

# **The CPA's Guide to Ethical Behavior**

By  
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## Table of Contents

- I. Objectives of Course
- II. Reasons to Study Ethics
- III. Accounting Ethics Courses – Do They Work?
- IV. Ethical Principles, Morals, and Values and post-Enron era
  - A. Ethical Approaches
  - B. Culture in Organizations
  - C. The Accounting Profession: Articulation of Standards
  - D. Reasoning and Dilemmas
  - E. Post-Enron era and importance of independence
    - Exhibit 1 – Independence Self-Test*
  - F. Ethical Management Checklist
- V. Rules of Professional Conduct
  - A. PowerPoint Presentation
  - B. Detail Narrative of Rules of Public Conduct
  - C. General Provisions
    - 1. Preamble and General Principles - Section 501.51
    - 2. Selected Definitions - Section 501.52
    - 3. Professional Standards
- VI. Subchapter B - Professional Standards
  - A. Rationale
  - B. Section 501.60 Auditing Standards
  - C. Section 501.61 Accounting Principles
  - D. Section 501.62 Other Professional Standards
  - E. Audit Standards in 2014
- VII. Subchapter C - Responsibilities to Clients
  - A. Section 501.70 Independence
  - B. Section 501.71 Receipt of Commissions and Other Compensation
  - C. Section 501.72 - Contingency Fees
  - D. Section 501.73 - Integrity and Objectivity
  - E. Section 501.74 - Competence
  - F. Section 501.75 - Confidential Client Communications
  - G. Section 501.76 - Records and Work Papers
  - H. Section 501.77 - Acting through Others
- VIII. Subchapter D - Responsibilities to the Public
  - A. Rationale

- B. Section 501.80 - Practice of Public Accountancy
- C. Section 501.81 - Registration Requirements
- D. Section 501.82 - Advertising
- E. Section 501.83 - Firm Names
- F. Section 501.84 - Form of Practice

IX. Subchapter E - Responsibilities to the Board/Profession

- A. Rationale
- B. Section 501.90 - Discreditable Acts
- C. Section 501.91 - Reportable Events
- D. Section 501.92 - Frivolous Complaints
- E. Section 501.93 - Responses
- F. Section 501.94 - Mandatory Continuing Professional Education

X. Corporate Scandals of the 21<sup>st</sup> Century

**Course Title: The CPA's Guide to Ethical Behavior**

**CPE Hours: 4 hours**

**Field of Study: Personal Development**

**Prerequisites: None**

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# **The CPA's Guide to Ethical Behavior**

## **I. Objectives of Course**

Attendees will fulfill the Texas requirements for Ethics CPE by taking this course with 4 CPE units. Attendees will:

1. Increase their ethical sensitivity so as to lessen the frequency and severity of ethical lapses should they occur
2. Become aware of the reasons that fraud occurs in organizations
3. Master the Rules of Conduct as set forth by the Texas State Board of Public Accountancy
4. Identify elements for a "culture of honesty" in organizations

## **II. Reasons to Study Ethics**

Accountants are perhaps the most valuable employee-fraud fighters because they possess the best understanding of how businesses operate and how transactions flow through the financial or "central nervous system" of the operation.

*From Forensic and Investigative Accounting, p. 5-2*

## **III. Accounting Ethics Courses – Do They Work?**

Ethics training is part of the professional's obligations. Essentially, the Texas CPA requires 4 hours of Ethics CPA biennially and is supported in the research as being needed:

" . . . to increase one's ethical sensitivity."

" . . . to lessen the frequency and severity of ethical lapses in the profession."

It is debatable as to whether or not ethics courses stop fraud; courses can, however, mitigate the likelihood that fraud will occur. Without reminders (or "burst learning opportunities"), human behavior will likely fall victim to fraud.

The field of behavioral ethics emphasizes the need to consider how individuals actually make decisions, rather than how they would make decisions in an

ideal world. Research in behavioral ethics reveals that our minds have two distinct modes for making decisions – “System 1” and “System 2” thinking (Mintz, p. 49). System 1 thinking is our intuitive system of processing information with speed and minimal effort. System 2 thinking is slower, conscious, effortful, explicit, and a more reasoned decision process. Obviously, there can be times that either approach is better. However, the broader point is that the decision-making model that one uses should be an ethical one.

You should use a decision-making model in your mode of operation. One such model set forth by Datar (p. 8) follows:

<b><u>5-Step Decision-Making Process</u></b>
<b>1. Identify the problem and uncertainties.</b>
<b>2. Obtain information.</b>
<b>3. Make predictions about the future.</b>
<b>4. Make decisions by choosing among alternatives.</b>
<b>5. Implement the decision, evaluate performance, and learn.</b>

With this model, human activity generally prevails because management is primarily a human activity that encourages individuals to do their jobs better. For this reason, the model should recognize the behavioral elements of the decision-making process.

Anyone can behave inappropriately as Ariely writes in his book The (Honest) Truth About Dishonesty (p. 142). Since Roman times, we have heard “memento more,” which means “remember your morality” (Ibid., p. 247). Being aware of whatever process we are doing is the crucial first step to creating better societies. Human elements are ever-present and pervasive. We may not understand how the social sciences work; sometimes we do not see certain things in ourselves. Yet, the real goal should be to consider **human elements** when making decisions.

#### **IV. Ethical Principles, Morals, and Values**

Since the beginning of time, man has been guided by reason and the Golden Rule. To be moral is a desirable quality professed to children at a very young age. Immanuel Kant (1724 - 1804) developed a well-articulated vision of ethics as measured by the rightness of rules rather than their consequences. Kant's view was that a moral person made ethical decisions based on "what is right" - rather than because of "fear of being caught" (Hartman, p. 8). Kant concluded that to perform acts are dictated by law or custom was immoral. Only those acts undertaken from "a sense of duty dictated by reason" were considered moral.

Some people go beyond what the law requires. For instance, under United States bankruptcy laws, companies liquidate and arrive at agreements to pay creditors a certain amount, such as 30 cents of every dollar that was owed. Some people, however, believe "the right thing to do in such circumstances is to be beyond what is required by the law to make good on your debts" (Ibid, p. 103). Such practice certainly allows one to sleep at night. When those who emerge from bankruptcy pay their debts because it is a moral or ethical issue, one cannot help but recognize that moral and righteous behavior goes beyond the law.

Ethics is a matter of **ethos**, participation in a community, a way of life. In addition, there is a more general set of basic rules that are not part of any particular society, community, or practice. These rules apply everywhere and determine the legitimacy of every practice. These rules are the rules of morality; to be moral, means doing things right. Most of the time being moral is no big deal. One does not praise an accountant for not cheating on the corporation tax return, and one does not praise an employee for not stealing from the company. Morality is simply not doing what no one should think of doing in the first place.

To be moral in business means practicing "good business." Theorists argue about whether ethical decisions lead to more significant profits than unethical decisions. But the issue often turns to the business case for return on investment. There is evidence that good ethics is good business; yet the dominant thinking is that, if one cannot measure it, it is not important. Efforts have been made to measure the bottom-line impact of ethical decision making. Recent research found that in emerging markets, cost savings and revenue growth were the most important activities. The research concludes that it does pay businesses to pursue a wider role on environmental and social issues. In addition, studies have found greater outcomes and benefits from ethical leadership. The communication practices and the resulting corporate culture sets the tone in an organization. Research in 2017 emphasized the importance of corporate culture in organizations and has described culture as a corporate asset (NACD, 2017). This premise continues to this day in 2021.

## **A. Ethical Approaches**

Articulating an organization's culture through a code of ethics or statement of values is a good place to begin. The vision is oftentimes inspiring. As Jim Collins,

author of Built to Last and Good to Great explains “we did not find ‘maximizing shareholder wealth’ or ‘profit maximization’ as the dominant driving force in most companies” (Hartmann, p. 192). The message tended to produce a cluster of objectives, of which money is only one - and not necessarily the primary one. But the message produced core tenets on which a company is built . . . and is effectively laying down the law with regard to the basis and objectives of an organization (Ibid, p. 193).

What comes out of mission statements should be core tenets and values. Values should emulate from the top of an organization. Leaders with good judgments preserve important values in their organizations and hold fast to them. Such companies are generally good companies for which to work.

## **B. Culture in Organizations**

***It is vital that practitioners and licensees gain an understanding of the culture of the organization in which they perform professional services.***

The culture in organizations needs to permeate an environment that supports and nourishes ethics. One way to create such a culture is to set the tone from the top - and it starts with the CEO. When organizational change is initiated, many leaders struggle; it most certainly is not an easy feat. Culture should be engrained within the organization.

The CEO should continuously demonstrate his/her expectations. The display of ethical leadership then serves as a constant reminder to employees to follow suite in their daily jobs. The CEO should require his/her management team to expect good, clear numbers/measurements in operations. When problems do occur, the situation should be rectified in a fair manner. When tips or adverse information becomes available, it should be dealt with fairly. When these practices become the norm, the culture stands a good chance of becoming “an ethical culture.” But, the practices must be constant, performed under fire, and become habit for the organization.

The 2005 National Business Ethics Survey report states that ethics and compliance programs can and do make a difference (Ethics Resource Center, NBES 2005) in the workplace. Such programs help by creating forums of ethical issues and dilemmas that often face employees. In such settings or ethical training situations, discussions demonstrate what employees should do when situations pose ethical dilemmas or problems. Ethical and compliance training provides opportunities to articulate steps to resolve matters in accordance with good business practices. Such training discussions can highlight the methods which should be taken to resolve such situations. If corrective action is taken no matter what it takes, employees get the message that things must be done right. Conversely, if employees see that management bends the rules or plays with the numbers, employees discover that ethics



may not matter in the organization. The culture is formulated and set in such intricate and critical encounters. Obviously, the culture is can be severely impaired if the wrong message is sent.

Ethical leadership requires that ethical reasoning come through in various ways throughout the organization. The CEO must lead by example. The CEO and executive team in organizations need to display the expectation for ethical standards continuously. Ethical practices can be reinforced through ethical and compliance training programs. Steps for ethical reasoning should be documented in the policy and procedure manuals of organizations. Such supportive steps nourish ethical practices in organizations. Ethics is more likely to permeate an organization when ethics is taught by example, when expectations for ethical practices are well documented, and when ethics are practiced in training sessions. Ethics can and should become the rule for the organization.

Formulating an ethical climate in organizations is good business. The first step to maintaining public confidence in business organizations is to follow good business practices. For the first time (in 2017), the NACD called for performance evaluation of CEO's to ensure that corporate cultures are being nourished. Even though our private enterprise system has experienced flaws, we have no better system. CPAs need to expect the organizations they serve to better understand their own organizational cultures and to improve operations. It begins by developing an expectation for ethical leadership that works for the public interest.

### **C. The Accounting Profession: Articulation of Standards**

The accounting profession articulates its rules and standards of professional conduct under the Public Accountancy Act, which directs the Texas State Board of Public Accountancy to promulgate rules of professional conduct in order to establish and maintain high standards of competence and integrity in the practice of public accountancy and to ensure that the conduct and competitive practices of licensees serve the purpose of the Act and the best interest of the public. It is recommended that the course participant obtain a copy of the current Rules of Professional Conduct from the Texas State Board of Accountancy.

The public has expectations of behavior appropriate for a profession. A professional works with something of value where trust in how competently they function or how responsibly they conduct themselves is particularly important. The values for a profession determine how decisions are made and how actions are taken.

### **D. Reasoning and Dilemmas**

Volumes of literature are devoted in general terms to the question of defining ethics. Ethics involves judgments as to good and bad, right and wrong, and what ought to be. An ethical dilemma exists when two or more values are in conflict. One's guiding

principles must be applied to making a decision. A worthwhile tip for all leaders is to ask the question: Is the decision or alternative ethical? That might be added as the last step to the decision-making process.

How then can we encourage ethical behavior on the part of decision makers? Should ethics be the basis for management decisions? Of course - especially if ethical behavior *always* leads to higher profits as well as higher-quality products or services. We say that ethical business persons will be more likely to succeed than unethical business persons. However, note that higher ethics may lead to higher profits but it does not always do so. As long as there is some perceived benefit to unethical behavior, some decision makers may be persuaded to leave their ethics at the door.

The Institute for Business, Technology, and Ethics suggests the following “nine Good Reasons” to run a business ethically (Ethix, p. 11):

1. Litigation/indictment avoidance
2. Regulatory freedom
3. Public acceptance
4. Investor confidence
5. Supplier/partner trust
6. Customer loyalty
7. Employee performance
8. Personal pride
9. It's right.

Ethics demands the integrity to act according to our personal values as well as accountability for each decision that we make in our lives according to those values. Great minds don't think alike; they think for themselves! If someone were asked to choose between allowing a loved one to die by following the law, or breaking the law in order to allow him or her to live, many may be willing to break the law. Their justification might be “I had no choice - I had to do it to save my mother/brother/father/sister, etc.” The truth is that we all have choices. If you are asked to choose between terminating a subordinate or losing your job, you might fire the worker, claiming “I have no choice but to do this. Sorry.” In fact, you would have a choice - terminate the subordinate or lose your job. You may not like the alternatives offered, but it is a choice nonetheless.

## **E. Post-Enron Era and Importance of Independence**

In the post-Enron era, it is absolutely paramount that organizations create a culture of ethics in their operations. We should consider what it means to be independent.

The Securities and Exchange Commission (SEC) has relied (since 1934)-on the independent public accountant to assume responsibility to perform audits of financial statements that demands a “public watchdog” function while maintaining

independence from the client at all times and requires complete fidelity to the public trust. Chief Justice Warren Burger made independence very clear in the unanimous opinion of the Supreme Court in 1984. Consequently, what does it mean to be independent?

Independence refers to a “state of mind” that permits the rendering of an opinion without being affected by the influences that compromise professional judgment with respect to clients. Furthermore:

- it requires that CPA’s approach attest engagements with professional skepticism;
- it means to exercise professional judgment free from all financial, business, and family relationships that might influence one’s ability to make objective decisions;
- it requires that CPA’s avoid circumstances that might be viewed by a reasonable person as impairing one’s ability to make objective decisions;
- it is enabled by a heightened sensitivity to appearances since even the perception that a CPA lacks independence can lead a reasonable person to question the objectivity of the CPA in rendering an opinion on client financial statements.
- it means to adopt an “unbiased viewpoint” in performing audit tests, evaluating the results, and issuing the audit report.
- the SEC requires that public companies have their financial statements examined by a CPA who is independent of the client and renders an unbiased opinion on those statements.
- those who use financial statements for decision making, such as investors and creditors, rely on the honesty and integrity of CPA’s to ensure that the statements present fairly the financial position and results of operations.

### Exhibit I - Independence Self-Test

Independence standards affect a CPA in performing a variety of professional services for a client whenever the CPA also performs audit and other attest-related services (i.e., reviews) for the client. The purpose of the independence self-test is to provide a starting point for the discussion of independence standards.

*Exhibit 1 – Independence Self-Test*

*Answer each question with YES or NO assuming the CPA is a member of the AICPA.*

- 1. Must CPA's be independent in the performance of all professional services?*
- 2. Does the GAO permit government auditors to perform nonaudit services for entities under its independence rules?*
- 3. Can a CPA own a 40-foot sailboat in partnership with two of his/her major audit clients?*
- 4. A CPA audited the year-end financial statements of a client. During the following year and prior to the audit, the CPA assisted the client in obtaining financing under an arrangement whereby the fee for such a service would not be paid unless the financing was obtained. Is independence impaired by the arrangement?*
- 5. Can a CPA who is approached by the CFO of an audit client to perform personal financial planning services for the CEO agree to such services and accept a commission?*
- 6. A CPA is approached by a company that provides accounting services including tax preparation and financial planning for the public. The company offers to buy out the nonattest practice of the CPA. The CPA would continue to service mutual clients for their attest needs through her/his separate practice. Would the CPA's independence be violated if s/he sells the nonattest practice and affiliates with the public company as stated?*
- 7. Can a CPA perform bookkeeping services for an audit client that is not a public company if the client makes all management decisions and performs all management function?*
- 8. Would a CPA on the attest engagement team be independent if her/his spouse was the controller of an audit client?*
- 9. Can a CPA accept a contingent fee for providing tax services to an audit client if the amount of the fee is disclosed?*
- 10. Can a CPA provide tax advice and make recommendations to assist an audit client's management in performing functions without impairing audit independence?*
- 11. Would the independence of a CPA who is on the attest engagement team be violated if an immediate family member is employed by the client in a key position?*
- 12. Can a CPA firm perform audit services for a financial institution client if members of the attest engagement team have material indirect ownership with the client?*
- 13. Can a CPA provide internal audit services for a nonpublic audit client without impairing independence?*
- 14. Should CPA's who perform audits of public companies registered with the SEC follow all current and future audit standards and independence rules of the AICPA?*

15. *Should CPA's who perform audits of government entities follow the independence standards of the Government Accountability Office (GAO) instead of the AICPA?*
16. *Should a CPA communicate with an audit committee (or those charged with governance) all matters that reflect differences of opinion with management on the applications of generally accepted accounting principles (GAAP)?*
17. *Would independence always be impaired when a CPA firm that is registered with the PCAOB provides services related to marketing, planning, or opining in favor of a tax treatment of a transaction?*
18. *Can a CPA not in public practice who is a controller of a company submit financial statements of the company to a bank for a loan without violating independence?*
19. *Under the Sarbanes-Oxley Act of 2002, are audit committee members (or those charged with governance) of public companies subject to the same independence requirements as CPA's?*
20. *Under the Sarbanes-Oxley Act of 2002, can a CPA who audits a public company also perform bookkeeping services for that client?*

#### **Answers and Explanations to Self-Test**

1. **No.** *Independence is required only when performing audit and other attest-related services such as reviews.*
2. **Yes.** *The GAO Independence Standard permits auditors to participate on committees or task forces in a purely advisory capacity and to provide routine advice without making decisions.*
3. **No.** *The joint ownership with two audit clients of a material investment impairs audit independence.*
4. **Yes.** *The arrangement constitutes a contingent fee and it violated independence when such a payment is received for nonattest services provided to an audit client.*
5. **No.** *Independence is impaired when a CPA provides nonaudit services (personal financial planning) for an audit client when payment for such services is in the form of a commission.*
6. **No.** *Alternative practice structures have become common in accounting. The CPA should take steps to prevent management of the company from influencing the judgment of the CPA when providing audit services for mutual clients.*
7. **Yes.** *Nonpublic companies come under a different set of rules (AICPA) than public companies. The latter now come under the rules of the Public Company Accounting Oversight Board (PCAOB). While the latter prohibits bookkeeping services for companies that are registered with the SEC, the AICPA permits such services for nonpublic companies as long as management is still in control of the decision making.*

8. **No.** *There would be a familiarity threat to the CPA's ability to perform attest services with an independent state of mind.*
9. **No.** *Both the AICPA and PCAOB prohibit the acceptance of a contingent fee for any service provided to a client when also performing attest services for that client.*
10. **Yes.** *Even under the more restrictive PCAOB independence rules, permitted tax services include routine tax preparation and tax compliance, general tax planning and advice, and employee tax services as long as management is responsible for final decision making and adequately oversees such services.*
11. **Yes.** *Members of the "immediate family" of a CPA on the "attest engagement team" come under the same independence rules as a CPA with the family member holding a key position in the client entity.*
12. **No.** *Holding a direct or material indirect financial interest in the client creates the appearance that independence may be impaired in providing audit services.*
13. **Yes.** *The AICPA permits such services as long as the client takes responsibility for the internal control system and manages internal audit activities while the SEC permits them as long as they are not subject to audit procedures.*
14. **No.** *The audit and independence standards of the AICPA served as interim standards for the PCAOB but the PCAOB is now issuing its own standards that are to be applied in lieu of AICPA standards for public companies.*
15. **No.** *Those CPA's must follow both the AICPA independence standards and the GAO (the Yellow Book) standards.*
16. **Yes.** *One role of the audit committee (or those charged with governance) is to oversee financial reporting and discuss with the independent auditor how differences with management in the application of GAAP have been resolved.*
17. **No.** *According to PCAOB rules, independence would be impaired if the opinion was based on an aggressive interpretation of applicable tax laws and regulations or meets specific criteria defined in the rules.*
18. **Yes.** *AICPA standards permit CPA's not in public practice who are controllers of a company to submit financial statements of the company to a bank as long as the CPA does not imply that s/he is independent of the company.*
19. **No.** *While the Act requires all members of the audit committee to be independent of management, it does not establish specific independence requirements and prohibitions as is the case with independence requirements for CPAs.*
20. **No.** *The Sarbanes-Oxley Act precludes certain nonattest services for audit clients including bookkeeping services. Examples of other precluded services are financial information systems design and installation and internal audit services.*

Conclusion: At this point in the course, you are not expected to know all standards. But after taking this Self-Test, you should have a starting point for discussions of the independence standards. The Self-Test should serve as a tool to inform you about the broad application of independence standards in conducting audits of financial statements.

## **F. Ethical Management Checklist**

It is absolutely essential that practitioners implement a corporate ethics policy that conveys good ethics. Research suggests a possible disconnect between companies' intentions and the degree to which they truly value ethical behavior. For this reason and others, practitioners should do the following:

1. Develop a Code of Ethics. Practitioners should consider acting ethically as being professional.
2. Communicate and Awareness campaigns. This is a continuous process. Communication of a company ethics policy never ends.

Research shows that most companies' efforts tend to fail after Step 2 above (Barman and White, 2014).

3. Training and reinforcement. Most organizations now offer online anti-bribery training. On its own, this is not enough. There is no substitute for face-to-face, qualitative training with discussion and debate of understanding and practical application.

Discussion is the answer to ethical dilemmas. Discussion of scenarios can help employees explore ethical issues in training issues. A worthwhile training exercise is to role play scenarios of possible violations that occurred in the past so as to exemplify proper ways of handling the situation.

4. Supporting Context and Culture. Practitioners might be asked whether they challenged or raised and resolves issues leading to fraud. The process of how the culture supports practitioners is very important in the post-Enron era.
5. Monitoring and Accountability. Effective speak-up arrangements, such as anonymous help lines through which employees can raise concerns in confidence about unsafe, unethical or unlawful practices are an important element of good corporate governance. A key component is that practitioners feel comfortable that they can raise issues without fear of retribution.

The ultimate test is the litmus test set forth by Barman and White on page 11 of their 2014 article. Ethics policy should be embedded in the organization so that an employee feels comfortable enough to speak up if he or she has a concern and whether he or she believes the company will respond and take

appropriate action. Once an ethics policy is embedded in a company, you have a wider value chain. Today's complex environment require that companies perform due diligence on suppliers and manage ethics across the board; it has serious implications for organizations in the post-Enron era. Helping to raise standards and awareness through organizations is beneficial for all. After all, good companies do business with good companies (Barman and White, 2014). Practitioners should follow profoundly follow effective ethics policy.

## Exhibit II – Best Practices for Making an Ethics Code Effective (Barman and White, 2014)

- Root the code in core values such as trust and integrity.
- Give a copy to all staff.
- Provide a way to report breaches in a confidential manner.
- Include ethical issues in corporate training programs.
- Set up a board committee to monitor the effectiveness of the code.
- Report on the code's use in the annual report.
- Make conformity to the code part of a contract of employment.
- Make the code available in the language of staff located overseas.
- Make copies of the code available to business partners, including suppliers.
- Make a named individual responsible for code implementation.
- Review the code in light of changing business challenges.
- Make sure senior staff "walk the talk."

--from Developing a Code of Business Ethics, *Institute of Business Ethics*

## **Learn how to Read Red Flags**

From scandals, we see red flags that were present in organizations. You should always be cognizant and aware of red flags which can sway individuals in organizations.

### ***10 Ways to Defend Yourself from Coercive Pressure***

#### **Before You Are Asked – Prepare to Say No:**

1. Plan Ahead
2. Live Within Your Means
3. Understand the Pressure and People Landscapes
4. Work with Others to Set the Right Tone
5. Have Some Advisors



## **When You Are Asked – Saying No:**

6. Beware of Little Asks
7. Watch Your Tendency to be a Pleaser
8. Guard Against Rationalization
9. Explain Your Role as a Financial Professional
10. Articulate the Ask and the Possible Consequences

## **V. Rules of Professional Conduct**

Chapter 501 of the Rules of Professional Conduct sets forth general provisions of the standards for the practice of CPAs in the State of Texas. It also lists professional standards, responsibilities to clients, and responsibilities to the public as well as to the board and profession. It is highly recommended that a copy of the Chapter be obtained before answering questions in this course, or at a minimum peruse the online set of Rules of Professional Conduct.

### **A. PowerPoint Presentation of Rules of Professional Conduct**

The Rules of Professional Conduct exist “in order to establish and maintain high standards of competence and integrity in the practice of public accountancy and to ensure that the conduct and competitive practices of licensees serve the purposes of the Act and the best interest of the public.” The previous sentence, as taken directly from Section 501.51, is the reason for the Rules of Professional Conduct.

[This PPT summarizes the Texas Rules of Professional Conduct.](#)

### **B. Detail “Narrative” of Rules of Professional Conduct**

#### **1. Preamble and General Principles - Section 501.51**

The Rules of Professional Conduct directs the Texas State Board of Public Accountancy to promulgate rules of professional conduct. The purpose of the rules is “. . . to establish and maintain high standards of competence and integrity in the practice of public accountancy and to ensure that the conduct and competitive practices of licensees serve the purposes of the Act and the best interest of the public.”

The Rules apply to professions practicing public accountancy. The rules recognize the services of the profession to the public. The public’s reliance imposes

obligations on the certificate holder. The Texas State Board of Public Accountancy has an underlying duty to the public to insure the obligations are met by practitioners in order to serve the public interest. The rules also recognize the duty of certified public accountants to refrain from committing acts discreditable to the profession. Such acts negatively impact upon the public's view of the profession.

## **2. Selected Definitions - Section 501.52**

Knowledge of terms as defined in accordance with Chapter 501 of the Administrative Code, Title 22, Part 22 should be gained in order to fully understand the responsibilities and obligations of certificate holders.

### **Act**

The *Public Accountancy Act, Chapter 901, Occupations Code (Vernon's 1999)*.

### **Advertisement**

A message which is transmitted to persons by, or at the direction of, a certificate or registration holder and which has reference to the availability of the certificate or license holder to perform professional services.

### **Board**

The Texas State Board of Public Accountancy

### **Certificate or registration holder**

The holders of all currently valid:

- A) certificates issued to individuals who have been awarded the designation certified public accountant by the board pursuant to the *Act*, or pursuant to corresponding provisions of a prior Act; and
- B) registrations with the board for the practice of public accounting in this State.

### **Client**

- A) The person or entity which retains a certificate or registration holder for the performance of professional services regardless of the fee arrangement;
- B) Any person or entity upon whose financial statements the certificate or registration holder is retained to report or opine, whether or not this is the same person or entity which retains the certificate or registration holder.

### **Commission**

Compensation for recommending or referring any product or service to be supplied by another person.

### **Contingent fee**

A fee for any service whether no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. However, a certificate or registration holder's non-contingent fees may vary depending, for example, on the complexity of the services rendered.

Fees are not contingent if they are fixed by courts or governmental entities acting in a judicial or regulatory capacity, or in tax matters if determined based on the results of judicial proceedings or the findings of governmental agencies acting in a judicial or regulatory capacity, or if there is a reasonable expectation of substantive review by a taxing authority.

### **Client Practice**

Client practice of public accountancy is the offer to perform or the performance for a client or a potential client or a service involving the use of accounting, attesting, or auditing skills. The phrase “service involving the use of accounting, attesting, or auditing skills” includes:

- A) the issuance of reports on, or the preparation of, financial statements, including historical or prospective financial statements or any elements thereof;
- B) the furnishing of management or financial advisory or consulting services;
- C) the preparation of tax returns or the furnishing of advice or consultation on tax matters;
- D) the advice or recommendations in connection with the sale or offer for sale of products (including the design and implementation of computer software), when the advice or recommendations routinely require or imply the possession of accounting or auditing skills or expert knowledge in auditing or accounting; and/or
- E) litigation support services.

### **Fiduciary duties**

Duties to act for the benefit of someone else. A fiduciary must exercise a high degree of care and must subordinate his/her own personal interests in the event of conflicts of interest.

### **Professional services**

Any services performed or offered to be performed in the course of the practice of public accountancy.

### **Report**

When used with reference to financial statements, means either an engagement performed through the application of procedures under the *Statement on Standards for Accounting and Review Services* or any opinion, report, or other form of language that states or implies assurance as to the reliability of any financial statements and/or includes or is accompanied by any statement or implication that the person or firm issuing it has special knowledge or competence in accounting or auditing. Such a statement or implication of special knowledge or competence may arise from use by the issuer of the report of names or titles indicating that he or it is an accountant or auditor or from the language of the report itself. The term “*report*” includes any form of language which disclaims an opinion when such form of language is conventionally understood to imply any assurance as to the reliability of the financial statements to which reference is made and/or special competence on the part of the person or firm issuing such

language; and it includes any form of language conventionally used with respect to a compilation or review of financial statements, and any other form of language the it implies such special knowledge or competence.

### **3. Professional Standards**

Section 501.6 states that a certificate or registration holder shall not permit his name to be associated with financial statements in such a manner as to imply that he is acting as an auditor with respect to such financial statements unless he has complied with applicable generally accepted auditing standards. Generally accepted accounting principles must also be used. The certificate holder must be independent in fact and in appearance when performing an engagement in which a report on financial statements is issued.

## **VI. Subchapter B - Professional Standards**

### **A. Rationale**

The reasons and purpose of professional standards are very clear in Subchapter B. The professions equate to an avowal of belief in a faith or religion or to **an** occupation requiring advanced education and training (according to Webster). The public accounting profession has a duty to follow generally accepted auditing standards, generally accepted accounting principles, or other applicable professional standards, such as for consulting services.

Certificate holders and licensees work in firms and should exemplify good business practices and ethical leadership. The ideals and expectations for the business should be kept in mind as CPAs work in a business environment that may or not be desirable. CPAs should use judgment to assess the environment and conduct their professional services with the culture in mind.

The high-performance business model creates an environment wherein the following principles exist:

- Focus on stakeholders
- Broad-based involvement
- Leadership support
- Mission centeredness
- Respect for people
- Promotion of collaboration
- Agility and responsiveness to change
- Foresight to plan proactively
- Fact-based information gathering
- Integrity in words and deeds

These principles are well grounded in business theory and represent a holistic approach to a sound business model. When some or all of the principles are absent, the model is less than desired - a condition which the CPA should assess and consider.

## **B. Section 501.60 - Auditing Standards**

A certificate or registration holder shall not permit his name to be associated with financial statements in such a manner to imply he is acting as an auditor with respect to such financial statements unless he has complied with generally accepted auditing standards. Statements on auditing standards included in *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions* issued by the United States General Accounting Office and in other pronouncements having similar generally recognized authority are considered to be interpretations of generally accepted auditing standards; any departures from such pronouncements must be justified.

## **C. Section 501.61 - Accounting Principles**

A certificate or registration holder shall not issue a report asserting that financial statements are presented in conformity with generally accepted accounting principles if such financial statements contain any departure from such accounting principles which has a material effect on the financial statements taken as a whole, unless the certificate or registration holder can demonstrate that by reason of unusual circumstances the financial statements would otherwise have been misleading. In such a case, the certificate or registration holder's report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the generally accepted accounting principle would result in a misleading statement. For purposes of this section, generally accepted accounting principles are considered to be defined by pronouncements issued by the Financial Accounting Standards Board and its predecessor entities and similar pronouncements issued by other entities having similar generally recognized authority.

## **D. Section 501.62 - Other Professional Standards**

A certificate or registration holder in the performance of consulting services, accounting and review services, or any other attest service shall conform to the professional standards applicable to such services. For purposes of this section, such professional standards are considered to be interpreted by:

- 1) *Statements on Standards on Consulting Services (SSCS)* issued by the American Institute of Certified Public Accountants;
- 2) *Statements on Standards for Accounting and Review Services (SSARS)* issued by the American Institute of Certified Public Accountants;
- 3) *Statements on Standards for Attestation Engagements (SSAE)* issued by the American Institute of Certified Public Accountants; or
- 4) *Similar pronouncements by other entities having similar generally*

*recognized authority.*

## **E. Audit Standards to Combat Financial Statement Fraud**

Audit standards have come a long way in the last twenty years. In fact, the standards in 2014 provide a framework to evaluate internal controls and assess audit risk, and they point out red flags that indicate fraud may be present. COSO guidelines provide that internal controls are an integral part of the reasonable assurance given in audit reports.

The Fraud Triangle shown later in this course provides better understanding of fraud and fraudulent practices. A strong corporate governance system, including an independent audit committee, effective internal controls over financial reporting, and audit risk assessment, is the best way to prevent fraud. External auditors should communicate with the audit committee about any accounting irregularities or weaknesses in internal control. The foundation of a strong corporate governance system is to create an ethical organization environment and build integrity into the financial reporting process. In 2014, all parties expect that financial statements are in conformity with GAAP and the audit has been conducted in accordance with established audit standards.

## **VII. Subchapter C - Responsibilities to Clients**

### **A. Section 501.70 Independence**

- A) A certificate or registration holder must be independent in fact and in appearance when performing an engagement in which a report will be issued on financial statements.
  - B) Independence will be considered to be impaired if the certificate or registration holder:
    - 1) had or was committed to acquire any direct or material indirect financial interest in the client
    - 2) was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client;
    - 3) had any joint closely-held business investment with the client or any officer, director, partner, or principal stockholder thereof which was material in relation to the net worth of the certificate or registration holder; or
    - 4) had any loan to or from the client or any officer, director, partner, or principle stockholder thereof other than certain “grandfathered loans” and “other permitted loans” which will not be considered to impair independence.
- (A) Grandfathered loans - Loans from a financial institution made under that institution’s normal lending procedures, terms, and requirements and that meet the other conditions stated herein. Grandfathered loans must, at all times, be current as to all terms and such terms shall not be renegotiated after the latest of the dates in clauses (1) - (iv) of this paragraph.

Grandfathered loans include those which:

(i) existed as of January 1, 1997;

(ii) were obtained from a financial institution prior to its becoming a client requiring independence;

(iii) were obtained from a financial institution for which independence was not required and that were later sold to a client for which independence is required; or

(iv) were obtained from a firm's financial institution client requiring independence by a borrower prior to his or her becoming a member of the firm or registration holder, such as:

- Loans obtained by the certificate or registration holder which are not material to the net worth of the borrower;
- Home mortgages; and
- Other secured loans in which the collateral must equal or exceed the remaining balance of the loan at January 1, 1997, and at all times thereafter.

(B) Other permitted loans - Personal loans obtained from a financial institution client from which independence is required which were made under that institution's normal lending procedures, terms and requirements. Such loans must, at all times, be kept current as to all terms. Other permitted loans include:

- Automobile loans and leases collateralized by the automobile;
- Loans of the surrender value under terms of an insurance policy;
- Loans fully collateralized by cash deposits at the same financial institution; and
- Credit cards and cash advances on checking accounts with an aggregate balance not paid currently of \$5,000 or less.

(C) Independence also will be considered to be impaired if, during the period covered by the financial statements, during the period of the professional engagement, or at the time of issuing his report, the certificate or registration holder:

- Was connected with the client 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;
- Was a trustee for any pension or profit-sharing trust of the client;
- Receives from a third party, or had a commitment to receive from the client or third party, with respect to services or products procured or to be procured by the client, other compensation which was material in relation to the aggregate normally-recurring fees charged annually to the client for reports on financial statements;
- Had a commitment from the client for a contingent fee in violation of Section

501.72 of this title (relating to Contingency Fees); or

- Had an engagement to provide for the supervision of an individual as provided for in Section 511.124 (a) (1) of this title (relating to Acceptable Supervision).

(D) Independence will be presumed to be impaired if the certificate or registration holder performs audit services, other than for charitable organizations, for a fee that is less than the direct labor cost reasonably expected, at the time the engagement was accepted, to be incurred in performing such services. For this purpose, direct labor costs means the total compensation of the person or persons expected to perform the service for the time they are expected to serve on the audit plus all payroll expenses related to such compensation.

(E) A certificate or registration holder's independence may be impaired by a close relative's association with a client. Close relatives are defined as spouses and dependent persons, whether or not related, and defined as dependent and non-dependent children, grandchildren, stepchildren, brothers, sisters, parents, grandparents, parents-in-law, and their respective spouses.

- Certificate and registration holders must consider whether the strength of personal and business relationships between the certificate or registration holder and the close relative would lead a reasonable person who is aware of all the facts to conclude that the situation poses an unacceptable threat to the certificate or registration holder's objectivity and appearance of independence. In reaching this conclusion, the certificate or registration holder should consider the specific association with the client.
- A certificate or registration holder's independence will be presumed to be impaired with respect to a client if:
  - A) during the period of the professional engagement or at the time of expressing an opinion, the certificate or registration holder participating in the engagement has knowledge of a close relative who has a material financial interest in the client;
  - 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 certificate or registration holder participating in the engagement has a close relative who could exercise significant influence over the operative, financial, or accounting policies of the client or is otherwise employed in a position in which the close relative's activities are normally an element of or subject to significant internal accounting controls;
    - A proprietor, shareholder, or individual in a managerial position in a certificate or registration holder's office, has a close relative who could exercise significant influence over the client's operating, financial, or accounting policies, if that proprietor, shareholder or individual participated in a significant portion of the



engagement.

- (F) The examples of impaired independence described in subsections (B) - (E) of this section are not intended to be all-inclusive.

## **B. Section 501.71 Receipt of Commissions and Other Compensation**

- (A) A certificate or registration holder shall not for a commission recommend or refer to a client any product or service or refer any product or service to be supplied to a client, or receive a commission, when the licensee or the licensee's firm also performs services for that client requiring independence under Section 502.70 of this chapter (relating to Independence).
- (B) This prohibition applies during the period in which the certificate or registration holder is engaged to perform any of the services requiring independence and during the period covered by any of the historical financial statements involved in such services requiring independence.
- (C) A certificate or registration holder who receives or agrees to receive compensation with respect to services or products recommended, referred, or sold by him to another person shall, no later than the making of such recommendation, referral, or sale, make the following disclosures in writing to such other person:
- (1) if the other person is a client, the nature, source, and amount or all such other compensation; or
  - (2) if the other person is not a client, the nature and source of any such other compensation.
- (D) The disclosure shall be made regardless of the amount of other compensation involved.
- (E) This section does not apply to payments received from the sale of all, or a material part, of an accounting practice, or to retirement payments to personas formerly engaged in the practice of public accountancy.

## **C. Section 501.72 - Contingency Fees**

- (A) A certificate or registration holder shall not perform for a contingent fee any professional services for, or receive such a fee from, a client for whom the certificate or registration holder performs services requiring independence under Section 501.70 of this chapter (relating to Independence).
- (B) A certificate or registration holder shall not prepare an original or amended tax return or claim for a tax refund or other similar tax services for a contingent fee for any client during the period in which the licensee or the licensee's firm is engaged to perform any of the services referenced by subsection (a) of this section and the period covered by any historical or prospective financial

statements involved in any of the referenced services.

(C) A certificate or registration holder shall not perform an engagement as a testifying accounting expert for a contingent fee.

(D) The prohibitions outlined in subsections (A) and (B) of this section apply during any period in which the certificate or registration holder is engaged to perform any of the services listed under subsections (A) and (B) of this section, and the period covered by any historical or prospective financial statements involved in any of the referenced services.

#### **D. Section 501.73 - Integrity and Objectivity**

(A) A certificate or registration holder in the performance of professional services shall maintain integrity and objectivity, shall be free of conflicts of interest and shall not knowingly misrepresent facts nor subordinate his or her judgment to others. In tax practice, however, a certificate or registration holder may resolve doubt in favor of his client as long as there is reasonable support for the position.

(B) A conflict of interest may occur if a certificate or registration holder performs a professional service for a client or employer and the certificate or registration holder has a relationship with another person, entity, product, or service that could, in the certificate or registration holder's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the certificate or registration holder's objectivity. If the certificate or registration holder believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, then this rule shall not operate to prohibit the performance of the professional service because of a conflict of interest.

(C) Certain professional engagements, such as audits, reviews, and other services, require independence. Independence impairments under Section 501.70 (relating to Independence), its interpretations and rules cannot be eliminated by disclosure and consent.

(D) A certificate or registration holder shall not pay a commission to a third party to obtain a client unless, prior to being engaged by such client, the certificate or registration holder discloses to the client in writing the fact and the fixed or variable amount of such commission. This section does not apply to payments made to a certificate or registration holder for the purchase of all, or a material part, of an accounting practice, or to retirement payments to persons formerly engaged in the practice of public accountancy.

(E) A certificate or registration holder shall not concurrently engage in the practice of public accountancy and in any other business or occupation which impairs independence or objectivity in rendering professional services, or which is conducted so as to augment or benefit the accounting practice unless these rules are observed in the conduct thereof.

## **E. Section 501.74 - Competence**

(A) A certificate or registration holder shall not undertake any engagement for the performance of professional services which he cannot reasonably expect to complete with due professional competence, including compliance, where applicable, with Section 501.60 of this title (relating to Auditing Standards), Section 501.61 of this title (relating to Accounting Principles), and Section 501.62 of this title (relating to Other Professional Standards).

1) Competence to perform professional services involves both the technical qualifications of the certificate or registration holder and the certificate or registration holder's staff and the ability to supervise and evaluate the quality of the work being performed.

2) The certificate or registration holder may have the knowledge required to complete the professional services with competence prior to performance. In some cases, however, additional research or consultation with others may be necessary during the performance of the professional services. If a certificate or registration holder is unable to gain sufficient competence through these means, the certificate or registration holder shall suggest to the client the engagement of someone competent to perform the needed professional service, either independently or as an associate.

(B) A certificate or registration holder shall exercise due professional care in the performance of professional services.

(C) A certificate or registration holder shall adequately plan and supervise the performance of professional services.

(D) A certificate or registration holder shall obtain sufficient data to afford a reasonable basis for conclusions and recommendations in relation to any professional services performed.

## **F. Section 501.75 - Confidential Client Communications**

Except by permission of the client or the authorized representatives of the client, a certificate or registration holder or any partner, officer, shareholder, or employee of a certificate or registration holder shall not voluntarily disclose information communicated to him by the client relating to, and in connection with, professional services rendered to the client by the certificate or registration holder. Such information shall be deemed confidential. However, nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in court proceedings, pursuant to a subpoena or other compulsory process, in investigations or proceedings under the Act, in ethical investigations conducted by private professional organizations, or in the course of quality reviews.

## **G. Section 501.76 - Records and Work Papers**

(A) Upon request, regardless of the status of the client or former client's account, a certificate or registration holder shall provide to the client or former client any accounting or other records, whether in the form of hard copy or computer readable format, belonging to, or obtained from or on behalf of, the client that the certificate or registration holder removed from the client's premises or received on behalf of the client. The certificate or registration holder may make and retain copies of such records when they form the basis of work done by him. For a reasonable charge for personnel time and photocopying, a certificate or registration holder shall furnish to his client or former client, upon request made within a reasonable time after original issuance of the document in question:

1) a copy of the client's tax return;

2) a copy of any report or other document previously issued by the certificate or registration holder to or for such client provided that furnishing such reports to or for a client or former client would not cause the certificate or registration holder to be in violation of the portions of Section 501.60 of this title (relating to Auditing Standards) concerning subsequent events;

3) a copy of the certificate or registration holder's working papers, to the extent that such working papers include records which would ordinarily constitute part of the client's books and records and are not otherwise available to the client.

(B) A certificate or registration holder, when performing an engagement that is terminated prior to the completion of the engagement, is required to return or furnish the originals of only those records originally obtained by the certificate or registration holder from the client.

(C) Working papers developed by a certificate or registration holder during the course of a professional engagement as a basis for, and in support of, an accounting, audit, consulting, tax, or other professional report prepared by the certificate or registration holder for a client, shall be and remain the property of the certificate or registration holder who developed the working papers.

1) Working papers, whether in the form of hard copy or computer readable format, are those papers developed by the certificate or registration holder incident to the performance of his engagement which do not result in changes to the client's records or are in part of the records ordinarily managed by the client.

2) Analyses of inventory or other accounts as part of the certificate or registration holder's selective audit procedures, even when prepared by client personnel at the request of the certificate or registration holder, are the certificate or registration holder's working papers.

3) If the analyses described in paragraph (2) of this subsection result in changes to the client's records, the certificate or registration holder is required to furnish the details from his working papers in support of the journal entries recording such changes unless the journal entries themselves contain all necessary details.

(D) Working papers include, but are not limited to:

- 1) letters of confirmation and representation;
- 2) excerpts of company documents;
- 3) audit programs;
- 4) internal memoranda;
- 5) schedules;
- 6) flowcharts; and
- 7) narratives.

(E) Working papers which constitute client records include, but are not limited to:

- 1) worksheets in lieu of books of original entry such as listings and distributions of cash receipts or cash disbursements;
- 2) worksheets in lieu of general ledger or subsidiary ledgers, such as accounts receivable, job cost and equipment ledgers, or similar depreciation records;
- 3) all adjusting and closing journal entries and supporting details when the supporting details are not fully set forth in the explanation of the journal entry; and
- 4) consolidating or combining journal entries and worksheets and supporting detail in arriving at final figures incorporated in an end product such as financial statements or tax returns.

## **H. Section 501.77 - Acting through Others**

A certificate or registration holder shall not permit others to carry out on his behalf, either with or without compensation, acts which, if carried out by the certificate or registration holder, would place him in violation of these rules of professional conduct.

## **VIII. Subchapter D - Responsibilities to the Public**

### **A. Rationale**

The reasons for responsibility “to serve the public interest” goes without saying. A certificate or registration holder that advertises must do so in accordance with the professional standards. Certainly, a certificate or registration holder that allows his/her name to be associated with a set of financial statements has clear lines of responsibility to investors and others who may use the financial statements in the conduct of

business. The scandals contributed to a major expectations gap to describe the difference between what the public thinks it is getting in an audited financial statement and what it actually gets as measured by the public outrage with the scandals. Resultantly, the Rules of Professional Conduct clearly state responsibilities of certificate or registration holders to the public in Subchapter D.

Certificate holders or licensees have a duty to ensure "the public interest" in the practice of public accountancy. To fully protect the spirit of "protecting the public interest," a sound operating business model on the part of clients as well as CPAs is recommended.

## **B. Section 501.80 - Practice of Public Accountancy**

(A) A certificate or registration holder may not engage in the practice of public accountancy unless he holds a valid license issued by the board. A license is not valid for any date or for any period prior to the date it is issued by the board and it automatically expires and is no longer valid after the end of the period for which it is issued.

(B) Any licensee of this board in good standing as a certified public accountant or public accountant may use such designation whether or not the licensee is in the client, industry, or government practice of public accountancy. However, a licensee who is not in the client practice of public accountancy may not in any manner, through use of the CPA designation or otherwise, claim or imply independence from his employer or that the licensee is in the client practice of public accountancy.

## **C. Section 501.81 - Registration Requirements**

(A) A certificate or registration holder engaged in the client practice of public accountancy must practice through an entity meeting the ownership requirements of the Act and registered with the board pursuant to the Act. Section 901.351, if:

1) the certificate or registration holder engages in the client practice of public accountancy in an entity that is eligible for registration and its required to register under the Act, Sections 901.351 and 901.354; or

2) the services offered or performed include the performance of attest or compilation services, or issuance of reports on financial statements, including historical or prospective financial statements or any element thereof.

(B) A certificate or registration holder engaged in the client practice of public accountancy who is not required to practice through an entity registered with the board pursuant to subsection (a) of this section must, in each advertisement or written statement by the certificate or registration holder and/or by his employer or principal, in which reference is made to the certificate or registration holder's CPA designation or his or her association with the employer or principal as such, include an asterisk by the name of the employer or principal, which asterisk shall refer to a notation included within

conspicuous proximity and with reasonable prominence that says “Not qualified to register with the Texas State Board of Public Accountancy to practice public accountancy in Texas.” The notation must be printed in type not less bold than that contained in the body of the advertisement or written statement. If the advertisement is in audio format only, the forgoing notation shall be clearly declared at the conclusion of each such presentation.

(C) The requirements of this section do not apply with regard to a certificate or registration holder performing services:

1) as a licensed attorney at law of this state while in the practice of law or as an employee of a licensed attorney when acting within the scope of the attorney’s practice of law; or

2) as an employee, officer, or director of a federally-insured depository institution, when lawfully acting within the scope of the legally permitted activities of the institution’s trust department.

(D) On the third determination by the board that a certificate holder has practiced without a license or through an unregistered entity in violation of subsection C of this Section, the individual’s certificate shall be subject to revocation and may not be reinstated for at least 12 months from the date of the revocation.

#### **D. Section 501.82 - Advertising**

(A) A certificate or registration holder shall not use or participate in the use of:

1) any written, oral, or electronic communication having reference to the certificate or registration holder’s professional services that contains a false, fraudulent, misleading, or deceptive statement or claim; nor

2) any written, oral or electronic communication that refers to the certificate or registration holder’s professional services that is accomplished or accompanied by coercion, duress, compulsion, intimidation, threats, overreaching, or vexatious or harassing conduct.

(B) Definitions:

1) A “false fraudulent, misleading, or deceptive statement or claim” includes, but is not limited to, a statement or claim which:

A) contains a misrepresentation of fact;

B) is likely to mislead or deceive because it fails to make full disclosure of relevant facts;

C) is intended or likely to create false or unjustified expectations of favorable results;

D) implies educational or professional attainments or licensing recognition not supported in fact;

E) represents that professional services can or will be completely performed for a stated fee when this is not the case, or make representations with respect to fees for professional services that do not disclose all variables that may reasonably be expected to affect the fees that will in fact be charged;

F) contains other representations or implications that in reasonable probability will cause a reasonably prudent person to misunderstand or be deceived;

G) implies the ability to improperly influence any court, tribunal, regulatory agency or similar body or official due to some special relations;

H) consists of self-laudatory statements that are not based on verifiable facts;

I) makes untrue comparisons with other accountants; or

J) contains testimonials or endorsements that are not based upon verifiable facts.

2) Broadcast - Any transmission over the airwaves or over a cable, wire line, Internet, or e-mail system.

3) Coercion - Compelling by force so that one is constrained to do what his free will would otherwise refuse.

4) Compulsion - Driving or urging by force or by physical or mental constraint to perform or forbear from performing an act.

5) Direct personal communication - Either a face-to-face meeting or a conversation by telephone.

6) Duress - Any conduct which overpowers the will of another.

7) Harassing - Any word, gesture, or action which tends to annoy, alarm, and verbally abuse another person.

8) Intimidation - Willfully to take, or attempt to take, by putting in fear of bodily harm.

9) Overreaching - Tricking, outwitting, or cheating a person into doing an act which he would not otherwise do.

10) Threats - Any menace of such a nature and extent as to unsettle the mind of the person on whom it operates, and to take away from his acts that free and voluntary action which along constitutes consent.



11) Vexatious - Irritating or annoying.

(C) It is a violation of these rules for a certificate or registration holder to persist in contacting a prospective client when the prospective client has made it known to the certificate or registration, or the certificate or registration holder should have known the prospective client's desire not to be contacted by the certificate or registration holder.

(D) In the case of direct mail communication, the certificate or registration holder shall retain a copy of the actual mailing along with a list or other description of persons to whom the communication was mailed or otherwise distributed. Such copy shall be retained by the certificate or registration holder for a period of at least 36 months from the date of the last transmission or use.

(E) Subsection (D) of this section does not apply to persons when:

1) the communication is made to a person who is at that time a client of the certificate or registration holder;

2) the communication is invited by the person to whom it was made; or

3) the communication is made to a person seeking to secure the performance of professional services which are currently not being provided by another certificate or registration holder.

(F) In the case of radio and television broadcasting, the broadcast shall be recorded and the certificate or registration holder shall retain a recording of the actual transmission for at least 36 months.

## **E. Section 501.83 - Firm Names**

(A) A firm name may not include descriptive words relating to the quality of services offered or that is misleading about the legal form of the firm, or about the persons who are partners, officers, or shareholders of the firm, or about any other matter. However, names of one or more former partners or shareholders may be included in the name of a firm or its successor.

(B) A firm name is misleading if:

1) it is not the lawful and registered name of the firm;

2) the name contains a misrepresentation of facts;

3) the name indicates character or grade of service which is not based upon verifiable facts;

4) the name is likely to mislead or deceive because it fails to make full disclosure of relevant facts; the following are examples, but are not inclusive:

A) the name indicates a geographic area of service which is not based on verifiable facts; or

B) the firm name includes a non-owner firm employee or a non-CPA.

5) the name is intended or likely to create false or unjustified expectations of favorable results;

6) the name implies special expertise;

7) the name implies educational or professional attainment of licensing recognition of the firm and/or its owners, partners, or shareholders which are not supported in fact;

8) the name of the firm that is incorporated does not include the words "corporation," "incorporated," "professional corporation," or "company," or an abbreviation thereof as a part of the firm name; the words "professional corporation," or "PC" are not included with the firm name each time it is used;

9) the name includes the designation "and company," "company," "group," "associates" or "and associates" or abbreviations thereof or similar names implying more than one employed licensee in the firm unless there are at least two licensees involved full time in the practice.

10) the name of a firm that is a partnership or professional corporation fails to contain the personal name or names of one or more individuals presently or previously a partner, officer, or shareholder thereof; except that an acronym may be used for a firm name if the acronym is composed exclusively of the first letters of the surnames of current or past partners or shareholders of the firm;

11) the name of a firm that is a sole proprietorship fails to contain the name of the sole proprietor; or

12) the name contains other representations or implications that in reasonable probability will cause a reasonably prudent person to misunderstand or be deceived.

(C) A partner surviving the death or withdrawal of all other partners may continue to practice under a partnership name for up to two years after becoming a sole practitioner.

(D) The name of any former partner or former shareholder may not be used in a registered firm name during the period when the former partner or former shareholder has been prohibited from practicing public accountancy or prohibited from using the title "CPA" or "PA."

## **F) Section 501.84 - Form of Practice**

A certificate or registration holder may practice public accountancy only in a

proprietorship, a partnership, a limited liability company, a registered limited liability partnership, a professional public accounting corporation organized under the laws of the State of Texas or an equivalent law of another state, territory, or foreign country, or as an employee of one of these entities.

## **IX. Subchapter E - Responsibilities to the Board/Profession**

### **A. Rationale**

The magnitude of the scandals (Enron, WorldCom, Arthur Andersen, and others) has impacted the **self-policing** that the accounting profession has endured. Now, in 2007, we have the U.S. Sentencing Guidelines and Sarbanes-Oxley Act reforms that are intended to document consequences for adhering to good professional practices. Certainly, Subchapter E documents responsibilities for practitioners to their profession and to the Texas State Board of Public Accountancy.

The certificate holder or licensee has a duty to be responsible to the profession while practicing public accountancy. Such tone in operations by the CPA is essential for integrity in performance.

### **B. Section 501.90 - Discreditable Acts**

A certificate or registration holder shall not commit any act that reflects adversely on his fitness to engage in the practice of public accountancy. A discreditable act includes but is not limited to:

- 1) fraud or deceit in obtaining a certificate as a certified public accountant or in obtaining registration under the Act or in obtaining a license to practice public accounting;
- 2) dishonesty, fraud or gross negligence in the practice of public accountancy;
- 3) violation of any of the provisions of Subchapter K or Section 901.458 of the Act applicable to a person certified or registered by the board;
- 4) final conviction of a felony or imposition of deferred adjudication in connection with a criminal prosecution of a felony under the laws of any state or in the United States;
- 5) final conviction of any crime or imposition of deferred adjudication in connection with a criminal prosecution, an element of which is dishonestly or fraud under the laws of any state or the United States;
- 6) cancellation, revocation, suspension or refusal to renew authority to practice as a certified public accountant or a public accountant by any other state for any cause other than failure to pay the appropriate registration fee in such other state;
- 7) suspension or revocation of or a voluntary consent decree concerning the right

to practice before any state or federal agency for a cause which in the opinion of the board warrants its action;

8) knowingly participating in the preparation of a false or misleading financial statement or tax return;

9) fiscal dishonestly or breach of fiduciary responsibility of any type;

10) failure to comply with a final order of any state or federal court;

11) repeated failure to respond to a client's inquiry within a reasonable time without good cause;

12) misrepresenting facts or making a misleading or deceitful statement to a client;

13) false swearing or perjury in any communication to the board or any other federal or state regulatory or licensing authority.

14) threats of bodily harm or retribution to a client;

15) public allegations of a lack of mental capacity of a client which cannot be supported in fact;

16) causing a breach in the security of the CPA examination;

17) voluntarily disclosing information communicated to the certificate holder by an employer, past or present, or through the certificate holder's employment in connection with accounting services rendered to the employer, except:

A) by permission of the employer;

B) pursuant to the Government Code, Chapter 554 (commonly referred to as the "Whistle Blowers Act");

C) pursuant to a subpoena or other compulsory process in a court proceeding;

D) in an investigation or proceeding by the board under the Public Accountancy Act; or

E) in an ethical investigation conducted by a professional organization of certified public accountants; and

18) breaching the terms of an agreed consent order entered by the board or violating any Board Order.

### **C. Section 501.91 - Reportable Events**

(A) A licensee shall report in writing to the board the occurrence of any of the following events within 30 days of the date the licensee has knowledge of these events:

1) the conviction or imposition of deferred adjudication of the licensee of any of the following:

A) a felony or any crime of which fraud or dishonesty is an element;

B) any crime related to the qualifications, functions, or duties of a public accountant or certified public accountant, or to acts or activities in the course and scope of the practice of public accountancy or as a fiduciary.

2) the cancellation, revocation, or suspension of a certificate, other authority to practice or refusal to renew a certificate or other authority to practice as a certified public accountant or a public accountant, by any state, foreign country or other jurisdiction; or

3) the cancellation, revocation, or suspension of the right to practice as a certified public accountant or a public accountant before any governmental body or agency or other licensing agency.

(B) The report required by subsection (A) of this section shall be signed by the licensee and shall set forth the facts which constitute the reportable event. If the reportable event involves the action of an administrative agency or court, then the report shall set forth the title of the matter, court or agency name, docket number, and dates of occurrence of the reportable event.

(C) Nothing in this section imposes a duty upon any licensee to report to the board the occurrence of any of the events set forth in subsection (A) of this section either by or against any other licensee.

(D) As used in this section, a conviction includes the initial plea, verdict, or finding of guilt, plea of no contest, or pronouncement of sentence by a trial court even though that conviction may not be final or sentence may not be actually imposed until all appeals are exhausted.

## **D) Section 501.92 - Frivolous Complaints**

A certificate holder who, in writing to the board, accuses another certificate holder of violating the rules of the board shall assist the board in any investigation and/or prosecution resulting from the written accusation. Failure to do so, such as not appearing to testify at a hearing or to produce requested documents necessary to the investigation or prosecution, without good cause is a violation of this rule.

## **E) Section 501.93 - Responses**

(A) An applicant, certificate or registration holder shall substantively respond in writing to any communication from the board requesting a response within 30 days of the

mailing of such communication by registered or certified mail to the last address furnished to the board by the applicant, certificate or registration holder.

(B) Failure to respond substantively to written board communications, or failure to furnish requested documentation and/or working papers, constitutes conduct indicating lack of fitness to serve the public as a professional accountant.

(C) Each applicant, certificate holder and each person required to be registered with the board under the Act shall notify the board, in writing, of any and all changes in such person's mailing address and the effective date thereof within 30 days before or after such effective date.

## **F) Section 501.94 - Mandatory Continuing Professional Education**

Each certificate or registration holder shall comply with the mandatory continuing professional education reporting and the mandatory continuing professional education attendance requirements of Chapter 523 of this title (relating to Mandatory Continuing Professional Education Program). Once an individual's license has been suspended a third time by the board for failing to complete the 120 hours of continuing professional education required by Section 523.63 of this title (relating to Mandatory CPE Attendance), the individual's certificate shall be subject to revocation and may not be reinstated for at least 12 months from the date of the revocation.

## X. CORPORATE SCANDALS IN THE 21<sup>ST</sup> CENTURY

Immediately after the turn of the century, numerous corporate scandals occurred. Investor confidence in corporate ethics was at an all-time low. The outcome was that corporate governance and the accounting profession needed reforms. In light of the scandalous times, all certificate holders should re-evaluate their own ethics and approaches to the practice of public accountancy in the time after the Sarbanes-Oxley Act of 2002.

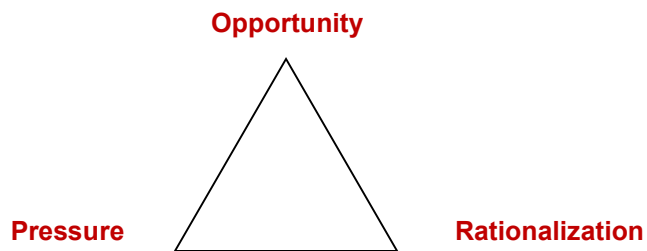
Most observers agree that Enron's problems were caused by a failure of the board of directors to exercise adequate oversight. This allowed the misuse of special purpose entities to manipulate financial reports, mislead investors, and self-remunerate the external audit firm, Arthur Andersen. Andersen disintegrated, and the accounting profession was significantly altered with the passage of the Sarbanes-Oxley Act (SOX) in 2002.

WorldCom was another case that involved substantial fraudulent activity that resulted in its filing for bankruptcy. Overstatements of cash flow were accounted for improperly in order to inflate income. Many of the WorldCom manipulations reduced operating expenses in order to state higher operating income. Non-GAAP accounting practices were the culprit. Arthur Andersen was the audit firm for WorldCom.

The ethical implications to certificate holders necessitate a re-evaluation for responsible ethical behavior. The fiduciary failure of the Enron board of directors caused board members across the country to call for training on corporate governance. In 2006, many boards are leading ethics and compliance programs. In the post-scandal years, boards are taking a more active lead in hiring auditors, in development of ethics and compliance programs, and in corporate governance. Accountants have begun questioning risky practices and non-GAAP compliance. To be effective in their roles, accountants have to operate in a new mode - that is, to be less timid; they should take a proactive role to protect the assets of shareholders. Certificate holders have to help set the tone, conveying the message that an ethical approach to transactions and business decisions is important. Certificate holders most clearly must be aware of red flags and signals of unscrupulous activity. Certificate holders need to be involved in educating the board on accounting matters and issues. CPA's should also ensure that corporate leaders are adhering to sound ethics and culture nourishment; boards of directors are evaluating whether or not a CEO nourishes a sound corporate culture in organizations.

The costs of occupational fraud have reached \$600 billion in society, according to the Association of Certified Fraud Examiners. Fraud costs all of us. Good employees can go bad and commit fraud. Reasons for fraud have been studied by Dr. Donald Kressey who explains fraud with The Fraud Triangle as illustrated on the next page.

## Fraud Triangle



When there are pressures in the lives of employees, good employees can go bad by seeing that an opportunity exists (if the controls are weak); they then rationalize the fraudulent action as being rational. Common rationalizations are that they will pay the money back or that they had never done anything wrong.

To counter the elements of the Fraud Triangle, internal controls should be strong in organizations. A culture of honesty is important. Certificate holders should look for warning signs of fraud. Certificate holders should also look for fraud in the performance of attest functions; this is required by SAS 99 and SAS 122.



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