







Question 1 of 9

The table below includes unrelated situations encountered by a CPA firm. For each situation identified, select the most appropriate response.

Situation	Response
A partner is a member of a country club that is a potential new audit client of the CPA firm. The partner has financial decision making powers at the club but would not serve as the primary engagement partner.	<input type="text"/> 
A CPA firm just retained a new audit client. The new client's CFO has offered the engagement manager four tickets for personal use to a national televised sporting event, along with the use of the client's corporate jet to travel to the event.	<input type="text"/> 
In order to meet the deadline of a client's annual report, the engagement partner issues the final audit report prior to completion of the fieldwork. The company is the CPA firm's largest client.	<input type="text"/> 
A new administrative staff member at a CPA firm sits on the Board of Trustees at a nonissuer audit client. The staff member performs routine clerical functions related to the engagement.	<input type="text"/> 
A client informed the engagement partner that \$190,000 of its inventory is deemed obsolete and is unwilling to adjust the financial statements. Accordingly, the financial statements have not been adjusted. The engagement partner, who has substantial experience in this industry, is aware of the client's position but has agreed to issue an unmodified opinion on the financial statements. The materiality on the audit is \$100,000.	<input type="text"/> 
A CPA firm submitted a proposal to perform agreed-upon procedures for Birch Co. The engagement partner's wife is the administrative assistant to the sales team of Birch Co.	<input type="text"/> 

Available Options for Row 1:

- A. The firm can accept the country club as a new client because of the scope and nature of the services being provided.
- B. The firm can accept the country club as a new client because the firm is independent and objective.

- C. The firm can accept the country club as a new client because the partner will not be involved with the engagement.
- D. The firm cannot accept the country club as a new client because the client lacks integrity.
- E. The firm cannot accept the country club as a new client due to a lack of independence and objectivity.
- F. The firm cannot accept the country club as a new client unless it includes a disclosure of the relationship in the notes to the financial statements.

Available Options for Row 2:

- A. The engagement manager can accept the tickets provided that this is disclosed in the client representation letter.
- B. The engagement manager can accept the tickets provided that this is disclosed in the notes to the financial statements.
- C. The engagement manager can accept the tickets with no effect on due care.
- D. The engagement manager can accept the tickets with no effect on independence and objectivity.
- E. The engagement manager cannot accept the tickets in order to exercise due care.
- F. The engagement manager cannot accept the tickets in order to maintain the appearance of independence and objectivity.

Available Options for Row 3:

- A. Because the company is the CPA firm's largest client, there is a conflict of interest and a lack of independence.
- B. The firm's lack of internal quality control procedures suggests that the firm is not exercising due care.
- C. The firm's lack of internal quality control procedures suggests that the firm is not exercising objectivity.
- D. The issuance of the audit report is acceptable, as long as the situation is disclosed in the client representation letter.
- E. The issuance of the audit report is in accordance with the firm's internal professional code of conduct.

Available Options for Row 4:

- A. The firm is independent of the client and can issue an unmodified opinion, assuming that no additional issues are identified.

- B. The firm is independent of the client but must issue a modified opinion disclosing the nature of the relationship.
- C. The firm is not independent of the client and must disclaim an opinion of the financial statements.
- D. The firm is not independent of the client and must disclose the relationship in the financial statements.
- E. The firm is not independent of the client and must withdraw from the engagement.

Available Options for Row 5:

- A. The financial statements are materially misstated, and the engagement partner has exercised due care.
- B. The financial statements are materially misstated, and the engagement partner has not exercised objectivity and integrity.
- C. The financial statements are materially misstated, and the engagement partner is not independent.
- D. The financial statements are not materially misstated, and the engagement partner has exercised due care.
- E. The financial statements are not materially misstated, and the engagement partner has exercised objectivity and integrity.
- F. The financial statements are not materially misstated, and the engagement partner is not independent.

Available Options for Row 6:

- A. The firm can accept Birch Co. as a new client because the firm is independent and objective.
- B. The firm can accept Birch Co. as a new client with a disclosure of the relationship in the attestation report.
- C. The firm cannot accept Birch Co. as a new client due to a lack of independence and objectivity.
- D. The firm cannot accept Birch Co. as a new client due to a lack of integrity.
- E. The firm cannot accept Birch Co. as a new client due to the nature and scope of the services being provided.

Explanation

Background Information

	Members in public practice	Members in business	Other members
Independence	For attest services	No	No
Integrity and objectivity	Always	Always	Always
Due care	Always	Always	Always

An *individual* CPA may be a member of the AICPA, a state society of CPAs, and/or various professional organizations. As such, each CPA is subject to **independence** rules and regulations of regulatory entities, such as the SEC and PCAOB.

Members in public practice are required to maintain independence (in fact and appearance) for all attest engagements. Because public CPA firms must meet regulatory independence rules, so too must their CPA employees, even if the employees are not members of the AICPA or a state society.

CPAs must also show integrity, objectivity, and due care. *Public accounting firms* should therefore establish **quality control** procedures to identify threats to independence, as well as methods to resolve any discrepancies.

For example, CPAs may not perform management functions for an attest client because doing so is perceived as an independence threat. For members providing *nonattest* services to clients, some functions are permitted.

Some independence rules apply to family members, as well:

- **Immediate family** includes spouses and dependents (related or not)
- **Close relatives** include parents, siblings, and nondependent children

Relationships between family and clients that *impair independence* generally depend on whether the family member is in a key position with the client or has financial interests in the client that provide significant influence over the client or are *material* to the relative.

CPAs *not in public practice* are hired to advance the interests of their employers and hence are *not required* to be independent.

Situation 1: Country Club

Situation	Response
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<p>A partner is a member of a country club that is a potential new audit client of the CPA firm. The partner has financial decision making powers at the club but would not serve as the primary engagement partner.</p>	<p>The firm cannot accept the country club as a new client due to a lack of independence and objectivity.</p>
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When performing an attest service (eg, an audit), members in public practice must maintain independence in fact and appearance and cannot have a *direct* financial interest or direct financial decision making powers in the client as this creates a conflict of interest. Since the partner does have a direct financial interest, the firm cannot accept the country club as a new client.

Situation 2: Sporting Event

Situation	Response
<p>A CPA firm just retained a new audit client. The new client's CFO has offered the engagement manager four tickets for personal use to a national televised sporting event, along with the use of the client's corporate jet to travel to the event.</p>	<p>The engagement manager cannot accept the tickets in order to maintain the appearance of independence and objectivity.</p>

Accepting gifts or entertainment from a client may create independence threats associated with self-interest, familiarity, and undue influence. If the gifts are reasonable in nature, the threat may be reduced to an acceptable level. However, four tickets to an expensive event, along with the use of a private plane, is *not reasonable* and attending the event would impair independence.

Situation 3: Early Release of Audit Report

Situation	Response
<p>In order to meet the deadline of a client's annual report, the engagement partner issues the final audit report prior to completion of the fieldwork. The company is the CPA firm's largest client.</p>	<p>The firm's lack of internal quality control procedures suggests that the firm is not exercising due care.</p>

A CPA firm must implement quality control procedures at the engagement level to give the auditor reasonable assurance of compliance with professional standards and applicable laws and regulations. Even though pressure may be explicitly or implicitly placed upon an accountant to breach the rules of conduct, any CPA in public practice should neither yield to such pressure nor exert pressure on others such that a breach may result. Because the firm issued a report *before* fieldwork was completed, there is a lack of quality control procedures that suggests that the firm is not exercising due care.

Situation 4: Board of Trustee Position

Situation	Response
A new administrative staff member at a CPA firm sits on the Board of Trustees at a nonissuer audit client. The staff member performs routine clerical functions related to the engagement.	The firm is independent of the client and can issue an unmodified opinion, assuming that no additional issues are identified.

A member in public practice is required to be independent for attest engagements, including audits. A CPA who must meet this requirement includes a member of an *attest engagement* team or an *individual* (eg, family member working for the client) in a position to influence the attest engagement. In this scenario, the firm would be considered independent since the staff member is *not involved* with audit decisions and not in a position to influence those decisions.

Situation 5: Obsolete Inventory

Situation	Response
A client informed the engagement partner that \$190,000 of its inventory is deemed obsolete and is unwilling to adjust the financial statements. Accordingly, the financial statements have not been adjusted. The engagement partner, who has substantial experience in this industry, is aware of the client's position, but has agreed to issue an unmodified opinion on the financial statements. The materiality on the audit is \$100,000.	The financial statements are materially misstated, and the engagement partner has not exercised objectivity and integrity.

Failure to correct materially false and misleading financial statements creates both integrity and objectivity threats. In this case, the partner failed to require the client to adjust the financial statements; therefore, the engagement partner has not exercised objectivity and integrity.

Situation 6: Family Member Works for Client

Situation	Response
A CPA firm submitted a proposal to perform agreed-upon procedures for Birch Co. The engagement partner's wife is the administrative assistant to the sales team of Birch Co.	The firm can accept Birch Co. as a new client because the firm is independent and objective.

In general, members of a CPA's immediate family, which include the CPA's spouse or spousal equivalent and all dependents are required to comply with the independence rules to avoid impairing the independence of the CPA. However, an immediate family member may be employed by an attest client provided they are not in a *key position*. In this example, an administrative assistant to the sales team is not considered a key position, so the firm can accept the new client.






Question 2 of 9

Situation:

An ERISA employee benefit plan, the United Mind Workers of Vermont (UMW) plan, fired its auditor and hired the Locan Firm as a replacement. Locan has only one office, which is located in Burlington, VT. Locan wants to do things right and not violate any independence rules.

Required:

Answer the following questions “yes” or “no.”

1. Should Locan first consider Department of Labor (DOL) independence regulations?	<input type="text"/> 
2. Should Locan apply the DOL's conceptual framework to answer important independence questions?	<input type="text"/> 
3. Tolan is a tax partner in Locan's office who will have nothing to do with the audit. Must Tolan be independent of the UMW plan?	<input type="text"/> 
4. Hernandez is a tax manager in Locan's office who will have nothing to do with the audit. Must Hernandez be independent of the UMW plan?	<input type="text"/> 
5. Before the UMW fired its earlier auditor, Locan maintained the plan's financial records, which were then audited by the other firm. To ease continuity, Locan and the UMW intend that Locan will continue to maintain the plan's financial records. Is this permitted?	<input type="text"/> 

Available Options for Table 1:

- A. Yes
- B. No

Explanation

1. Yes. DOL independence rules are of utmost importance to any auditor who is auditing an employee benefit plan regulated by the Department of Labor.

2. No. Unlike the GAO, the SEC, and the AICPA, DOL has not yet adopted the conceptual framework approach to determining the answer to tricky independence questions.
 3. Yes. Under DOL rules, the “members” who must be independent includes all professional employees located in an office of the firm participating in a significant portion of the audit.
 4. Yes. Under DOL rules, the “members” who must be independent includes all professional employees located in an office of the firm participating in a significant portion of the audit.
 5. No. Although DOL rules allow an auditor to provide some nonaudit services (NAS) to the benefit plans it audits, this service is not one of them. An accounting firm should not audit its own work.
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Question 3 of 9

Situation:

Your accounting firm is on double secret probation with the AICPA and wants to ensure that it doesn't violate any ethics rules. Therefore, it is reviewing all the financial relationships that its employees have with audit clients.

Required:

Answer the following questions by selecting "yes" or "no" as appropriate.

1. Ian is on the firm's audit team for client DEF Co. Ian owns no DEF stock. Ian is a general partner of a business that has stashed its spare cash in the stock market. It owns a small amount of DEF stock. Does this situation reflect impaired independence?	<input type="text"/> 
2. Ian is on the firm's audit team for client DEF Co. Ian owns no DEF stock. Ian is a member of a member-managed LLC that has stashed its spare cash in the stock market. It owns a small amount of DEF stock. Does this situation reflect impaired independence?	<input type="text"/> 
3. Ian is on the firm's audit team for client DEF Co. Ian owns no DEF stock. Ian is a limited partner of a business that has stashed its spare cash in the stock market. Under the partnership agreement, Ian has no authority to influence the partnership's investments in any way. The business owns a very small amount of DEF stock. Does this situation reflect impaired independence?	<input type="text"/> 
4. Kroll is a tax partner in the audit firm. Kroll owns no DEF stock. He is asked to serve as a trustee of a trust set up by a local businessman. He would not have any input into any investment decisions made by the trust. Still, the trust has 14% of its assets in DEF stock. If Kroll serves as a trustee, would independence be impaired?	<input type="text"/> 
5. Simonds just joined the firm and has been assigned to the DEF audit team. Simonds owns some DEF stock and it is one of his favorite investments. If he placed the stock in a blind trust would impairment of independence be avoided?	<input type="text"/> 

Available Options for Table 1:

- A. Yes
- B. No

Explanation

1. Yes. Given Ian's ability to control the partnership's investments, this is a direct interest. So, even if the amount invested is immaterial, there is an independence problem.
 2. Yes. Member-managed LLCs are usually treated the same as general partnerships.
 3. No. This is an indirect investment and it appears to be immaterial in nature.
 4. Yes. Even if Kroll does not have any input into the investment decisions, if the trust has more than 10% of its assets in the audit client's stock, independence is impaired.
 5. No. Both a blind trust and its underlying investments are deemed to be direct financial interests of the grantor (Simonds) and even an immaterial amount impairs independence.
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Question 4 of 9






Elvis and SEC Independence Rules

Situation:

Elvis Corporation acquired Presley Corporation in a hostile merger and will control it as a large, wholly-owned subsidiary. Your audit firm has audited Elvis Corporation for a long time. Now, you are being asked to audit Presley Corporation, the new subsidiary, as well. You begin doing research regarding potential independence complications with Securities and Exchange Commission (SEC) rules because both Elvis and Presley are large, public corporations subject to SEC rules and requirements.

Required:

Analyze the following questions and answer them with a “yes” or “no.”

	A	B
1	Kimberly, who is the senior partner on the Elvis audit team, owns a small amount of Presley stock. However, her team is headquartered in Atlanta and the audit team that will handle the Presley account is headquartered in your firm's San Francisco office. Do Kimberly's stock holdings present an independence issue?	<input type="text"/> 
2	Your firm would like to place Tran on the Presley audit team. However, when she was in college getting her accounting degree, Tran borrowed money from Presley to fund her student loan. Some of that loan is still outstanding. Does Tran have an independence problem?	<input type="text"/> 
3	Your firm would also like to place Reynaldo on the Presley audit team, but he has also borrowed money from Presley in the past, secured by a mortgage on his home. Does Reynaldo have an independence problem?	<input type="text"/> 
4	Your firm's CEO has made a lot of money over the years and is in an investment partnership with Toobin, Presley's largest single shareholder. Toobin owns 8% of Presley's stock. No other single shareholder owns more than 1.5%. Does this partnership create an independence problem?	<input type="text"/> 
5	Now that your firm has learned that it has independence issues due to some of the situations outlined in the first four questions above, must it resign as auditor for both Elvis and Presley?	<input type="text"/> 

Available Options for Table 1:

- A. Yes
- B. No

Explanation

1. Yes. Kimberly must be independent not only of Elvis, but also of its affiliates. Because Presley is such a significant corporation, it is undoubtedly material to Elvis and that's why Kimberly must sell those shares. Her independence problem arises not because she is a partner in a particular office, but because she owns shares in an audit client's important subsidiary.
2. No. Because Tran borrowed this money when she was a student and long before she became a covered person regarding Presley, this loan is exempt under SEC rules and creates no independence issues.
3. No. Because the loan occurred before Reynaldo became a covered person regarding Presley and because it is a secured loan, no independence problem arises.
4. Yes. SEC rules say that an independence issue may arise if a covered person has a business relationship with a beneficial owner of an audit client's stock who has significant influence over the entity under audit. Given that Toobin is by far the largest individual shareholder of Presley, he likely meets this "significant influence" criterion.
5. No. The SEC realizes that mergers and acquisitions can create such independence issues. Therefore, it forgives any such problems if (a) the firm has been in compliance with independence rules up until the merger, and (b) the firm promptly addresses and resolves conflicts arising from the merger (such as those mentioned in this question), and (c) the firm has in place a proper quality control system.

Question 5 of 9

Situation:

Your accounting firm has been hired to audit for the next two years People & Snakes, a nonprofit organization that educates people about reptiles and derives most of its financial resources from grants issued by various federal government entities.

Required:

Answer the following questions by clicking on the answer cells and selecting “true” or “false.”

1.	So long as your firm meets the independence standards of the AICPA Code of Professional Conduct, it need not worry further about independence issues.	<input type="text"/>
2.	Unlike the AICPA Code of Professional Conduct, the GAO’s Ethical Principles focus only on actual impairment of independence and do not concern themselves with mere appearances of such impairments.	<input type="text"/>
3.	The GAO’s Ethical Principles incorporate a “threats & safeguards” conceptual framework that is similar to that contained in the AICPA’s Code of Professional Conduct.	<input type="text"/>
4.	Last year People & Snakes suffered a major scandal when its treasurer was caught embezzling funds. As part of the engagement letter, your firm may agree to take custody of and account for all funds flowing into People & Snakes.	<input type="text"/>
5.	Your firm intends to put Susie in charge of the audit and add Alan to the team. Alan will do most of the actual audit work. Alan has no experience with auditing entities in accordance with GAGAS and has not had any continuing professional education (CPE) that related directly to government auditing. Alan may meet CPE requirements by the on-the-job training that Susie intends to give him in order to get him up to speed.	<input type="text"/>

Available Options for Table 1:

- A. True
- B. False

Explanation

Rationale

1. False. Because People & Snakes receives government awards, it should be audited in compliance with GAGAS. Those who audit in accordance with GAGAS are supposed to follow the GAO's Ethical Principles as well as the AICPA Code of Professional Conduct.
 2. False. The GAO's Ethical Principles demand "professional behavior," which includes "sensitivity to appearance of impropriety."
 3. True. The GAO's Ethical Principles contain a conceptual framework for deciding what to do in situations where no clear rules apply that is nearly identical to the AICPA's.
 4. False. Auditors may perform some nonaudit services to audited clients without impairing independence, but taking custody of an audited entity's assets is not one of them. It is one of the specific management actions that impairs independence.
 5. False. On-the-job training does not qualify as CPE under GAO rules, and over a two-year period, Alan will need 80 hours of CPE, of which at least 24 hours should cover subject matter that deals directly with auditing in the government environment.
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Question 6 of 9

Situation:

Charlene has a lot of audit experience, but only with private companies. She has never audited government agencies before, but it looks like her career is heading in that direction. She needs some guidance.

Required:

Answer the following questions by clicking on the answer cells and selecting “yes” or “no.”

1.	The GAO’s ethical guidelines apply to those who conduct audits of government entities, such as federal, state, and local units. Do they also apply to audits of entities that receive government grants?	<input type="text"/>
2.	If Charlene, while auditing a government agency, happens across information that she can use for personal gain, should she do so?	<input type="text"/>
3.	Charlene knows that Sarbanes-Oxley prohibits audit firms from providing most nonaudit services (NAS) to public companies. Could NAS raise an issue in government audits?	<input type="text"/>
4.	Are the threats to independence in the GAO’s conceptual framework identical to those in the AICPA’s conceptual framework?	<input type="text"/>

Available Options for Table 1:

- A. Yes
- B. No

Explanation

Rationale:

1. Yes. These are the two situations where the GAO’s ethical rules apply.
2. No. A key aspect of the GAO ethics rules is the prohibition of using government information, resources, and positions for personal gain.

3. Yes. They could indeed, which is why the GAO ethics guidelines have requirements pertaining to provision of NAS.
 4. No. Most important, the GAO's conceptual framework includes a unique "structural threat" that derives from an auditing organization's placement within a government entity which might, in combination with the structure of the entity being audited, impact the auditor's ability to work and report results objectively.
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Question 7 of 9

Situation:

Your accounting firm wants to hire Sally, who is a pretty darned good auditor. However, you do not wish to create any independence problems. Therefore, you investigate Sally pretty closely.

Required:

Answer the questions by selecting “yes” or “no” as appropriate.

1. You want to put Sally on the audit team for ABC Manufacturing Co. Sally borrowed \$100,000 from ABC last year and still owes most of that amount. Would putting her on the audit team impair independence?	<input type="checkbox"/> 
2. You want to put Sally on the audit team for the Sixth National Bank. She borrowed \$20,000 from SNB last year while she was working for a different accounting firm. Her payments on the loan are up-to-date and the terms of the loan are completely normal in all respects. Would putting Sally on this audit team impair independence?	<input type="checkbox"/> 
3. You want to put Sally on the audit team for the Hereford National Bank. Last year while she was working for another accounting firm, she borrowed \$20,000 from Hereford so she could buy a car. The loan repayments on are schedule and the auto itself collateralizes the loan. Would putting Sally on this audit team impair independence?	<input type="checkbox"/> 
4. You want to put Sally on the audit team for the Mustang Auto Company. Mustang is currently leasing its place of business from Sally, who inherited the property last year from her grandfather. If Mustang keeps making regular payments, it will own the property after seven years. Would putting Sally on this audit team impair independence?	<input type="checkbox"/> 
5. You want to put Sally on the audit team of the Smitheral Manufacturing Company. Both Sally and Smitheral own Google stock. Would putting Sally on this audit team impair independence?	<input type="checkbox"/> 

Available Options for Table 1:

- A. Yes
- B. No

Explanation

1. Yes. A loan from an audit client that normally doesn't loan money (like a manufacturing company) is going to create an independence problem.
 2. No. All the requirements appear to be met to keep this loan from being problematic. If Sally renegotiates the loan to improve her terms or falls behind on payments in the future, then problems will arise.
 3. No. The conditions to avoid an independence problem seem to be in place so long as Sally keeps making payments regularly and doesn't renegotiate the loans.
 4. Yes. A lease-to-own is problematic here.
 5. No. Both Sally and Smitheral can own the stock of a widely held public company without being viewed as joint investors.
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Question 8 of 9

Situation:

Marsha owns a small accounting firm in a rural town. The town's biggest employer is a trade school that receives substantial federal funding in the form of scholarship money and subsidies—Murray Welding School (MWS). After MWS's longtime auditor retired, the school asked Marsha's firm to perform the annual audit necessary to produce financial statements that would satisfy federal requirements placed on MWS. There are three auditors in Marsha's firm—Marsha, Jorge, and Tina—whose practice is to do all audits as a team.

Required:

Answer the following questions "yes" or "no."

1. Is Marsha right to assume that because MWS receives federal funding, her firm will have to comply with the GAO's Yellow Book's rules on independence and other ethical principles?	<input type="text"/> 
2. If Marsha begins evaluating her firm's independence and finds no specific requirements being violated, then do all independence concerns disappear?	<input type="text"/> 
3. Marsha remembers that from six years before the period covered by the audit to four years before, her husband, Sam, was a high-level employee at MWS. Does this present a significant independence problem?	<input type="text"/> 
4. Marsha learns that Jorge's son is a student at the welding school. Does that create an insurmountable independence problem?	<input type="text"/> 
5. During the audit, staff at MWS who know it is Tina's birthday throw an impromptu party one morning before the workday begins. They provide a birthday cake purchased at a local grocery store. Does this create an insurmountable independence problem?	<input type="text"/> 

Available Options for Table 1:








- A. Yes
- B. No

Explanation

1. Yes. GAO standards apply to those who audit government entities and entities, like WMS, that receive government awards.
 2. No. Even if Marsha finds that her firm would be violating no specific independence or other ethical rules in auditing MWS, she should still utilize the GAGAS conceptual framework to ensure no independence problems. This requires (1) identifying threats to independence, (2) evaluating the significance of any threats discovered, and (3) applying safeguards as necessary to eliminate the threats or to reduce them to an acceptable level.
 3. No. The period of a professional engagement begins when the auditors either sign an initial engagement letter or begin to conduct the audit. Marsha's husband's earlier relationship, by itself, is unlikely to be problematic.
 4. No. That is not the sort of relationship that creates an independence problem under any AICPA, GAO, or other guidelines. Even if for some reason Marsha decided that this fact created the appearance of a lack of independence, GAGAS guidelines would enable her to mitigate the problem by taking steps such as dropping Jorge from the audit team or having the audit team's work reviewed by a competent third party.
 5. No. Such an insignificant gift to Tina does not create an independence problem. No reasonable person would believe that so minor a gift as a store-bought birthday cake would sway Tina's judgment. Even if a more significant gift were given, Marsha might well be able to mitigate any threat to independence by bringing in a third party to review all Tina's work on the audit.
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Question 9 of 9

For each of the unrelated situations for an attest client, select from the option list provided the best possible explanation as to why a covered member's independence is or is not impaired under the AICPA Code of Professional Conduct. An option may be used once, more than once, or not at all.

1	Situation	Explanation
2	A covered member invested \$200,000 in a limited partnership that is not the covered member's client. The partnership used the proceeds to make various stock investments. Of this amount, \$3,000 was invested in the stock of the covered member's client.	<input type="text"/> 
3	A covered member owns 4% of the outstanding shares of a diversified mutual fund. One of the underlying investments in the mutual fund is the stock of one of the covered member's clients.	<input type="text"/> 
4	A covered member's spouse owns 1% of the outstanding shares of the covered member's client.	<input type="text"/> 
5	A covered member is a beneficiary in a trust that holds an 8% stock ownership interest in the covered member's client and guides the trust's investments.	<input type="text"/> 
6	A covered member's cousin is a 30% general partner in a partnership that invested in 40% of the outstanding stock of the covered member's client.	<input type="text"/> 
7	A covered member owns 0.04% of the outstanding stock of the covered member's client. The value of this investment is not material to the covered member's net worth.	<input type="text"/> 
8	A covered member is a 6% limited partner in a partnership that invested in a client of the covered member's firm.	<input type="text"/> 

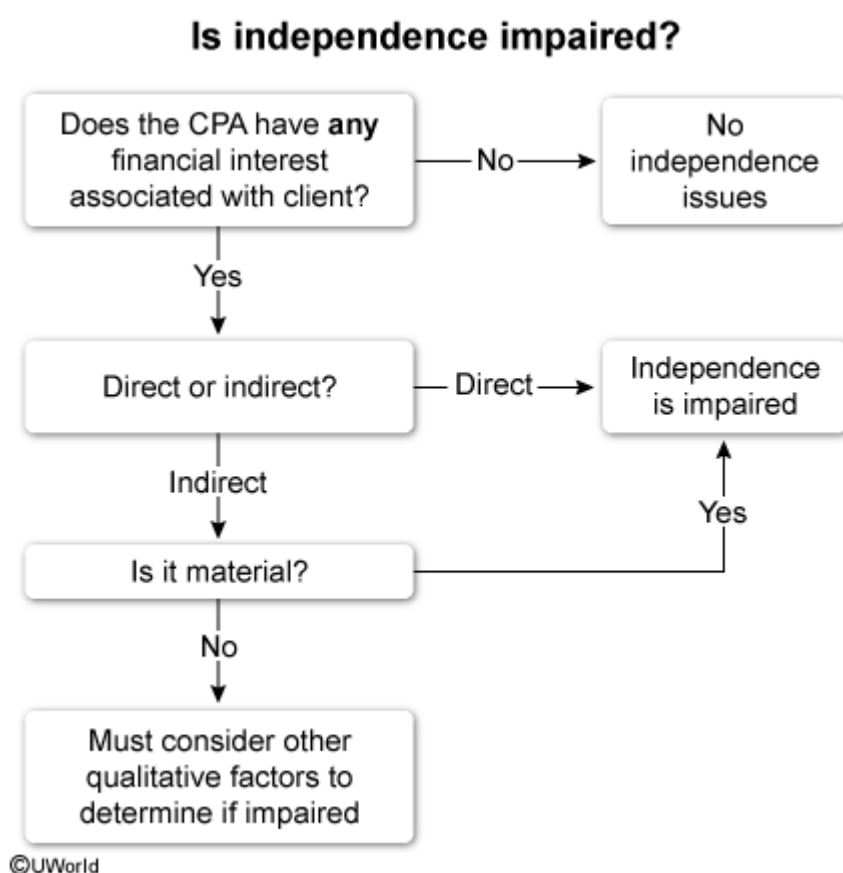
Available Options for Table 1:

- A. Independence is impaired because there is a direct financial interest in the client.
- B. Independence is impaired if the value of the covered member's financial interest exceeds 10% of the value of the client's equity.
- C. Independence is impaired if the value of the financial interest is material to the covered member's net worth.
- D. Independence is not impaired because a direct or indirect financial ownership interest does not exist.

- E. Independence is not impaired because financial interest in a client is indirect.
- F. Independence is not impaired because the value of the financial interest is not material.
- G. Independence is not impaired if a close family member executes a nondisclosure affidavit.

Explanation

Background



The AICPA Code of Professional Conduct (the Code) requires members in public practice to be **independent** when performing **attest** services. Independence is the ability to act with integrity and objectivity. This independence requirement applies to a covered member and the member's immediate family. The AICPA **conceptual framework** approach helps member CPAs apply the Code in practice by assisting them in identifying whether they face **self-interest threats** to independence due to financial interests.

If a CPA has any financial interest associated with a client, the CPA must determine if the interest is direct or indirect. **Direct financial interests** occur when a covered member has a direct ownership interest in the client, such as owning stock or other equity securities.

Indirect financial interests occur when a covered member has a close, but not direct, ownership relationship with the client; this could include ownership interests through a partnership or mutual fund. All direct interests and material indirect interests impair independence. To evaluate indirect interests that are immaterial, qualitative factors would need to be considered.

Clear violations of the rules or of Code interpretations *cannot be overcome* by applying the conceptual framework approach. However, this approach can assist the CPA in determining if the Code has been violated when the matter is not entirely clear.

Row 2: A covered member invested \$200,000 in a limited partnership.

Situation	Explanation
A covered member invested \$200,000 in a limited partnership that is not the covered member's client. The partnership used the proceeds to make various stock investments. Of this amount, \$3,000 was invested in the stock of the covered member's client.	Independence is impaired if the value of the financial interest is material to the covered member's net worth.

The covered member invested \$200,000 in a nonclient (ie, limited partnership). The nonclient partnership then invested \$3,000 of the \$200,000 investment to purchase stock in the covered member's client. This situation is an **indirect** financial interest. Independence is **impaired if the \$3,000** nonclient partnership investment is **material** to the covered member's net worth.

Row 3: A covered member owns 4% of shares of a diversified mutual fund.

Situation	Explanation
A covered member owns 4% of the outstanding shares of a diversified mutual fund. One of the underlying investments in the mutual fund is the stock of one of the covered member's clients.	Independence is not impaired because the value of the financial interest is not material.

A diversified mutual fund is an investment pool that spans a variety of stocks, bonds, or other securities. Due to the diversity of investments, the amount of the client's stock within

the covered member's 4% ownership is diversified and therefore diluted. This indicates that independence is **not impaired** because **the indirect financial interest is immaterial** to the covered member.

Row 4: A covered member's spouse owns 1% of shares of a client.

Situation	Explanation
A covered member's spouse owns 1% of the outstanding shares of the covered member's client.	Independence is impaired because there is a direct financial interest in the client.

The Code considers certain family relationships, like the covered member's spouse, to also be a covered member. The covered member's spouse has a **direct financial interest** in the client. Therefore, the covered member's **independence is impaired** regardless of the materiality of the investment.

Row 5: A covered member is a beneficiary in a trust.

Situation	Explanation
A covered member is a beneficiary in a trust that holds an 8% stock ownership interest in the covered member's client and guides the trust's investments.	Independence is impaired because there is a direct financial interest in the client.

The covered member is the beneficiary in the trust and guides the trust's investment decisions. The trust's 8% stock ownership interest in the covered member's client represents a **direct financial interest**; therefore, **independence is impaired**.

Row 6: A covered member's cousin is a 30% general partner.

Situation	Explanation
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A covered member's cousin is a 30% general partner in a partnership that invested in 40% of the outstanding stock of the covered member's client.	Independence is not impaired because a direct or indirect financial ownership interest does not exist.
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In this scenario, a covered member's cousin has an indirect financial interest in the covered member's client. Although the Code considers certain family members as covered members, a cousin is not one of them. Therefore, **independence is not impaired** because the covered member does **not have direct or indirect financial ownership** of their client's stock.

Row 7: A covered member owns 0.04% of stock of a client.

Situation	Explanation
A covered member owns 0.04% of the outstanding stock of the covered member's client. The value of this investment is not material to the covered member's net worth.	Independence is impaired because there is a direct financial interest in the client.

Independence is impaired when a **covered member** has any direct financial interest in a client, even when that interest is small (0.04%) and the investment value is immaterial to the covered member's net worth.

Row 8: A covered member is a 6% limited partner.

Situation	Explanation
A covered member is a 6% limited partner in a partnership that invested in a client of the covered member's firm.	Independence is impaired if the value of the financial interest is material to the covered member's net worth.

The covered member has an **indirect financial interest** in the client. Therefore, independence would be **impaired if** the financial interest in the partnership is **material to** the **covered member's** net worth.
