firm.

2) The characteristics of all other entities are considered to be whatever is legally permissible except as indicated in 3) below.

3) If a firm or organization not meeting the foregoing requirements performs compilations under SSARSs, a CPA must have ultimate responsibility for any such services and for each business unit performing such services. Moreover, any compilation report must be signed individually by a CPA.

b. Interpretation 505-2. A member in the practice of public accounting may own an interest in a separate business that performs the services for which standards are established. If the member, individually or with his/her firm or members of the firm, controls the separate business (as defined by U.S. GAAP), the entity and all its owners and employees must comply with the Code. Absent such control, the member, but not the separate business, its other owners, and its

employees, would be subject to the Code.

c. Interpretation 505-3. The overriding focus of the Council Resolution, the Code, and other AICPA requirements is that CPAs remain responsible, financially and otherwise, for the attest work performed to protect the public interest. However, in the context of alternative practice structures (APSs), CPAs may own the majority of financial interests in the attest firm, but substantially all revenues may be paid to another entity in return for services and the lease of employees, equipment, etc. Nevertheless, given the previously mentioned safeguards, if the CPA-owners of the attest firm remain financially responsible under state law, they are deemed to be in compliance with the financial-interests requirement of the Resolution.

Ethics Rulings on Other Responsibilities and Practices — Rules 501 -503, and 505.

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1. A firm may arrange with a bank to collect notes issued by a client in payment of fees.

2. A CPA employed by a firm with one or more non-CPA practitioners must obey the Rules of Conduct. If the CPA becomes a partner, (s)he is responsible for compliance with the Rules of Conduct by all associated practitioners.

3. A CPA who teaches a course is responsible for determining that promotional efforts are within Rule 502.

4. A member not in public practice who is controller of a bank may use the CPA title on bank stationery and in paid advertisements.

5. A member who is an attorney and a CPA may use a letterhead with both titles on it.

6. A member interviewed by the press should observe the Rules of Conduct and not provide information that the member could not publish.

7. A member may serve as a director of a consumer credit company if (s)he does not audit the company and avoids conflicts of interest.

8. Although members may share an office, have the same employees, etc., they should not use a letterhead with both their names unless a partnership exists.

9. CPA firms that wish to form an association are not allowed to use the title of an association (e.g., Smith, Jones & Associates) because the public may believe a true partnership exists instead of an association. Each firm should use its own letterhead indicating the others as correspondents.

10. A CPA and a non-CPA who dissolve their partnership should sign an audit report, after dissolution, in a way not implying a partnership.

11. The title “nonproprietary partner” should not be used by someone who is not a partner because it is misleading.

12. A member may have his/her own CPA practice and be a partner of a public accounting firm all other members of which are noncertified.

13. A partnership may continue to practice using the managing partner’s name as the firm name after (s)he withdraws. “And Company” should be added to the partnership name.

14. If a CPA forms a partnership with a non-CPA, the CPA is responsible for the non-CPA’s violation of the Code.

15. A firm may use an established firm name in different states even though the roster of partners differs.

16. When two partnerships merge, they may retain a title that includes a retired or former partner’s name.

17. A newsletter, tax booklet, etc., not prepared by the member or member’s firm (member) may be attributed to the member if the member has a reasonable basis to believe the information attributed to the member is not false, misleading, or deceptive.

18. If a CPA in public practice forms a separate business that centralizes billing services for physicians, the CPA must comply with the Rules of Conduct because this service is of a type performed by public accountants.

19. CPA firms that are associated for joint advertising and other purposes should practice under their own names and indicate the association in other ways.

20. A CPA is not required to give the client a prepared tax return if the engagement to prepare the return is terminated prior to completion. Only the records originally provided by the client must be returned.

21. The designation “Personal Financial Specialists” may only be used on a letterhead when all partners or shareholders have the AICPA-awarded designation. However, the individual members holding the designation may use it after their names.

22. A member is permitted to purchase a product and resell it to a client. Any profits collected are not considered a commission because the member had title to the product and assumed the risks of ownership.

23. A member may contract with a computer hardware maintenance servicer to support a client’s computer operations and charge a higher fee to the client than the servicer charges the member.

24. A member's spouse may provide services to the member's attest client for a contingent fee or refer products or services for a commission to or from the member's attest client, provided the spouse's activities are separate from the member's practice and the member is not significantly involved. However, a conflict of interest issue may arise.

25. A CPA may not refer for commissions products to clients through distributors and agents when the CPA is performing any of the services described in Rule 503. If the services are not being provided by the CPA, (s)he may refer the products provided (s)he discloses the commissions to the clients

26. Individuals associated with a client may be involved in an internal dispute, and each may request client records and other information. The CPA is under an obligation to supply certain information specified by Interpretation 501-1. This obligation is satisfied by turning over any required information to the designated client representative.

27. A CPA in partnership with non-CPA5 may sign the firm name to a report and below it affix his/her name with the CPA designation. However, it must be clear that the partnership does not consist entirely of CPAs.

28. Unless permitted by contract, if the relationship of a member who is not an owner of a firm is terminated, (s)he may not take or retain originals or copies from the firm's client files or proprietary information without permission.

29. See Ethics Ruling 14 under Rule 302.

CONSULTING SERVICES PROHIBITED BY SARBANES-OXLEY ACT OF 2002

Title II of the Sarbanes-Oxley Act of 2002 prohibits most "consulting" services outside the scope of practice of auditors.

(a) These services are prohibited even if pre-approved by the issuer's audit committee.
(b) Prohibited services include:

- Bookkeeping and related services,
- Design and implementation of financial information systems,
- Appraisal or valuation services (including fairness opinions and contribution-in-kind reports), (*Note:* The valuations relate to financial statement items and not valuations per se.)
- Actuarial services,
- Internal audit outsourcing, *Note:* "Operational" internal audits are allowed.
- Services that provide any management or human resources,
- Investment or broker/dealer services, and
- Legal and "expert services unrelated to the audit."

- Any other service that the board determines, by regulation, is impermissible.

(c) Services Not Prohibited. Firms, however, may provide tax services (including tax planning and tax compliance) or others that are not listed, provided the firm receives pre-approval from the board. However, certain tax planning products, like tax avoidance services, may be considered prohibited nonaudit services.

STANDARDS FOR TAX SERVICES

The AICPA has issued eight Statements on Standards for Tax Services. The statements are enforceable under the AICPA's *Code of Professional Conduct.*

SSTS No. 1 — *Tax Return Positions*

a. An AICPA member should not recommend a position unless (s)he has a good faith belief that the position has a realistic possibility of being sustained if challenged. A member may reach such a position on the basis of well-reasoned articles or treatises or pronouncements of the taxing authority.

b. A member should not prepare or sign a return if (s)he knows it takes a position that cannot be recommended as stated in a. above.

c. Despite a. and b., a member may recommend a position that is not frivolous (knowingly advanced in bad faith and improper) if (s)he advises disclosures. The member may prepare or sign a return containing such a position if the position is properly disclosed.

d. A member should advise the taxpayer of possible penalties associated with the recommended tax return position.

e. A member should not recommend a position that

1) Exploits the taxing authority's audit selection process, or
2) Is advanced solely to obtain leverage in the bargaining process.

f. A member has the right and responsibility to be an advocate for the taxpayer. A taxpayer has no obligation to pay more taxes than legally owed.

SSTS No.2— *Answers to Questions on Returns*

a. A member should make a reasonable effort to obtain appropriate answers to all questions on a tax return before signing as preparer.

b. Examples of reasonable grounds for omitting an answer

1) Information is not readily available, and the answer is insignificant with respect to taxable income or loss or the tax liability.
2) Genuine uncertainty exists as to the meaning of the question in relation to the particular return.
3) The answer to the question is voluminous, and the return states that the data will be supplied upon examination.

c. A taxpayer is not required to explain on the return the omission of an answer when reasonable grounds exist for the omission. The member should consider whether the omission causes the return to be incomplete.

SSTS No. 3— *Certain* ***Procedural Aspects of Preparing Returns***

a. A member may rely without verification on information provided by the taxpayer or third parties. Reasonable inquiries should be made if information appears to be incorrect, incomplete, or inconsistent on its face or on the basis of other facts known. Prior returns should be consulted if feasible.

b. Inquiries should be made to determine whether the taxpayer has met requirements to maintain books, records, or documentation to support deductions.

c. A member who prepares a return should consider information known from another taxpayer's return if it is relevant, its consideration is necessary, and its use does not violate any law or rule of confidentiality.

SSTS No.4— ***Use of Estimates***

a. A member may use the taxpayer's estimates if it is impracticable to obtain exact data, and the estimates are reasonable under the facts.

b. Estimates should be presented so as not to imply greater accuracy than exists.

c. The taxpayer is responsible for providing the estimated data.

d. Appraisals and valuations are not considered estimates.

SSTS No.5— ***Departure from a Position Previously Conducted in an Administrative Proceeding or Court Decision***

a. The treatment of an item as determined in an administrative proceeding or a court decision does not restrict the recommendation of a different tax treatment in later

years, unless the taxpayer is bound to a specified treatment in the later year.

SSTS No.6— *Knowledge of Error: Return Preparation*

a. The member should inform the taxpayer upon becoming aware of an error in a previously filed return or that the taxpayer did not file a required form.

b. The member should recommend measures to take.

c. The member is not obligated to inform the taxing authority and may not do so without the taxpayer's permission, unless required by law.

d. If the member is requested to prepare a return when the taxpayer has not corrected a previous year's error, the member should consider whether to continue a professional relationship with the taxpayer or withdraw.

e. If the member prepares the current return, the member should take reasonable steps to ensure that the error is not repeated.

SSTS No.7— *Knowledge of Error: Administrative Proceedings*

a. The responsibilities are the same as stated in SSTS No. 6 except that they relate to representation of a taxpayer in an administrative proceeding.

b. The taxpayer's agreement must be obtained to disclose the error to the taxing authority.

c. Errors include a position on a return that no longer meets these standards (SSTS No. 1) because of retroactive legislation, judicial decisions, or administrative pronouncements. An error does not include an item with an insignificant effect.

SSTS No. 8— *Form and Content of Advice to Clients*

a. When providing tax advice to a taxpayer, a member should use judgment to ensure that the advice reflects professional competence and meets the taxpayer's needs.

b. When advising or consulting on tax matters, the member should follow SSTS No. 1.

c. A member is not obligated to communicate with the taxpayer when subsequent developments affect previous advice. However, (s)he is obligated to do so when helping to implement the plans associated with the advice or when undertaking the obligation by specific agreement.

d. Tax advice can be in any form. However, important, unusual, or complicated transactions should be in writing.

Note: Members may use a trade name as long as it is not deceptive or misleading. "Pay Less" may be construed as misleading for a tax service.

DISCIPLINARY SYSTEMS WITHIN THE PROFESSION

1. The AICPA's disciplinary mechanisms include the Professional Ethics Division and a joint trial board..

a. The Professional Ethics Division investigates ethics violations. It imposes sanctions in less serious cases. For example, it may require an AICPA member to take additional CPE courses as a remedial measure.

b. More serious infractions come before a joint trial board panel, which can acquit, admonish (censure), suspend, or expel a member. It may also take such other disciplinary, remedial, or corrective action as it deems to be appropriate. The *CPA Letter* publishes information about suspensions and expulsions.

1) A decision of a trial board panel may be appealed to the full trial board. The determination of this body is conclusive.

2) Upon the member's exhaustion of legal appeals, automatic expulsion without a hearing results when a member has been convicted of, or has received an adverse judgment for,

a) Committing a felony
b) Willfully failing to file a tax return
c) Filing a fraudulent tax return on the member's or a client's behalf
d) Aiding in preparing a fraudulent tax return for a client

3) Automatic expulsion also occurs when a member's CPA certificate is revoked by action of any governmental agency, e.g., a state board of accountancy.

4) Expulsion from the AICPA or a state society does not bar the individual from the practice of public accounting.

a) A valid state-issued license is required to practice.

b) Thus, violation of a state code of conduct promulgated by a board of

accountancy is more serious than expulsion from the AICPA because it may result in revocation of the CPA certificate.

c. Joint Ethics Enforcement Program (JEEP)

1) The AICPA and most state societies have agreements that permit referral of an ethics complaint either to the AICPA or to a state society.

2) The AICPA handles matters of national concern, those involving two or more states, and those in litigation.

a) JEEP also promotes formal cooperation between the ethics committees of the AICPA and of the state societies.

2. The SEC, IRS, and PCAOB may also discipline accountants.

a. The SEC may seek an injunction from a court to prohibit future violations of the securities laws. Moreover, under its Rule of Practice 2(e), the SEC may conduct administrative proceedings that are quasi-judicial.

1) Pursuant to such proceedings, it may suspend or permanently revoke the right to practice before the SEC, including the right to sign any document filed by an SEC registrant, if the accountant

a) Does not have the qualifications to represent others

b) Lacks character or integrity

c) Has engaged in unethical or unprofessional conduct

d) Has willfully violated, or willfully aided and abetted the violation of, the federal securities laws or their rules and regulations

2) Suspension by the SEC may also result from

a) Conviction of a felony, or a misdemeanor involving moral turpitude
b) Revocation or suspension of a license to practice
c) Being permanently enjoined from violation of the federal securities acts

3) Some Rule 2(e) proceedings have prohibited not only individuals but also accounting firms from accepting SEC clients.

4) Under the Securities Law Enforcement Act of 1990, the SEC may impose civil

penalties in administrative proceedings of up to $100,000 for a natural person and $500,000 for any other person. Furthermore, the SEC may order a violator to account for and surrender any profits from wrongdoing and may issue cease-and-desist orders for violations.

b. The IRS may prohibit an accountant from practicing before the IRS if the person is incompetent or disreputable or does not comply with tax rules and regulations.

1) The IRS may also impose fines.

c. The PCAOB was established by the Sarbanes-Oxley Act of 2002.

1) A firm's registration application must contain information about a firm's quality control and a description of all actions pending against it. This information may have a great effect on enforcement actions and potential punishments. Moreover, the firm must give consent to cooperate with PCAOB investigations.

2) The PCAOB has rule-making authority regarding quality control, ethics and auditing standards. These rules, especially those governing quality control, will have great relevance to enforcement actions.

3) The PCAOB will inspect large firms annually and report violations to the SEC and state authorities. All attestation engagements, notably those in litigation, may be reviewed. The inspection also involves a quality control assessment. Furthermore, the inspection report must include the firm's response. The firm then has twelve months to correct the reported weaknesses.

4) The PCAOB has substantially the same investigatory scope with respect to accountants as the SEC. The PCAOB may request that the SEC issue subpoenas to third parties, and it may deregister any uncooperative firm.

5) The PCAOB has no injunctive power, but it may institute administrative proceedings. It may seek disassociation of a person from a registered firm, suspension (temporary or permanent) of the firm's registration, or a penalty of up to $15 million. The extreme cases in which the harshest penalties may be imposed include repeated instances of negligent misconduct. By contrast, the SEC may impose the severest punishments when the firm has engaged in just one instance of highly unreasonable conduct.

3. State boards of accountancy and state CPA societies also have codes of ethics and/or rules of conduct.

a. State boards are governmental agencies that license CPAs to use the designation "Certified Public Accountant" and prohibit non-CPAs from performing the attest function. They can suspend or revoke licensure through administrative process.

    1) Like the AICPA, state boards have trial boards to conduct administrative hearings.

b. State societies are voluntary, private organizations that can admonish, suspend, or expel members.

Note: A CPA may not claim to be endorsed by the Institute. A member may, however, state that (s)he is a member.

CORPORATE RESPONSIBILITY LAW (SARBANES-OXLEY ACT) (www.whitehouse.gov/infocus/corporateresponsibility/)

President George W. Bush signed the Sarbanes-Oxley Act of 2002 (Public Law 107-204) on Tuesday, July 30, 2002. Congress presented the act to the president on July 26, 2002, after passage in the Senate by a 99-0 vote and in the House by a 423-3 margin.

As enacted, the law will directly impact the following groups:

1. CPAs and CPA firms auditing public companies;
2. Publicly traded companies, their employees, officers, and owners—including holders of more than 10 percent of the outstanding common shares. This category would include CPAs employed by publicly traded companies as chief financial officers (CFOs) or in the finance department;
3. Attorneys who work for or have as clients publicly traded companies; and
4. Brokers, dealers, investment bankers and financial analysts who work for these companies.

The Act changes how publicly traded companies are audited, and reshapes the financial reporting system. This Act adopts tough new provisions to deter and punish corporate and accounting fraud and corruption, ensures justice for wrongdoers, and protects the interests of workers and shareholders.

This law improves the quality and transparency of financial reporting, independent audits, and accounting services for public companies. It also:

- Creates a Public Company Accounting Oversight Board (**www.pcaobus.org**) to enforce professional standards, ethics, and competence for the accounting profession;
- Strengthens the independence of firms that audit public companies;

- Increases corporate responsibility and the usefulness of corporate financial disclosure;
- Increases penalties for corporate wrongdoing;
- Protects the objectivity and independence of securities analysts; and
- Increases Securities and Exchange Commission resources.

Under this law, CEOs and chief financial officers must personally vouch for the truth and fairness of their company's disclosures. And those financial disclosures will be broader and better than ever before.

Corporate officials will play by the same rules as their employees. In the periods when workers are prevented from buying and selling company stock in their pensions or 401 (k)s, corporate officials will also be banned from any buying or selling.

Corporate misdeeds will be found and punished. This law authorizes new funding for investigators and technology at the SEC to uncover wrongdoing. The SEC will now have the administrative authority to bar dishonest directors and officers from ever again serving in positions of corporate responsibility. The penalties for obstructing justice and shredding documents are greatly increased.

Specifics

<u>New Public Company Accounting Oversight Board (PCAOB)</u>

- The law establishes a five-member accounting oversight board that is subject to Securities and Exchange Commission (SEC) oversight.
- Though the board oversees accounting firms, only two members of the board may be CPAs.
- The SEC will appoint the board.
- Duties of the board include registering public accounting firms that prepare audit reports; and establishing or adopting auditing, quality control, ethics and independence standards.
- The board also inspects, investigates and disciplines public accounting firms and enforces compliance with the act.
- **Registration with the Board Is Mandatory.** For public accounting firms, foreign or domestic, that participate in the preparation or issuance of any audit report with respect to a public company. Registration and annual fees collected from each registered CPA firm will go towards the costs of processing and reviewing applications and annual reports.
- **Seven-Year Record Retention Requirement.** PCAOB must adopt a rule to require registered CPA firms to prepare and maintain audit work papers and other information

related to an audit for at least seven years in sufficient detail to support the conclusions reached in the audit report. (A separate criminal provision requires retention of all audit and review workpapers for five years from the end of the fiscal year in which the audit or review was completed.)

- **Cooperation with CPA Groups.** The board will cooperate with professional accountant groups and advisory groups to increase the effectiveness of the standards setting process. (The PCAOB may cooperate, but authority to set standards rests with the PCAOB, subject to SEC review.)

- **Annual Inspections.** Inspection of registered public accounting firms shall occur annually for every registered public accounting firm that regularly provides audit reports for more than 100 issuers (at least once every three years for registered firms that audit fewer than 100 issuers).

- **Investigations.** The board may investigate any act, omission or practice by a registered firm or an individual associated with a registered firm for any possible violation of the act, the board's rules, professional standards, or provisions of the securities laws relating to the preparation and issuance of audit reports.
  (a) The board may require testimony or documents and information (including audit work papers) from a registered firm or individual associated with a registered firm or in the possession of any other person.

- Sanctions for violations that the board finds may include:
  (a) Suspension or revocation of a registration;
  (b) Suspension or bar of a person from further associating with any registered public accounting firm;
  (c) Limitations on the activities of a firm or person associated with the firm; and
  (d) Penalize the firm up to $2 million per violation, up to a maximum of $15 million.
  (e) Individuals employed or associated with a registered firm who violate the act can face penalties that range from required additional continuing professional education (CPE) or training, disbarment of the individual from further association with any registered public accounting firm, or even a fine up to $100,000 for each violation, up to a maximum of $750,000.
  (1) A portion of the penalties collected will go to accounting scholarships.

- **Funding.** The law also provides independent funding for the Financial Accounting Standards Board (FASB). While the SEC and American Institute of CPAs (AICPA) both have recognized FASB as the standard setting body for accounting principles, federal authority to issue auditing, quality control, ethics and independence standards may seriously impact the AICPAs' role in official pronouncements.

  (a) **Source.** The budget for the board and FASB will be payable from "annual accounting support fees" set by the board and approved by the Commission. The fees will be collected from publicly traded companies and will be determined by dividing the average

monthly equity market capitalization of the company for the preceding fiscal year by the average monthly equity market capitalization of all such companies for that year.

Other Requirements for CPA Firms

- **Audit Reports Require Concurring Partner Review.** Requires a concurring or second partner's review and approval of all audit reports and their issuance.
- **"Revolving Door" Employment of CPAs with Audit Clients Is Banned.** A registered CPA firm is prohibited from auditing any SEC registered client whose chief executive, CFO, controller or equivalent was on the audit team of the firm within the past year.
- **Audit Partner Rotation Required.** Audit partners who either have performed audit services or been responsible for reviewing the audit of a particular client must be rotated every five consecutive years. CPAs should read carefully the requirements for rotation of both the partner-in-charge and the concurring review partner for certain organizational constraints.
  (a) **No Firm Rotation Requirement.** Firm rotation is not required. However, the U.S. Comptroller General will study and review the potential effects of mandatory rotation and will report its findings to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services.
- **CPA Firms Are Required to Report Directly to the Audit Committee.**
- **CPA Firm Consolidations to Be Studied.** The U.S. Comptroller General will conduct a study analyzing the impact of the merger of CPA firms to determine if consolidation leads to higher costs, lower quality of services, impairment of auditor independence, or lack of choice.
- **Corporate and Criminal Fraud Accountability.** Changes to the securities laws can penalize anyone found to have destroyed, altered, hid or falsified records or documents to impede, obstruct or influence an investigation conducted by any federal agency, or in bankruptcy, with fines or up to 20 years imprisonment, or both.
- **Current Requirements for Audit Firms.** Accountants are required to maintain all audit or review workpapers for a period of five years from the end of the fiscal period in which the audit or review was concluded.
- **Additional Rules.** The law requires the SEC to promulgate rules and regulations on the retention of any and all materials related to an audit, including communications, correspondence and other documents created, sent or received in connection with an audit or review.
  (a) **Penalties.** For violating the requirement or the rules that will be developed will result in a fine, or up to 10 years imprisonment, or both.

Internal Control Report.

Under Section 404 of the act, management must establish and document internal control procedures and include in the annual report a report on the company's **internal control over financial reporting.** This report is to include

1. A statement of management's responsibility for internal control;
2. Management's assessment of the effectiveness of internal control as of the end of the most recent fiscal year;
3. Identification of the framework used to evaluate the effectiveness of internal control (such as the report of the Committee of Sponsoring Organizations);
4. A statement about whether significant changes in controls were made after their evaluation, including any corrective actions; and
5. A statement that the external auditor has issued an attestation report on management's assessment.

Because of Section 404, two audit opinions are expressed: one on **internal control** and one on the **financial statements**. The auditor must attest to and report on management's assessment.

The auditor must evaluate whether the structure and procedures

- Include records accurately and fairly reflecting the firm's transactions.
- Provide reasonable assurance that transactions are recorded so as to permit statements to be prepared in accordance with GAAP.

The auditor's report also must describe any material weaknesses in the controls. The evaluation is not to be the subject of a separate engagement but be in conjunction with the audit of the financial statements.

Of Note to Industry Members—Requirements for Corporations, Their Officers and Board Members

- **No Lying to the Auditor.** The act makes unlawful for an officer or director or anyone acting for a principal to take any action to fraudulently influence, coerce, manipulate or mislead the auditing CPA firm.

- **Code of Ethics for Financial Officers.** The SEC is mandated to issue rules adopting a code of ethics for senior financial officers.

- **Financial Expert Requirement.** The SEC is required to issue rules requiring a publicly traded company's audit committee to be comprised of at least one member who is a financial expert.

- **Audit Committee Responsible for Public Accounting Firm.** The Act vests the audit committee of a publicly traded company with responsibility for the appointment,

compensation and oversight of any registered public accounting firm employed to perform audit services.

- **Audit Committee Independence.** Requires audit committee members to be members of the board of directors of the company, and to otherwise be independent.

- **CEOs & CFOs Required to Affirm Financials.** Chief executive officers (CEOs) and CFOs must certify in every annual report that they have reviewed the report and that it does not contain untrue statements or omissions of material facts.
  (a) **Penalty for Violation.** If material noncompliance causes the company to restate its financials, the CEO and CFO forfeit any bonuses and other incentives received during the 12-month period following the first filing of the erroneous financials.

- **CEOs & CFOs Must Enact Internal Controls.** CEOs and CFOs will be responsible for establishing and maintaining internal controls to ensure they are notified of material information.

- **Penalties for Fraud.** The Act also has stiffened penalties for corporate and criminal fraud by company insiders. The law makes it a crime to destroy, alter or falsify records in a federal investigation or if a company declares bankruptcy. The penalty for those found guilty includes fines, or up to 20 years imprisonment, or both.

- **Companies Affected by the Act.** Publicly traded companies affected by the Act are those defined as an "issuer" under Section 3 of the Securities Exchange Act of 1934, whose securities are registered under Section 12 of the 1934 Act. An issuer also is considered a company that is required to file reports under Section 15(d) of the Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933.

- **Debts Not Dischargeable in Bankruptcy.** Amends federal bankruptcy law to make non-dischargeable in bankruptcy certain debts that result from a violation relating to federal or state securities law, or of common law fraud pertaining to securities sales or purchases.

- **Expanded Statute of Limitations for Securities Fraud.** For a civil action brought by a non-government entity or individual, an action involving a claim of securities fraud, deceit or manipulation may be brought not later than the earlier of two years after discovery or five years after the violation.

- **No Listing on National Exchanges for Violators.** The SEC will direct national securities exchanges and associations to prohibit the listing of securities of a noncompliant company.

- **No Insider Trading.** No insider trading is permitted during pension fund blackout periods. The insider must forfeit any profit during this period to the company.

- **SEC Rules on Enhanced Financial Disclosures.**
  (a) Off-Balance Sheet Transactions: All quarterly and annual financial reports filed with the SEC must disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities. Disclosure must be made on significant aspects relating to financial condition, liquidity, capital expenditures, resources, and components of revenue and expenses.
  (b) Pro Forma Figures: Pro forma financial information in any report filed with the SEC or in any public release cannot contain false or misleading statements or omit material facts necessary to make the financial information not misleading.

- **No Personal Loans.** No personal loans or extensions of credit to company executives either directly or through a subsidiary, except for certain extensions of credit under an open-ended credit plan or charge card, home improvement and manufactured home loans, or extensions of credit by a broker or dealer to its employee to buy, trade or carry securities.
  (a) The terms of permitted loans cannot be more favorable than those offered to the general public.

Criminal Penalties Enhanced

BEHAVIOR	SENTENCE
The alteration, destruction, concealment of any records with the intent of obstructing a federal investigation.	Fine and/or up to 10 years imprisonment.
Failure to maintain audit or review "workpapers" for at least five years.	Fine and/or up to 5 years imprisonment.
Anyone who "knowingly executes, or attempts to execute, a scheme" to defraud a purchaser of securities.	Fine and/or up to 10 years imprisonment.
Any CEO or CFO who "recklessly" violates his or her certification of the company's financial statements. If violation is willful.	Fine of up to $1,000,000 and/or up to 10 years imprisonment. Fine of up to $5 million and/or up to 20 years imprisonment.
Two or more persons who conspire to commit any offense against or to defraud the U.S. or its agencies.	Fine and/or up to 10 years imprisonment.

Any person who “corruptly” alters, destroys, conceals, etc., any records or documents with the intent of impairing the integrity of the record or document for use in an official proceeding.	Fine and/or up to 20 years imprisonment.
Mail and wire fraud. Violating applicable Employee Retirement Income Security Act (ERISA) provisions.	Increase from 5 to 20 years imprisonment. Various lengths depending on violation.

CHAPTER 3
MASSACHUSETTS ETHICS

LEARNING OBJECTIVES:

After studying this chapter you will be able to:

1. Outline the professional ethics and conduct for Massachusetts CPAs.
2. Summarize the ethical concepts promulgated in the Code of Professional Conduct.

CMR 252 Rules and Regulations

1.00: Regulations Governing the Board and the Conduct of Its Business

PREAMBLE. 252 CMR is adopted by the Massachusetts Board of Public Accountancy, pursuant to its authority under M.G.L. c. 112, § 87½. The purpose is to promote and protect the public interest by implementing the provisions of M.G.L. c. 112, § 87A through 87E½., which provides for the issuance of certificates as certified public accountants; the issuance of licenses to practice public accountancy; and the regulation of the practice of public accountancy, all to the end of enhancing the reliability of information which is used for guidance in financial transactions or for accounting for or asserting the financial status or performance of commercial, noncommercial and governmental enterprises.

Throughout 252 CMR, the "Public Accountancy Act of 1963", as amended, may be referred to as "the Act", the "Board of Public Accountancy" as "the Board", "examination" means the examination required for a certificate as a certified public accountant prescribed by M.G.L. c. 112, § 87A.

2.01: Eligibility of Candidates to Take Examination

(1) Persons desiring to take the examination for qualification as a certified public accountant should apply on a form provided by the Board, or its designated exam administrator. The forms are obtainable from the Board's exam administrator's offices. Different forms and instructions will be provided for original examinations and for re-examinations.

(2) Prior to 2004, the CPA examination was a written paper examination and a candidate must have sat for all four parts of the exam at his/her first sitting and thereafter until at least one conditional credit was earned (See 252 CMR 2.06(2).) As of January 1, 2004, the CPA examination is a Computer Based Examination (CBT) and first time candidates are subject to the conditional credit rules set forth in 252 CMR 2.06(5).

To sit for either examination (written or CBT), a candidate must be 18 years of age or older and must:

(a) have qualified for the written CPA examination in Massachusetts prior to 1975 (no college degree required); or

(b) meet the educational (but not the experience) requirements of 252 CMR 2.07(2) for the 1992 examination; or

(c) have qualified for the written examination as a candidate in his/her final academic term until January 1, 2004; or

(d) qualify for the CBT under the educational requirements of 252 CMR 2.01(4) and no candidate will be allowed to sit for the examination in his/her final academic semester.

(3) (a) Prior to the November 1992 examination, no particular course requirements need be fulfilled.

(b) Effective with initial application for admission to the November 1992 examination, an accounting concentration shall be defined as a minimum of 24 semester hours (36 quarter hours) in accounting subjects (Accounting, Auditing, and Taxation). Accounting subjects do not include elementary or introductory accounting courses.

1. The minimum accounting course requirement for an accounting concentration shall consist of the following subjects:

Intermediate/Financial Accounting six semester hours or nine quarter hours
Advanced/Managerial Accounting three semester hours or 4½ quarter hours
Cost Accounting
Auditing three semester hours or 4½ quarter hours
Taxation three semester hours or 4½ quarter hours

2. The remaining nine semester hours (13½ quarter hours) may be obtained in additional accounting, auditing, or taxation courses or the subject areas listed in 252 CMR 2.01(3)(b)2. The maximum number of hours in each subject as listed shall be as follows:

Business Law three semester hours or 4½ quarter hours
Business Statistics three semester hours or 4½ quarter hours
Quantitative Applications
Computer Science/Information Systems three semester hours or 4½ quarter hours
Finance three semester hours or 4½ quarter hours

(c) Prior to November 2002, if a candidate's degree does not include an accounting concentration as described in 252 CMR 2.01(3)(b), the candidate may become eligible for

examination and certification by the Board by successfully completing the course requirements listed in 252 CMR 2.01(3)(b) at a college or university approved by the Board.

(4) Effective with initial application for admission to the November 2002 examination, a candidate must have completed 150 semester hours (225-quarter hours) of college or university education to include a bachelor's degree from a nationally or regionally accredited institution approved by the Board. For the purposes of determining equivalence of quarter hours,4½-quarter hours will equal three credit hours. The Board will review successful completion of three-quarter hour courses; provided that the accounting and business course requirements total 36-quarter hours each. The candidate must have completed the 150-hour education requirement in accordance with one of the following four provisions:

1. Earned a graduate degree in accounting from a program at a nationally or regionally accredited college or university approved by the Board that is further accredited by the AACSB – The International Association for Management Education (AACSB). Programs not accredited by AACSB must be approved by the Board as having substantially equivalent educational program requirements. The Board, or an Educators Credential Committee appointed by the Board, will review the graduate accounting programs of a nationally or regionally accredited college or university to determine if such programs are substantially equivalent to AACSB standards, upon a written request from such college or university. The Educators Credential Committee will consist of at least three accounting educators selected by the Board from the faculty of nationally or regionally accredited educational institutions located in the Commonwealth of Massachusetts;

2. Earned a graduate degree in accounting, business administration or law from a nationally or regionally accredited college or university approved by the Board. This degree must include 24 semester hours (36-quarter hours) of accounting at the undergraduate level, or 18 semester hours (27 quarter hours) of accounting at the graduate level, or an equivalent combination thereof. Elementary or introductory accounting courses will not qualify for this course requirement. The accounting credits shall include coverage in financial accounting, auditing, taxation, and management accounting. In addition, the degree must include or be supplemented by, 24 semester hours (36 quarter hours) of business courses (other than accounting courses) at the undergraduate level or 18 semester hours (27 quarter hours) at the graduate level, or an equivalent combination thereof;

3. Earned at least a bachelor's degree in business from a nationally or regionally accredited college or university approved by the Board. This degree must include 24 semester hours (36-quarter hours) of accounting, exclusive of elementary or introductory accounting courses. The accounting credits shall include coverage in financial accounting, auditing, taxation, and management accounting. In addition, the degree must include, or be supplemented by, 24 semester hours (36-quarter hours) of business courses other than accounting courses. These business courses shall include coverage in the areas of business law, quantitative applications in

business, information systems, finance, and coverage in at least one of the areas of economics, business organizations, professional ethics, and/or business communication; or

4. Earned a bachelor's degree from a nationally or regionally accredited college or university approved by the Board. This degree must include, or be supplemented by, 24 semester hours (36-quarter hours) in accounting courses at the undergraduate level, exclusive of elementary or introductory accounting courses. The accounting credits shall include at least three semester hours in each of the subject areas of financial accounting, auditing, taxation, and management accounting. In addition, the degree must include, or be supplemented by, 24 semester hours (36-quarter hours) of business courses at the undergraduate level, to include at least three semester hours in the subject areas of business law, business information systems, professional ethics and finance. Courses in quantitative applications in business, business management of organizations, economics, and/or business communication may be included for the business course requirements.

Effective with initial application to the November 2002 examination, the required business and accounting concentration courses must be completed, or accepted in transfer, at a four-year accredited college or university approved by the Board. Associate Degree/Junior College courses will be accepted only if transferred into a four-year bachelor's degree program.

2.02: Times and Places of Examinations

Prior to January 2004, all examinations were written and were held in May and November of each year in the Commonwealth of Massachusetts at a time and place set by the Board. Upon implementation of the Computer Based Examination (CBT), the procedures for the CBT and its availability are described in 252 CMR 2.00. For all examinations, the applications must be accompanied by a payment for the prescribed fee required. Those whose applications are approved by the Board will receive notice from the Board or its designee of the place, date and hours of such examinations. The Board, in its discretion, may permit an applicant who is a resident of the Commonwealth of Massachusetts to sit for the examination in another state; the taking of such examination by such applicant, however, shall be under the jurisdiction of this Board and subject to 252 CMR.

2.03: Administration and Grading of Examinations

The Board has adopted and makes use of the examinations (Uniform CPA Examination) and advisory grading service provided by the Board of Examiners of the American Institute of Certified Public Accountants (AICPA).

2.04: Subject Matter of Examinations

(1) Effective with the May 1994 Uniform CPA Examination through December 2003, the component parts and schedule of the written examination consisted of four sections which were given on designated Wednesdays and Thursdays of every May and November.

(2) As of January 1, 2004, the Computer Based Examination consists of four sections. The titles of the CBT sections are: Auditing and Attestation; Financial Accounting and Reporting; Regulation; and Business Environment and Concepts.

2.05: Recognition of Full or Partial Credits Granted by Other States

Recognition will be given to satisfactory completion of one or more subjects given by a licensing authority in another state, if the examination given by the licensing authority in the other state was the Uniform CPA Examination set and graded as passing by the Board of Examiners of the AICPA, provided that conditional credit would have been given under 252 CMR 2.06(2) and 2.06(5) had the examination been taken in Massachusetts.

2.06: Granting of Full or Partial Credits to Candidates Who Pass Examination in One or More Subjects; Re-examination; etc.

(1) Passing All Subjects. A candidate who receives a grade of 75 or higher in each of the four subjects on the first sitting, shall have passed the examination.

(2) Conditional Credit. Prior to January 1, 2004, a candidate who passed two or more subjects at any written examination given by the Board and attained a grade of 50 or more in each subject which the candidate failed, shall be credited with the subjects in which the candidate received a grade of 75 or higher. The candidate has the right to be re-examined in only the remaining subject or subjects at any of the six subsequent examinations; provided, however, that if a candidate received a grade of 75 or higher in three subjects and a grade below 50 in the failed subject, the Board has the right to consider whether credit would be granted for the parts passed.

(3) Re-examination. Prior to January 1, 2004, a candidate who would have received a conditional credit or credits under 252 CMR 2.06(2), would receive a further conditional credit in the subject or subjects in which the candidate receives a grade of 75 or higher if upon such re-examination the candidate receives a grade of 50 or higher in each subject which the candidate failed.

(4) Time Limit on Conditional Credits.

(a) Prior to January 1, 2004, conditional credits continued to be valid only when the remaining subjects were successfully completed at any of the six paper examinations given by the Board immediately following the examination in which the candidate first received a conditional credit. However, the Board, in its discretion and under extenuating circumstances, can extend the period within which conditional credits continued to be valid.

(b) Prior to January 1, 2004, a candidate who, on first examination, failed to qualify for a conditional credit or credits under 252 CMR 2.06(2) was required to sit for the entire examination.

(5) Passing the Computer Based Examination.

(a) As of January 1, 2004, upon implementation of a Computer Based Examination, a candidate must take the required Test Sections individually and in any order. Credit for any Test Section(s) shall be valid for 18 months from the actual date the candidate took the Test Section, without having to attain a minimum score on any failed Test Sections(s) and without regard to whether the candidate has taken other Test Sections.

1. Candidates must pass all four Test Sections of the Uniform CPA Examination within a rolling 18 month period, which begins on the date that the first Test Section(s) that is passed is taken.

2. Candidates cannot retake a failed Test Section(s) in the same examination window. An examination window refers to a three-month period in which candidates have an opportunity to take the CPA examination composed of two months in which the examination is available to be taken and one month in which the examination will not be offered, while routine maintenance is performed and the item bank is refreshed. Thus, candidates will be able to test two out of the three months within an examination window.

3. In the event all four Test Sections of the Uniform CPA Examination are not passed within the rolling 18 month period, credit for any Test Section(s) passed outside the 18 month period will expire and Test Section(s) must be retaken.

(b) Candidates having earned conditional credits on the written examination, as of the launch date of the Computer Based Examination, will retain conditional credits for the corresponding Test Sections of the Computer Based Examination as follows:

Written Examination Computer Based Examination
Auditing and Attestation
Financial Accounting and Reporting
(FARE) Financial Accounting and Reporting
Accounting and Reporting (ARE) Regulation
Business Law and Professional
Responsibilities (LBR) Business Environment and Concepts

1. Candidates who have attained conditional credit status as of the launch date of the Computer Based Examination will be allowed a transition period to complete any remaining Test Sections

of the Computer Based Examination. The transition period is the maximum number of consecutive opportunities that candidates (who were conditioned under the written examination) would have had remaining, at the launch of the Computer Based Examination, multiplied by three months, to a maximum of 18 months from April 5, 2004.

2. If a previously conditioned candidate does not pass all remaining Test Sections during the transition period described in 252 CMR 2.06(5)(b)1., the conditional credits earned under the written examination will expire and the candidate will lose credit for Test Sections earned under the written examination. However, any Test Section passed during the transition period of the Computer Based Examination is subject to the conditioning provisions as indicated in 252 CMR 2.06(5)(a).

(c) A Candidate shall retain conditional credit for any and all Test Sections of an examination passed in another state if such credit would have been given, under the applicable requirements, as if the candidate had taken the examination in Massachusetts.

(d) The Board may in particular cases extend the term of conditional credit validity notwithstanding the requirements of 252 CMR 2.06(5)(a), (b) and (c), upon a showing that the credit was lost by reason of mitigating circumstances beyond the candidates control.

(e) A candidate shall be deemed to have passed the Uniform CPA Examination once the candidate holds at the same time valid credit for passing each of the Four Test Sections of the Examination. For purposes of 252 CMR 2.06(5)(e), credit for passing a Test Section of the Computer Based Examination is valid from the actual date of the testing event for that Test Section, regardless of the date the candidate actually receives notice of the passing grade.

(6) Military Service. The time limitations within which a candidate is required to pass subjects under 252 CMR 2.06(2), 2.06(3), and 2.06(5) shall not include any period during which the applicant is on active duty in the Armed Services of the United States.

(7) Massachusetts Bar Member.

(a) An applicant who sat for the Uniform CPA Examination prior to May 1994 who is a member of the Massachusetts Bar is not required to take the written examination in Business Law. To be excused from this examination such an applicant must present a certificate from the Clerk of the Supreme Judicial Court attesting to the fact that the applicant is a member of the Massachusetts Bar in good standing.

(b) Beginning with the May 1994 examination, members of the Massachusetts Bar will no longer be exempt from taking the Business Law & Professional Responsibilities (LPR) section of the examination. Effective with the May 1994 examination, members of the Massachusetts Bar will be required to take all sections of the Uniform CPA Examination.

(8) Examination Results. The Board or its designee will advise a candidate whether the candidate has passed all or any part of the examination.

2.07: Education, Experience and Other Requirements for Issuance of Certificate as Certified Public Accountant

(1) Formal Application. An applicant for a certificate who has passed the examination set by the Board must file with the Board a formal application for such certificate, accompanied by payment of the required fee. A form for application is prescribed and may be obtained from the offices of the Board. An applicant must also submit official transcript(s) from colleges or universities as provided in 252 CMR 2.07(2), experience letter(s) from employer(s) as provided in 252 CMR 2.07(3), and three letters from employers, business associates or clients testifying to the applicant's character and fitness. A recent unmounted photograph at least 2" by 2" in size must also be attached.

(2) Education and Experience Requirements. An applicant for a certificate as a certified public accountant who has successfully passed the examination, and qualifies otherwise in the opinion of the Board, shall receive a certificate as a certified public accountant upon satisfying the Board that the applicant meets the following requirements of education and experience:

(a) The applicant is a graduate of a college or university approved by the Board with a bachelor's degree or its equivalent, with an accounting concentration, as described in 252 CMR 2.01(3) (no person shall be required to have an accounting concentration until July 1, 1992), and that the applicant has had at least three years' experience in the full-time practice of public accounting of the type described in 252 CMR 2.07(3) (5460 total hours required); or

(b) The applicant is a graduate of a college or university approved by the Board with a bachelor's degree supplemented by a master's degree or its equivalent from a college or university also approved by the Board, provided the applicant's education has included an accounting concentration, as described in 252 CMR 2.01(3), or the equivalent thereof, and that the applicant has had at least two years experience in the full-time practice of public accounting of the type described in 252 CMR 2.07(3)(a) (3640 total hours required); or

(c) Subsequent to the May 2002 examination, the applicant is a graduate of a college or university approved by the Board with at least a bachelor’s degree, to include 120 semester hours with an accounting concentration, supplemented with an additional 30 semester hours as described in 252 CMR 2.01(4), provided that the applicant has had at least one year of experience in the full-time practice of public accounting of the type described in 252 CMR 2.07(3)(b) (1820 total hours required); or the applicant is a graduate of a college or university approved by the Board with a bachelor’s degree supplemented by graduate degree in accounting, business administration or law, including the course requirements described in 252 CMR 2.01(4), in which case experience in the practice of public accounting is not required for the issuance of a certificate as a certified public accountant.

(3) Type of Experience Required.

(a) The experience required in 252 CMR 2.07(2)(a) and 2.07(2)(b) for a certificate and license as a certified public accountant shall have been in public practice or its governmental equivalent, as defined in 252 CMR 2.07(6) and as approved by the Board, and that such experience shall have included 1000 hours in the report function on full disclosure financial statements, of which not more than 300 hours may consist of full disclosure compilations.

Commencing December 1, 2002, all applicants for certification who have not completed 1000 hours in the public accounting report function on full disclosure financial statements, must comply with requirements of 252 CMR 3.02(5). Applicants for the certificate and license must submit to the Board a letter or statement from each public accounting firm or government employer in which the experience was obtained over the most recent period of the applicant's experience of the length required. Such a statement shall be attested to, under the pains and penalties of perjury, by a partner, shareholder or member of such public accounting firm(s) or by the government supervisor describing the applicant's experience.

(b) The experience required in 252 CMR 2.07(2)(c) for a certificate as a certified public accountant shall have been in public practice or its governmental/non-public accounting equivalent, as set forth in 252 CMR 2.07(6). Applicants must submit a letter or statement to the Board from each public accounting firm or government/non-public employer in which the experience was obtained over the most recent period of the applicant's experience of the length required, including a description of the type and exact dates of experience, signed by a partner, shareholder or member of such public accounting firm, government supervisor or CPA supervisor of non-public experience under the pains and penalties of perjury.

(c) Commencing December 1, 2002, public accounting report experience will be a requirement for issuing reports on financial statements and a qualifying tenure of experience must extend for at least 12 consecutive months within a 36 month period.

(4) Exceptions to Education and Experience Requirements. The education requirements of 252 CMR 2.07(2)(a), 2.07(2)(b) and 2.07(2)(c) notwithstanding, a candidate who successfully passes the examination shall be eligible for the certificate of certified public accountant if the candidate meets the education and experience requirements that were requisite at the time the candidate first sat for the examination in some prior year. Commencing on December 1, 2002, a candidate who sat for the examination without complying with the provisions of 252 CMR 2.07(2)(c) may qualify under the experience requirement of 252 CMR 2.07(3)(a) or obtain the education requirements of 252 CMR 2.07(2)(c) subsequent to the completion of the exam.

(5) Calculation of Full-time Experience. The Board will provide credit for full-time experience as a practicing public accountant only if such full-time experience extends over an uninterrupted period of two months or more with a minimum of 35 hours worked per week in conformity with

252 CMR 2.07(3)(a). The Board will provide credit for part-time experience only if such part-time experience extends over an uninterrupted period of two months or more with a minimum of 20 hours worked per week in conformity with 252 CMR 2.07(3)(a), such credit to be granted only for experience in public accounting calculated on the basis of hours actually devoted to such qualifying part-time experience. For this purpose, sickness and legal holidays do not interrupt what would otherwise be uninterrupted service. Commencing on December 1, 2002, the Board will provide credit for:

(a) full-time experience government or non-public accounting equivalent described in 252 CMR 2.07(6), only if such full-time experience extends over an uninterrupted period of 12 months or more with a minimum of 35 hours worked per week in conformity with 252 CMR 2.07(3)(b);

(b) or part-time experience only if each part-time experience extends over an uninterrupted period of 12 months, with a minimum of 20 hours per week, calculated on the basis of hours actually devoted to such qualifying part-time experience.

(6) Government/Non-public Accounting Experience.

(a) Prior to November 2002, the Board, in its discretion, may grant credit of one year of requisite experience for every two full years of service in field audit work with the United States Government or with an agency of the commonwealth in a pay Grade or responsibility level above entry-level, provided that, in the opinion of the Board, such experience is substantially equivalent to that of public accounting practice. After November 2002, the experience requirement will be reduced for candidates with graduate degrees as set forth in 252 CMR 2.07(3)(b).

(b) After November 2002, the Board, in its discretion, may grant credit of one year of requisite experience for non-public accounting work or non-audit government work under the direct supervision of a Certified Public Accountant, for every three full years of service in a responsibility level above entry-level, provided that, in the opinion of the Board, such experience is substantially equivalent to that of public accounting practice.

(c) The Board, in its discretion, may grant credit for field audit work, including the direct supervision of field audit work, with the United States Government or any agency or subdivision of the commonwealth with a demonstrated emphasis on the expression of opinions on financial statements in accordance with generally accepted auditing standards, the review of and report on internal controls, the application of varied auditing procedures, the preparation of audit working papers for account examinations, the planning of auditing work programs, the preparation of written explanations and comments on examination findings and the preparation and analysis of financial statements. The experience required by this clause, as approved by the board, shall be considered work experience on the same basis as experience in public accounting practices; provided, however, that adherence to the standard of independence is strictly applied.

(7) Waiving Requirements Before Examination. Applicants who qualify in other respects may sit for the examination before satisfying the experience requirements of 252 CMR 2.07(2)(a), 2.07(2)(b) and 2.07(2)(c).

(8) Rejection of Application. If an application for a certificate is rejected by the Board for insufficient experience or other cause, the applicant, at any later time, may request the Board to reconsider the application if the deficiencies have been removed.

2.08: Reciprocity for Persons Qualified in Other States and/or Canada and Other Jurisdictions

(1) The Board, upon formal application, may issue a license to practice to a certified public accountant of another state or other jurisdictions provided:

(a) The applicant meets all current requirements in Massachusetts at the time application is made, or at the time of the issuance of the applicant's certificate in the other state, the applicant met all requirements then applicable in Massachusetts, or if the applicant meets all such requirements except that the examination was passed under different credit provisions then applicable in Massachusetts, and provided that each passed part of the exam received a grade issued by the AICPA of 75 or better, then the applicant must have been engaged in public practice, in the other state or must have been under the direct supervision of a partner, shareholder or member of a public accounting firm on a full-time basis for four of the last ten years prior to the applicant's Massachusetts reciprocal application and commencing upon the date of original certification from the other state;

(b) The applicant holds a valid, current license to practice in the other state.

(c) The applicant furnishes written credentials in regard to education, character, and general qualifications in the same form as is required of all other applicants; and

(d) The applicant, in attesting to the applicant's self-employment experience required by 252 CMR 2.07(3), submits examples of the applicant's report work product (a complete audit, review, and compilation report) issued within three years prior to the applicant's application for reciprocity, and/or the most recent quality review report issued on the applicant's practice, or three notarized statements from the applicant's three largest clients regarding the quality of services provided in a tax or consulting practice.

(2) (a) Canadian Chartered Accountants (CAs) who have successfully completed the Canadian Uniform Final Examination are not required to complete the Uniform CPA Examination in order to achieve the CPA designation. CA applicants for reciprocity are, however, required to pass the International Uniform CPA Qualification Examination (IQEX) designed to ensure that they have satisfactory knowledge of relevant U.S. legislation, standards, and practices. In addition to

passing IQEX, licensure applicants must satisfy the requirements of 252 CMR 2.07(3) regarding experience in order to obtain the CPA designation.

(b) CA applicants must also hold a valid, current license to practice in Canada.

(c) CA applicants shall also furnish written credentials in regard to education, character, and general qualifications in the same form as is required of all other applicants.

(3) The Board in its discretion and on a case by case basis, will accept applications for other foreign licensed Charter Accountants or CPAs to sit for and pass the IQEX and apply for the reciprocity based upon their compliance with the education and experience requirements of 252 CMR 2.07 and all applicants must hold a current license to practice in these other jurisdictions. These applicants shall furnish written credentials with regard to character and general qualifications in the same form as is required for all other applicants.

2.09: Destroying Examination Papers

The Board in its discretion may authorize examination papers to be destroyed six months after the examination.

2.10: Code of Ethics and Rules of Professional Conduct

The Board has adopted and published 252 CMR 3.00: Code of Ethics Rules of Professional Conduct for fixing and maintaining high standards of integrity and dignity in the profession of public accounting in Massachusetts. Such Code and Rules apply in equal measure to all certified public accountants and public accountants licensed under M.G.L. c. 112, §§ 87A through 87E½.

The Board also adopts by reference the Code of Professional Conduct of the American Institute of Certified Public Accounts as published by the American Institute of Certified Public Accountants as of June 1, 2004 to the extent that the applicable provisions thereof do not conflict with the Code and Rules of 252 CMR 3.00

2.11: Affirmative Action Against Unlawful Discrimination

(1) Purpose. 252 CMR 2.00 is adopted to assure that every person licensed by the Board complies with the equal employment, housing, public accommodations and fair business practices provisions of M.G.L. c. 151B in the conduct of his or her profession.

(2) Authority. 252 CMR 2.00 is adopted pursuant to M.G.L. c. 30A, § 2; Executive Order 74 as amended by Executive Order 116; and M.G.L. c. 112, § 87A½ (the statutory authority of the Board to regulate the standard of conduct for this profession).

(3) Standard of Conduct. The standard of conduct of this profession requires that every applicant or licensee comply with the equal employment, housing, public accommodations and fair business practices provisions of M.G.L. c. 151B in the conduct of his or her profession.

(4) Disclosure of Unlawful Practices. Every applicant for registration and every applicant for renewal of a license shall disclose as part of the application, any finding of any unlawful practice which has been made by the Massachusetts Commission Against Discrimination or by a court pursuant to M.G.L. c. 151B, §§ 5 and 9.

(5) Adjudicatory Hearing. The Board may conduct an adjudicatory hearing to consider the fitness of an applicant or licensee to practice or to continue to practice the profession after a finding of an unlawful practice which has been made by the Massachusetts Commission Against Discrimination or by a court.

(6) Disciplinary Action. After an adjudicatory hearing, the Board shall consider and may take appropriate disciplinary action including censure, suspension, revocation or denial of licensure or fine against an applicant or licensee who is the subject of a finding of unlawful practice which has been made by the Massachusetts Commission Against Discrimination or by a court.

2.12: Communications

A certified public accountant, or CPA Firm when requested, shall respond to communications from the Board within 30 days of the mailing of such communications by regular mail, registered or certified mail. A certified public accountant or licensed firm shall notify the Board, in writing, within 30 days of any change in the licensee's name, or legal address.

2.13: Non-prohibited and Prohibited Services

As provided in M.G.L. c. 112, § 87D, subsections (a), (b), and (c), no person or firm not holding a valid license shall issue a report (audit, review or compilation) on financial statements of any person, firm, organization or governmental unit. This prohibition does not apply to an officer, partner, shareholder or member or employee of any firm or organization affixing a signature to any statement or report in reference to the financial affairs of such firm or organization or subsidiary or franchise of said organization with any wording designating the position, title or office held therein; nor does it apply to any act of a public official or employee in the performance of official duties as such; nor does it apply to the performance by persons other than licensees of other services involving the use of accounting skills, including the preparation of tax returns and the preparation of financial statements without the issuance of reports thereon.

2.14: Mandatory Continuing Professional Education

(1) Purpose. 252 CMR 2.14 may be cited and referred to as the "Public Accountancy Continuing Education Rules". They are subject to amendment, modification, revision,

supplement, repeal or other change by appropriate action in the future. The purpose of these rules is to require all certified public accountants licensed under the Massachusetts Public Accountancy Act to comply with continuing education requirements. The Board anticipates that licensees will maintain the high standards of the profession in selecting quality educational programs to fulfill the continuing education requirement.

(2) Effective Date. The Continuing Education Rules became effective July 1, 1979.

(3) Basic Requirements. During the two-year period immediately preceding re-licensing, applicants for biennial license renewal must complete 80 hours of acceptable continuing education, except as stated in 252 CMR 2.14(6). Effective for all licenses expiring on or after June 30, 2007, four hours of acceptable continuing education shall be in the area of professional ethics. Although 80 hours acquired in one of the two years covered by the registration period qualifies a registrant for the two-year period, no carryover is permitted from one two-year period to another. Only class hours or the equivalent (and not student hours devoted to preparation) will be used to measure the hours of continuing education submitted by individual candidates to the Continuing Education Committee, appointed by the Board. The Board may provide for prorated continuing professional education requirements to be met by applicants whose initial licenses were issued substantially less than two years prior to the renewal date.

(4) Programs Which Qualify.

(a) A specific program qualifies as acceptable continuing education if it is a formal program of learning which contributes directly to the professional competence of a licensee in public practice. Each individual licensee will determine the course of study to be pursued.

(b) The following are deemed to qualify as acceptable continuing education programs, provided the standards outlined in 252 CMR 2.14(4)(c) are maintained. The Board may require that sponsors of continuing education programs be pre-approved by registering with the Board or its designee.

1. Professional development programs of national and state accounting organizations.

2. Technical sessions at meetings of national and state accounting organizations and their chapters.

3. University or college courses:

- Credit courses - each semester hour credit shall equal 15 hours toward the requirement.

- Non-credit courses - each classroom hour will equal one qualifying hour.

4. Programs in other organizations (accounting, industrial, professional, etc.).

5. Other organized educational programs on technical and other practice subjects.

(c) In order to qualify under 252 CMR 2.14(4)(b), a program must:

1. require attendance;

2. be at least one class hour (50-minute period) in length;

3. be conducted by a qualified instructor or discussion leader;

4. require a maintained record of attendance; and

5. require a written outline to be retained.

(d) Formal correspondence or other individual study programs which provide evidence of satisfactory completion may qualify, with the amount of credit to be determined by the Continuing Education Committee. The Continuing Education Committee will not approve any program of learning that does not offer sufficient evidence that the work has actually been accomplished.

(e) Credit for one hour of continuing education will be awarded for each presentation hour completed as an instructor or discussion leader to the extent that the particular activity contributes to the professional competence of the registrant as determined by the Continuing Education Committee. Two hours of credit for preparation time will be allowed for each presentation hour. The maximum credit for such preparation and teaching shall not exceed a maximum of 50% of the renewal period requirement.

(f) Credit may be awarded for published articles and books. The amount of credit so awarded will be determined by the Continuing Education Committee and shall not exceed a maximum of 25% of the renewal period requirement.

(5) Control and Reporting. Candidates for biennial license renewal must provide a signed statement, under penalty of perjury, supported by documentation disclosing the following information pertaining to the education programs submitted for qualification under the Public Accountancy Continuing Education Rules:

(a) school, firm or organization conducting course;

(b) location of course;

(c) title of course or description of content;

(d) dates attended; and

(e) hours claimed.

The Continuing Education Committee will verify, on a test basis, information submitted by licensees. If a Continuing Education Statement submitted by an applicant for biennial license renewal as required by 252 CMR 2.00 is not approved, the applicant shall be so notified and the applicant may be granted a period of time by the Board in which to correct the deficiencies noted.

(6) Exceptions. The Board may make exceptions from the Public Accountancy Continuing Education Rules where:

(a) reasons of health, certified by a medical doctor, prevent compliance by the licensee;

(b) the licensee is on active duty with the Armed Services of the United States; or

(c) other good cause exists.

No exception shall be made solely because of age.

(7) Fees. The Board shall establish a biennial fee for processing and maintaining licensees' Continuing Education Statements and other related documents.

2.15: Quality Review Requirement

(1) Definitions.

(a) Board, Licensee, Practice of Public Accountancy, and Quality Review are defined as set forth in M.G.L. c. 112, § 87A.

(b) Practice Unit means:

1. Each individual licensed by the Board who is engaged in the practice of public accountancy as a sole proprietor; or

2. Each firm licensed by the Board to engage in the practice of public accountancy.

(c) Multi-jurisdictional Practice Unit means a practice unit with some members or employees who hold licenses issued by the Board and with other members or employees who have similar authority to practice public accountancy in one or more other jurisdictions.

(d) Approved Reviewer means an individual licensed by the Board who has been approved by a report acceptance body to be responsible for conducting quality reviews of practice units. Qualifications of approved reviewers are stated in 252 CMR 2.15(3).

(e) Report Acceptance Body means practice units, professional societies, or other organized groups of public accountants approved by the Board to be responsible for the selection of approved reviewers, the acceptance of quality reviews and letters of comments conducted by approved reviewers, and the consideration of any responses of a reviewed practice unit to its quality review.

(f) Review Oversight Board means a committee of individuals licensed and appointed by the Board to oversee the work of approved reviewers and report acceptance bodies.

(g) Compilation Engagement means an engagement undertaken by a practice unit in accordance with AICPA standards with the objective of presenting data supplied by the client in financial statement format without expressing an opinion or any other form of assurance on them.

(h) Review Engagement means an engagement undertaken by a practice unit in accordance with AICPA standards with the objective of reviewing financial statements to obtain a reasonable basis, usually by making inquiries and performing analytical procedures, for expressing limited assurance that there are no material modifications that should be made for the financial statements to conform with generally accepted accounting principles or other comprehensive basis for accounting.

(i) Audit Engagement means an engagement undertaken by a practice unit in accordance with AICPA standards with the objective of providing a reasonable basis for expressing an opinion that the financial statements are, in all material respects, in conformity with generally accepted accounting principles or other comprehensive basis for accounting by performing procedures in accordance with generally accepted auditing standards.

(j) On-site Quality Review means a quality review conducted at the office of a reviewed practice unit, which includes testing compliance of the practice unit's quality control policies and procedures and a review of selected accounting and auditing engagements, sufficient to provide the approved reviewer with a reasonable basis upon which to issue a quality review report meeting the requirements of 252 CMR 2.15(4).

(k) Off-site Quality Review means a quality review conducted outside the office of a reviewed practice unit, which consists of reviewing selected financial statements, the reports thereon, and related documents to determine compliance with professional standards, sufficient to provide the approved reviewer with a reasonable basis upon which to issue a quality review report meeting the requirements of 252 CMR 2.15(4).

(2) Quality Review Certification and Compliance of Requirements.

(a) EFFECTIVE JUNE 1, 1997, every licensee, as a condition for the renewal of a license to practice public accountancy, must certify under the pains and penalties of perjury either:

1. That the practice unit or, for individuals, the practice unit by which the individual is employed or is a member, partner or shareholder, has, within the three years immediately preceding the application for renewal, completed a quality review which has been accepted by a report acceptance body (or, for multi-jurisdictional practice units, a quality review which meets the requirements of 252 CMR 2.15(10)) and that such practice unit is in compliance with the terms of any quality review report and letter of comments accepted by, and any actions mandated by, the report acceptance body; or

2. That the practice unit, or for individuals, the practice unit by which the individual is employed or is a member, partner or shareholder, has conducted no audit, review or compilation engagements during the three years preceding the application for license renewal; and that the practice unit or individuals who are members, partners or shareholders of a practice unit will inform the Review Oversight Board if the practice unit undertakes an audit, review or compilation engagement and the practice unit, or, for individuals, the practice unit in which the individual is a member, partner or shareholder will undergo a quality review within one year of undertaking any such engagement.

(b) If a practice unit by which an individual licensee is employed or is a member, partner or shareholder has conducted an audit engagement during the three years preceding the application for license renewal, the licensee must further certify under the pains and penalties of perjury that the quality review completed was an on-site quality review.

(c) Every practice unit must cooperate with the approved reviewer, the report acceptance body, and the Review Oversight Board and take all steps necessary, including the payment of all costs and fees relating to the quality review, to comply with the quality review requirement.

(d) A practice unit and the members, partners or shareholders of a practice unit, that, after the date of renewal of a license, fails to continue to comply with the terms of the quality review report or letter of comments accepted by a report acceptance body, must promptly inform the Board of any non-compliance by the practice unit. Such non-compliance failure to report same promptly to the Board, failure to cooperate with the approved reviewer, the report acceptance body or the Review Oversight Board, or any other failure to comply with the quality review requirements of 252 CMR 2.15, shall be grounds for license revocation, suspension or other disciplinary action under M.G.L. c. 112, § 87C½ of any practice unit and any member, partner or shareholder thereof failing to comply or failing to report such non-compliance to the Board.

(3) Qualifications of Approved Reviewers.

(a) An approved reviewer must meet the following minimum qualifications:

1. hold a current individual license issued by the Board;

2. possess at least five years of current experience in the practice of public accountancy in the accounting and auditing function;

3. be independent from, and have no conflict of interest with, the licensees or practice unit being reviewed; and

4. be familiar with all specialized services in the area of accounting and auditing provided by the practice unit being reviewed.

(b) To be qualified as an approved reviewer, an individual licensed by the Board must provide a report acceptance body with documentation of his or her qualifications, as listed in 252 CMR 2.15(3)(a) and such other information requested by the report acceptance body.

(c) A report acceptance body, in its discretion, may terminate the appointment of an individual to act as an approved reviewer.

(4) Conduct of Quality Reviews.

(a) In the case of a practice unit which undergoes a quality review, upon completion of the review, the approved reviewer shall write a quality review report which, at a minimum, sets forth the nature (on-site or off-site) and scope of the quality review, including any limitations thereon, and the AICPA standards under which the quality review was performed. On-site quality review reports shall, at a minimum, set forth an opinion on whether, during the period under review, the system of quality control for the accounting and auditing practice of the reviewed practice unit met AICPA quality control standards and whether that system of quality control was being sufficiently complied with so as to provide the approved reviewer with reasonable assurance that the practice unit was conforming with AICPA quality control and professional standards. Off-site quality review reports shall disclaim an opinion or any form of assurance about the reviewed practice unit's quality control standards and procedures, and indicate if the financial statements and compilation or review reports submitted for review did not conform with AICPA requirements and describe significant departures from those standards.

(b) The quality review report shall also describe the reason for any qualification or limitation of the report and set forth any corrective measures to be undertaken by the practice unit to address any issues identified by the quality review.

(c) Upon completion of the quality review and preparation of the quality review report, the approved reviewer shall issue a copy of the quality review report to the practice unit and a report acceptance body.

(5) Qualifications of Report Acceptance Bodies.

(a) The Board, or, in the Board's discretion, the Review Oversight Board, shall approve one or more practice units, professional societies or other organized group of certified public accountants and/or public accountants to function as report acceptance bodies.

(b) The Board may, in its discretion, terminate its approval of a report acceptance body.

(6) Authority and Function of Report Acceptance Bodies.

(a) Within 30 days after an approved reviewer issues a quality review report, the reviewed practice unit must file a letter of response with the report acceptance body for consideration of the results of the review by the approved reviewer, unless the quality review report was not accompanied by a letter of comments.

(b) If a quality review report is accompanied by a letter of comments and no letter of response is received, then the report acceptance body may conduct a limited review of the quality review report and such other documents as deemed appropriate, and determine whether to accept, alter, or reject and return the quality review report for further review.

(c) A report acceptance body may mandate that corrective action be taken by the reviewed practice unit or that a further quality review of the practice unit be performed, or may recommend to the Review Oversight Board that limits be placed on the public accountancy practice of the reviewed practice unit.

(7) Authority and Function of Review Oversight Board.

(a) The Board may appoint up to five individual licensees to a Review Oversight Board to monitor programs administered by the report acceptance bodies and report periodically to the Board. Review Oversight Board members shall not be current members of the Board and may be removed or replaced by the Board in its discretion.

(b) A reviewed practice unit may request reconsideration of the action of a report acceptance body by the Review Oversight Board, which may accept, alter or reject and return for further review any action of a report acceptance body, and may mandate corrective action or impose other restrictions.

(c) Following reconsideration by the Review Oversight Board, a reviewed practice unit may request Board review of the action of the Review Oversight Board.

(d) During the pendency of a request for reconsideration by the Review Oversight Board or the Board, the reviewed practice unit must comply with the terms of a quality review report as accepted or altered by a report acceptance body.

(8) Confidentiality of Quality Review Reports.

(a) All quality review reports and related materials shall remain confidential, as provided in M.G.L. c. 112, § 87E½.

(b) Notwithstanding the provisions of 252 CMR 2.15(8) and M.G.L. c. 112, § 87E½, the Board shall have the right to inquire of a report acceptance body or the Review Oversight Board as to whether a quality review report has been accepted.

(9) Waiver of Quality Review.

(a) The Review Oversight Board may grant a waiver of or extension of time to meet the quality review requirement for the following reasons:

1. health;

2. military service; or

3. other good cause, as determined by the Review Oversight Board.

(b) Requests for waivers or extension of time shall be in writing, under oath, and submitted with the renewal form or as soon as practicable after the circumstances arise which are the basis for the request.

(c) Any practice unit which has been granted a waiver or extension of time shall immediately notify the Review Oversight Board when the basis upon which such waiver or extension of time was granted has ceased to exist. When the circumstances upon which such a waiver was granted cease to exist, the Review Oversight Board may require the practice unit to undergo a quality review at such time as the Review Oversight Board deems appropriate. A waiver shall only be effective for the calendar year for which it has been granted.

(d) A practice unit may request the Board to review a decision of the Review Oversight Board regarding a waiver or extension. Such request must be filed with the Board in a timely manner.

(10) Review of Multi-jurisdictional Practice Units. The Review Oversight Board may accept a quality review of a multi-jurisdictional practice unit which is based solely upon work conducted outside of Massachusetts as satisfying the quality review requirement if:

(a) the quality review was conducted within three years of the renewal application;

(b) the quality review is performed in accordance with requirements equivalent to those of the Board;

(c) the quality review studies, evaluates and reports on the financial reporting practice of the practice unit as a whole; and

(d) At the conclusion of the quality review, the quality reviewer issues a report meeting the requirements of 252 CMR 2.15(4).

2.16: Requirements for Reinstatement of Lapsed/Expired License

(1) A license which has lapsed for one renewal cycle or less may be reinstated upon:

(a) payment of the back license fee, a late fee and the current license fee;

(b) presentation of evidence satisfactory to the Board of having completed all required continuing professional education credits, as provided in 252 CMR 2.14; and

(c) completion of any other Board requirements.

(2) A license which has lapsed for more than one renewal cycle may be reinstated upon:

(a) If practicing in Massachusetts during the period the license was expired:

1. payment of all back license fees, a late fee and the current license fee;

2. presentation of evidence, satisfactory to the Board, of having completed all required continuing education credits, as provided in 252 CMR 2.14; and

3. completion of any other Board requirements, including re-examination and acknowledgment of practice during the period the license was expired.

(b) If not practicing during the period the license was expired:

1. payment of the current license renewal fee and a late fee;

2. presentation of evidence, satisfactory to the Board, of having completed all required continuing professional education credits, as provided in 252 CMR 2.14;

3. completion of any other Board requirements, including re-examination; and

4. submission of an affidavit signed under the pains and penalties of perjury that the individual has not been practicing during the period the license was expired.

(c) If practicing in another state during the period the Massachusetts license was expired:

1. payment of the current license renewal fee and a late fee;

2. submission providing to the Board of an official record of good standing or certified statement from other licensing authority indicating the license is in good standing in the state of current licensure; and

3. presentation of evidence, satisfactory to the Board, of having completed all required continuing professional education credits, as provided in 252 CMR 2.14.

(3) Notwithstanding the provisions of 252 CMR 2.16, the Board may refer cases of unlicensed practice to appropriate law enforcement authorities for prosecution.

2.17: Conversion of Public Accountant License to Certified Public Accountant License

(1) Pursuant to the M.G.L. c. 112, § 87C(a) and (b), the Board may issue the certificate and license to practice as a Certified Public Accountant (CPA) to an individual licensed as a Public Accountant (PA) by the Board who meets all the following requirements:

(a) The PA files an application with the Board for the conversion of the PA certificate and license to a CPA certificate and license;

(b) At the time of application for conversion of the PA certificate and license, the PA holds a current license issued by the Board;

(c) At the time of application for conversion of the PA certificate and license, any public accounting firm that employs the PA or in which the PA has an interest holds a current license issued by the Board and meets the quality review requirements of M.G.L. c. 112, § 87B½ and 252 CMR 2.15; and

(d) For the five year period prior to July 1, 1998 (or for the duration of licensure as a PA by the Board, if less than five years), the PA maintained a current PA license issued by the Board and completed all continuing education hours required pursuant to M.G.L. c. 112, § 87B(e) and 252 CMR 2.14.

(2) Subsequent to the approval of the application for conversion from a PA certificate and license to a CPA certificate and license, the licensee must cease to utilize the designation "PA" in all forms of practice and is limited to utilizing the designation "CPA" in all forms of practice.

REGULATORY AUTHORITY
252 CMR 2.00: M.G.L. c. 112, § 87A½.

The Code of Ethics and Rules of Professional Conduct derive their authority from M.G.L. c. 112, § 87A½ subsection (4) which provides that the Massachusetts Board of Public Accountancy may make such rules of professional conduct as may be instrumental in fixing and maintaining high standards of integrity and dignity in the profession of public accounting, and for the enforcement of such rules and other statutory requirements.

3.01: Independence, Integrity and Objectivity

(1) Independence. A certified public accountant or a firm of which the licensee is a partner, shareholder or member shall not express an opinion on financial statements of an enterprise unless the licensee or the licensee's firm are independent with respect to such enterprise. Independence will be considered to be impaired if, for example:

(a) During the period of the licensee's professional engagement, or at the time of expressing the licensee's opinion, the licensee or the licensee's firm:

1. Had or was committed to acquire any direct or indirect financial interest in the enterprise, or

2. Had any joint closely held business investment with the enterprise or any officer, director, member or principal stockholder, or

3. Had any loan to or from the enterprise or any officer, director, member 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: loans obtained by a member of the licensee's firm which are not material in relation to the net worth of such borrower; home mortgages; other secured loans, except loans guaranteed by 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 the licensee or the licensee's firm:

1. Was connected with the enterprise as a promoter, underwriter or voting trustee, a director or officer or in any capacity equivalent to that of a member of management or of any employee; or

2. Was a trustee of any trust or executor or administrator of any estate, if such trust or estate had a direct or indirect financial interest in the enterprise; or was a trustee for any pension or profit-sharing trust of the enterprise.

(2) Integrity and Objectivity. A certified public accountant shall not knowingly misrepresent facts, and when engaged in the practice of public accounting, including the rendering of tax, management advisory, or other financial services, shall not subordinate his or her judgment to others. In tax practice a certified public accountant may resolve doubt in favor of the licensee's client as long as there is reasonable support for the licensee's position.

3.02: Competence and Technical Standards

(1) Competence. A certified public accountant shall not undertake any engagement which the licensee's or the license's firm cannot reasonably expect to complete with professional competence.

(2) Auditing Standards. A certified public accountant shall not permit the licensee's name to be associated with financial statements in such a manner as to imply that the licensee is acting as an independent certified public accountant unless the licensee has complied with applicable generally accepted auditing standards.

(3) Accounting Principles. A certified public accountant 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 which has a material effect on the statements taken as a whole, unless the licensee can demonstrate that due to unusual circumstances the financial statements would otherwise have been misleading. In such cases the licensee's 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.

(4) Forecasts. A certified public accountant shall not permit the licensee's name to be used in conjunction with any forecast of future transactions in a manner which may lead to the belief that the certified public accountant vouches for the achievability of the forecast.

(5) Report Experience Requirement. Commencing December 1, 2002, a certified public accountant shall not permit the licensee's name to be associated with any issuance of financial statements unless the licensee has completed 1000 hours in the report function on full disclosure financial statements, of which, not more than 300 hours may consist of full disclosure compilations as set forth in 252 CMR2.07 (3). Such report experience must have been completed within three years prior to accepting a report engagement. The verification of such experience will be documented and included in the initial quality report review as required in 252 CMR 2.15. For certified public accountants who do not fulfill the report experience requirement at initial licensure as above, at least 80 hours of CPE continuing professional education in the attest function (reports on financial statements) must be completed within six months prior to the issuance of the first engagement report and official documentation of completion provided to the Board. Further, the licensee must enroll with a qualified Report Acceptance Body (252 CMR 2.15(1)(e) prior to the issuance of the initial report and complete a quality review within nine months subsequent to the issuance of the initial report.

3.03: Responsibilities to Clients

(1) Confidential Relationship. A certified public accountant shall not disclose any confidential information obtained in the course of a professional engagement, except with the consent of the

client. 252 CMR 3.03 shall not be construed to relieve a person of his obligation to comply with a validly issued subpoena or summons enforceable by order of a court, or to respond to proper inquiries made by the Massachusetts Board of Public Accountancy or in the course of quality reviews of said certified public accountant or the licensee's firm.

(2) Contingent Fees.

(a) "Contingent Fee" means a fee established for the performance of any public accounting service for which no fee will be charged unless a specified finding or result is attained, or for which the amount of the fee is otherwise dependent upon the finding or result of the service. A licensee shall not enter into an oral agreement that provides for a contingent fee for public accounting services.

(b) A licensee shall not accept or perform any public accounting services for a contingent fee or receive a contingent fee from a client for whom the licensee or the licensee's firm performs:

1. An audit;

2. A review;

3. A compilation of a financial statement when the licensee expects or reasonably might expect that a third party will use the financial statement and the licensee's report does not disclose a lack of independence; or

4. An examination of prospective financial information.

(c) The prohibition of 252 CMR 3.03(2)(b) applies during the period of time in which the licensee is engaged to perform those services and the period covered by any historical financial statements involved in those services.

(d) A licensee in public practice shall not prepare for a contingent fee:

1. An original or amended tax return or claim for a tax refund. Preparation of an original or amended tax return or claim for tax refund includes giving advice on events which have occurred at the time the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a return or claim for refund; or

2. An amended federal or state income tax return for a client claiming a refund of taxes because a deduction was inadvertently omitted from the return originally filed when there is no question as to the propriety of the deduction, rather the claim is filed to correct an omission.

(e) The following are examples of circumstances where a contingent fee would be permitted regardless of whether the licensee or licensee's firm is performing the services specified in 252 CMR 3.03(2)(b):

1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return;

2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case by a different taxpayer or with respect to which the taxing authority is developing a position;

3. Filing an amended federal or state income tax return or refund claim which claims a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation ($1,000,000 at March, 1991) or state taxing authority;

4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests;

5. Requesting, by means of protest or similar document, consideration by the state or local taxing authority of a reduction in the assessed value of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value; or

6. Representing a client to obtain a private letter ruling or influencing the drafting of a regulation or statute.

(f) Fees shall not be considered as contingent:

1. If fixed by courts or other public authorities; or

2. In tax matters if determined based on the results of judicial proceedings or the findings of governmental agencies. A fee is considered determined based on the findings of governmental agencies, if the licensee can demonstrate a reasonable expectation at the time of the fee arrangement, of substantive consideration by an agency with respect to the licensee's client. The expectation is deemed not reasonable in the case of preparation of original tax returns.

(g) Fees may vary depending on the complexity of services rendered.

(3) Records. In accordance with M.G.L. c. 112, § 87E, a certified public accountant shall furnish to the licensee's client or former client, upon request made within a reasonable time after original issuance of the document in question, if not previously furnished:

(a) A copy of a tax return of the client;

(b) A copy of any report or other document issued by the certified public accountant or public accountant to or for such client;

(c) Any accounting or other records belonging to, or obtained from or on behalf of, the client which the certified public accountant removed from the client's premises or received for the client's account, but the certified public accountant may make and retain copies of such documents of the client when they form the basis for work done by the licensee; and

(d) A copy of the certified public accountant's working papers, to the extent that such working papers include records that would ordinarily constitute part of the client's books and records and are not otherwise available to the client.

3.04: Responsibilities to Colleagues

(1) Combined and/or Consolidated Statements. Where a certified public accountant is required to express an opinion on combined or consolidated financial statements which include a subsidiary, branch or other component audited by another certified public accountant, the licensee may insist on auditing any such component which in the licensee's judgment is necessary to warrant the expression of the licensee's opinion.

(2) Referral Engagements. A certified public accountant who receives an engagement for services by referral from another certified public accountant shall not accept the client's request to extend the licensee's service beyond the specific engagement without first notifying the referring accountant.

3.05: Other Responsibilities and Practices

(1) Discreditable Conduct. A certified public accountant shall not commit any act discreditable to the profession.

(2) Solicitation and Advertising.

(a) Advertising. Certified Public Accountants may provide information to the public by advertising. Such advertising shall not:

1. be false, deceptive or misleading;

2. create false or unjustified expectations of favorable results;

3. imply the ability to influence improperly any court tribunal or regulatory agency;

4. fail to disclose all variables and other relevant factors for soliciting professional engagements;

5. violate M.G.L. c. 93A; or

(b) Solicitation. Certified Public Accountants may solicit professional engagements by direct communications. Such communications shall not:

1. be false, deceptive or misleading;

2. create false or unjustified expectations of favorable results;

3. imply the ability to influence improperly any court tribunal or regulatory agency;

4. fail to disclose all variables and other relevant factors for soliciting professional engagements;

5. violate M.G.L. c. 93A; or

6. be coercive, intimidating, threatening or overreaching.

(3) Commissions.

(a) "Commission" means any item of value given or received by a licensee to or from any third party in return for suggesting the purchase of any product or service.

(b) A licensee shall not recommend or refer to a client any product or service in exchange for a commission, recommend any product or service to be supplied by the licensee's client to a third party, or receive a commission when the licensee or the licensee's firm also performs for that client:

1. An audit or review of a financial statement;

2. A compilation of a financial statement when the licensee expects or reasonably might expect that a third party will use the financial statement and the licensee's report does not disclose a lack of independence; or

3. An examination of prospective financial information.

(c) The prohibition of 252 CMR 3.05(3)(b) applies during the period in which the licensee is engaged to perform any of the services listed in 252 CMR 3.05(3)(b)1., 2. and 3. and the period covered by any historical financial statements involved in the listed services.

(d) A licensee who is not prohibited from receiving a commission and who is paid or expects to be paid a commission shall disclose that fact, in writing, to any person or entity to whom the licensee recommends or refers a product or service to which the commission relates.

(e) A licensee who accepts a fee for recommending or referring any service of another licensee to any person or entity or who pays a fee to obtain a client shall disclose, in writing, the receipt or payment of the fee to the client.

(f) This rule shall not prohibit:

1. Payments for the purchase of an accounting practice; or

2. Retirement payments to individuals, and their heirs or estates, who were formerly engaged in the practice of public accounting.

(4) Incompatible Occupations. A certified public accountant who is engaged in the practice of public accounting shall not concurrently engage in any business or occupation which impairs his independence or objectivity in rendering professional services.

(5) Form of Practice and Name.

(a) Form of Practice. A certified public accountant may practice public accountancy only in a proprietorship, partnership, professional corporation, business corporation, limited liability partnership, or limited liability company, organized in accordance with M.G.L. c. 156A, c. 156B or c. 108A.

(b) Firm Names. A certified public accountant shall not practice public accountancy using a professional or firm name which is misleading as to the legal form of the firm or as to the persons who are partners, officers, shareholders or members of the firm, or as to any matter with respect to which public communications are restricted by 252 CMR 3.05(2)(a). A firm name is misleading, and thus prohibited if, among other things:

1. The firm name implies the existence of a corporation when the firm is not a corporation (as by use of the abbreviation "P.C.");

2. The firm name implies existence of a partnership when the firm is not a partnership;

3. The firm name implies the existence of a limited liability partnership or a limited liability company when the firm is not a limited liability partnership or a limited liability company as duly and validly registered in the Commonwealth of Massachusetts;

4. The firm name includes the name of a person who is neither a present nor a past partner, shareholder, or member of the firm; or

5. The firm name includes the designation "and Associates," "and Assoc.," "and Company," or "& Co." when there are not in fact at least two owners, or a sole proprietor or single owner CPA firm with at least one licensed full-time employee. Sole proprietors or single owner CPA firms must notify the Board, in writing, identifying the name of the licensed full-time employee for approval of a firm name designating other than the licensee's name.

(c) Fictitious Firm Names. A fictitious firm name is any firm name that does not consist of solely the last names (except that an individual's first name may be used with the individual's last name) of the living or deceased natural persons who constitute or constituted of one or more present or former owners of the firm together with any designation of the type of legal entity in which the firm is organized. A firm may not use a fictitious firm name unless:

1. such firm name consists solely of the initials of the last names of living or deceased natural persons who constitute or constituted one or more present or former owners of the firm, or a combination of such initials and the last names of living or deceased natural persons who constitute or constituted one or more present or former owners of the firm, together with any designation of the type of legal entity in which the firm is organized; and

2. such firm name has been registered with and approved by the Board as not being false or misleading, and as not reflecting discredit upon the accounting profession.

REGULATORY AUTHORITY
252 CMR 3.00: M.G.L. c. 13, §§ 33 and 34; c. 112, §§ 87A through E and 61

252 CMR 4.00 is adopted by the Board, pursuant to M.G.L. c. 108, § 45(8) and M.G.L. c. 112 § 87B½(g). 252 CMR 4.00 sets standards for required insurance coverage, or designated and segregated capital requirements, for registered limited liability partnerships, foreign registered limited liability partnerships, business corporations, limited liability companies, and domestic limited liability companies licensed by the Board.

4.01: Definitions

As used in 252 CMR 4.00, unless the context otherwise requires:

Board, Licensee and Practice of Public Accountancy are defined in M.G.L. c. 112, § 87A.

Business Corporation refers to a corporation, as defined in M.G.L. c. 156B, § 2, licensed by the Board.

LLC refers to any "limited liability company" and "domestic limited liability company", as defined in M.G.L. c. 156C, § 2(b)(5) and M.G.L. c. 112, § 87B 1/2(g), licensed by the Board.

LLP refers to any "registered limited liability partnership" or "foreign registered limited liability partnership," as defined in M.G.L. c. 108A, § 1, licensed by the Board.

Manager and Member are defined in M.G.L. c. 156C, § 2(b)(7) and (8), respectively.

4.02: Required Insurance and Capital Program

(1) An LLP, Business Corporation or LLC must maintain in good standing professional liability insurance which meets the following minimum standards:

(a) The insurance shall cover negligence, wrongful acts, errors and omissions and insure the LLP and the individual licensees who are partners or employees of the LLP, or the LLC and the individual licensees who are members, managers or employees of the LLC, or the Business Corporation and the individual licensees who are employees, shareholders, officers or directors of the Business Corporation;

(b) The insurance shall be in an amount for each claim of at least $100,000 multiplied by the number of individuals who are employed by, or partners of, the LLP; or the number of individuals who are employed by, or members or managers of the LLC, or the number of individuals who are employed by, or shareholders, officers or directors of, the Business Corporation; and in an aggregate amount of at least $300,000 multiplied by the number of individuals who are employed by, or partners of, the LLP; or the number of individuals who are employed by, or managers or members of, the LLC; or the number of individuals who are employed by, or shareholders, officers or directors of, the Business Corporation;

(c) The requirements of 252 CMR 4.02 shall be satisfied if the LLP, Business Corporation or LLC maintains insurance sufficient to provide coverage at a level of at least $600,000 for each claim with an aggregate top limit of liability for all claims, during any one year, of at least $ 2,000,000; and

(d) The insurance required by 252 CMR 4.02 may provide that it does not apply to: Any dishonest, fraudulent, criminal, or malicious act or omission of the insured LLP, Business Corporation or LLC, or any individual licensee who is a partner, manager, member, shareholder, officer, director or employee thereof; or the conduct of any business enterprise not involving the practice of public accountancy in which the insured LLP, Business Corporation or LLC may hold an ownership interest or in which the insured LLP, Business Corporation or LLC may be a partner or which may be controlled, operated, or managed by the insured LLP, Business Corporation or LLC, in its own or in a fiduciary capacity including the ownership, maintenance, or use of any property in connection therewith; and bodily injury to, or sickness, disease, or death of, any person, or to injury to or destruction of any tangible property, including the loss of

use thereof. The policy may contain reasonable provisions with respect to policy periods, territory, claims, conditions, and other usual matters.

(2) Designated Segregated Capital Option for LLPs.

(a) The insurance required by 252 CMR 4.02(1) is not required if the LLP maintains designated and segregated capital equal to the amount of insurance required in 252 CMR 4.02(1)(b) or (c).

(b) An LLP shall be considered to be in compliance with 252 CMR 4.02(2)(a) if the LLP provides an amount of funds equal to the amount of insurance required in 252 CMR 4.02(1)(b) or (c), which funds must be specifically designated and segregated for the satisfaction of judgments against the LLP or its partners based on negligence, wrongful acts, errors and omissions, by:

1. deposit in trust or in bank escrow of cash, bank certificates of deposit, or United States Treasury obligations; or
2. a bank letter of credit or insurance company bond.

(3) (a) An LLP, Business Corporation or LLC must notify the Board in writing, within five business days, if its insurance coverage is canceled or otherwise interrupted, or if the LLP's designated and segregated capital falls below the amount required in 252 CMR 4.02(2)(a). Failure to provide required notice to the Board will subject the LLP and its partners, or the LLC and its managers or members, or the Business Corporation and its shareholders, officers or directors who are licensed by the Board to disciplinary action, pursuant to M.G.L. c. 112, § 87C 1/2.

(b) At any time the LLP is not in compliance with 252 CMR 4.02, the LLP shall practice accountancy in the Commonwealth only as a general partnership until such time as the LLP is in compliance with 252 CMR 4.02. The LLP shall notify the Board, in writing, within five business days, that the LLP is in compliance with 252 CMR 4.02.

(c) In the event of cancellation or any other interruption in required insurance coverage for more than five business days, an LLC or Business Corporation may not practice public accountancy in the Commonwealth until such time as the LLC or Business Corporation is in compliance with 252 CMR 4.02.

(4) An LLP, Business Corporation or LLC may be required to provide verification of compliance with 252 CMR 4.02, satisfactory to the Board, on initial application, renewal, and at any other time, at the request of the Board.

REGULATORY AUTHORITY
252 CMR 4.00: M.G.L. c. 108A, § 45(8); c. 165C, §§ 6(c) and 65; c. 112, § 87B½.

GLOSSARY

ETHICS: standards of professional conduct and business practices adhered to by professionals in order to enhance their profession and maximize idealism, justice and fairness when dealing with the public, clients and other members of their profession.

LAWS: bodies of rules governing members of a community, state, organization, professional, etc ... and enforced by authority or compelling legislation.

MORAL: an accepted rule or standard of human behavior.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB) (**www.pcaobus.com**) established in 2002 as a result of the Sarbanes-Oxley Act, a private sector, non-profit corporation set up to oversee the audits of public companies and ensure that accountancy firms should no longer derive non-audit revenue streams, such as consultancy, from their audit clients.

SARBANES-OXLEY (SOX) ACT wide-ranging U.S. corporate reform legislation, coauthored by the Democrat in charge of the Senate Banking Committee, Paul Sarbanes, and Republican Congressman Michael Oxley. The Act, which became law in July 2002, lays down stringent procedures regarding the accuracy and reliability of corporate disclosures, places restrictions on auditors providing non-audit services and obliges top executives to verify their accounts personally. Section 409 is especially tough and requires that companies must disclose information on material changes in the financial condition or operations of the issuer on a rapid and current basis.