THE ACCOUNTING PROFESSION IN AMERICA

5. Ethical Standards for the American Accounting Profession

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5. Ethical Standards for the American Accounting Profession

One of the characteristics that distinguishes a profession from a mere occupation is a code of ethics. Research in accounting ethics has focused on the audit function, taxation, management advisory services, the practice of accounting, accounting education, setting GAAP, and the culture of accounting. The culture of accounting includes comparing the practices of different countries and ethics. This paper will discuss the ethical guidelines that are imposed on members of the accounting profession in America. A brief history of the development of accounting standards in the United States and Japan will be presented. There will be a discussion of the standards that apply to auditors in both countries today. The standard of independence will be emphasized.

I. Introduction

Webster's Dictionary defines "ethic" as "the discipline dealing with what is good and bad and with moral duty and obligation" or "the principles of conduct governing an individual or group." (Webster, 1990, p. 426) Black's Law Dictionary defines "ethics" as "relating to moral action, conduct, motive or character ... professionally right." (Black, 1990, p. 553) Kohler's Dictionary of Accounting Terms defines "ethics" as "a system of moral principles and their application to particular problems of conduct; specifically, the rules ... of conduct of a profession ..." (Kohler, 1983, p. 199) John Carey, in his work on professional ethics, stated that "(t)he rules of ethics are guides to right action, to action that will develop the professional attitude, and thus deserve public confidence." (Carey, 1956, p. 5)

Two professions, law and accounting, define ethics similarly to the ordinary usage of the term. Ethics relates to moral principles that govern conduct of individuals, both separately and in a group.

One of the traits that distinguishes a profession from an occupation is the existence of a code of ethics that guides members of the profession. There are several philosophical bases for ethical systems. Three bases are utilitarianism, deontologism and ethical realism (Cottell, 1990, pp. 1-12).

Under utilitarianism, or teleology, what is ethical is the course of action that results in the greatest good for the greatest number of people. Utilitarians look to consequences of an act and balance the good outcomes against the bad. Utilitarians believe that rights and duties have no independent existence. Instead, they flow from the goal of attaining the greatest good for the largest population. A utilitarian system of ethics involves balancing. The concept of balancing is familiar to accountants. A cost/benefit analysis is an example of the utilitarian balancing of positive (benefit) against negative (costs) (Frankena, 1963, pp. 13-15).

Deontologists, in contrast, believe that there are overriding principles that guide actions. Rights and duties have an intrinsic value of their own, without regard to the consequences that result. A deontologist would follow an ethical code because it was the morally correct thing to do. Immanuel Kant, an eighteenth century German philosopher, is the most well-known deontologist.

Both major ethical systems have their shortcomings. Ethics as actually practiced today seems to be neither purely utilitarianism nor deontologism. Ethics as practiced seems to have elements of both systems. Some philosophers have proposed a third system, ethical realism, to explain ethics as practiced.[(1)] Under a system of ethical realism, intellectual authorities within a community set ethical principles. Some principles are well-defined and others are not. The ethical priniciples are modified over a period of time through input by the community and its leaders. This model explains the development of accounting ethics quite well.

II. The History of Accounting Ethical Standards

The function of a profession's code of ethics is at least twofold: protection of the public from incompetent practitioners, and creation of goodwill for members of the profession (Green, 1930, p. 230). These functions have been recognized for over forty years, as a comparison of the writings of Green in his 1930 book *History* *and Survey of Accountancy* and an article by Herman Lowe in the Centennial Issue of the *Journal of Accountancy* shows (Lowe, 1987, p. 78).

The development of accounting ethics in the United States is inextricably linked with the rise of professional accounting organizations in the country. In 1887 a group of accountants formed an organization known as the American Association of Public Accountants (AAPA). Although it was primarily based in the state of New York, the organization was open to members throughout the country.

By 1897 New York had enacted the first public accountancy law which limited the practice of accountancy to certified public accountants (CPAs), and the first state society of CPAs had been created. In 1902 the Federation of Societies of Public Accountants was organized in Washington, D.C. Eight states had formed state societies (Roberts, 1987, p. 41). The Federation had as one of its purposes the encouragement of the formation of more state societies and the fostering of public accounting nationwide. The Federation also worked diligently for the federal regulation of accountancy.

In 1905 the Federation and the AAPA merged. The new organization retained the name, AAPA, and the goal of federal regulation of public accounting. In retrospect, it could be seen that the goal of federal regulation of accountancy was not to be accomplished.

The Tenth Amendment to the Constitution clearly means that the federal government has only those powers specifically given to it by the states and only those powers in specific areas where states are forbidden to act.(2) From its founding the United States has believed in retaining much power in the hands of the separate states. It is not surprising that the drive for federal regulation of public accountancy lost its appeal soon after it began.

The AAPA adopted its first ethical rules in 1905. By 1907 the ethical code consisted of five rules included in the Professional Ethics section of the bylaws (Bishop, 1987, p. 97). Because the regulation of ethics was largely left to the state societies, the AAPA was unable to effectively regulate the ethical standards of the profession.

In 1916 the AAPA underwent a major reorganization. It changed its name to the American Institute of Accountants (AIA). More importantly, the AIA changed its focus from federal regulation of the practice of accounting to one of state control. The members of the AIA gave the organization authority to develop and enforce rules of ethics. By 1917 the AIA had its first code of ethics, consisting of eight rules. The rules related to the receipt of commissions, opinions on statements containing material misstatements of fact or omissions, or on statements prepared under inadequate supervision, engaging in activities incompatible with the practice of public accounting and the obligations toward other members of the AIA (Bishop, 1987, pp. 97-98).

A competitor to the AIA, the American Society of Certified Public Accountants (ASCPA), was organized in Washington, D.C. in 1921. Membership in this society was also national in scope. Some perceived that the AIA was a geographically partisan group interested primarily in the problems of the national firms. In addition, the AIA required members to pass an examination in accountancy. Some perceived this as a competition to the CPA examination (Roberts, 1987, p. 42). The ASCPA had as its purposes protection of the CPA certificate, interaction with state societies and assistance of governmental bodies in the regulation of the practice of accounting (Green, 1930, pp. 217-228). The ASCPA left ethics regulation to the state societies (Roberts, 1987, p. 42). The ASCPA and the AIA merged in 1936.

The stock market crash of 1929 brought an increased effort to regulate the practice of the profession. The SEC was created in 1933. The SEC played and continues to play an active role in the regulation of accounting practice. In 1956 the AIA significantly expanded the code of ethics and published the code as a separate, unified document. The code was divided into five areas of conduct: members' relationships with clients and the public, technical standards, advertising, operating rules, and relationships between members.

In 1957 the name of the AIA became the American Institute of Certified Public Accountants (AICPA). The AICPA continued to increase its involvement of the state societies in the formulation of the code of ethics. Proposed changes in the code were circulated to the state societies, as well as members, to elicit as broad a range of opinion as possible before changes were made. Also at this time the code of ethics was expanded to cover areas not related to the attest function. Members engaged in tax or management advisory services were also regulated by the code of ethics, even if they were not attesting to the financial position of an entity (Lowe, 1987, p. 80).

The code of ethics underwent a major revision in 1973. The conceptual framework for the rules was included in the code. The code now consisted of two parts: Principles and Rules. Interpretations of the rules were also included in the code of conduct. The Principles constitute the theoretical ethical ground on which the rules are based. They are the goals to which each accountant should aspire. Violations of the Rules will result in disciplinary action. They represent the minimum standard of behavior. The code was revised in 1988 and again in 1991. The format each time remained essentially as it was in 1973.

At the turn of the century, while accounting was developing as a profession in the United States, similar changes were occurring in Japan. By 1907 the first group of professional accountants existed. Within the next twenty years the Accountants Law was passed and an institute of professional accountants was formed.

After World War II, there was an explosive growth in the number of CPAs. The Certified Public Accountants Law became effective in 1948. A year later the first CPA examination was held and the Japanese Institute of CPAs (JICPA) was formed. Membership in JICPA was voluntary. In 1950 *Auditing Standards* and *Working Rules of Field Work* were published. They were documents containing field work standards that were developed by the community of accountants. In 1953 JICPA was incorporated under the Civil Code of Japan, but membership was still voluntary. Three years later the publication of *Working Rules of Reporting* began. By 1967 thirty-one Reporting Rules had been issued. A year earlier JICPA was reorganized and membership was required of every CPA in Japan. The mandatory membership requirement of JICPA is in contrast to the voluntary membership of the American AICPA.

The Securities and Exchange Law was enacted in 1951. As in the United States, the passage of the securities law had a major impact on the profession and its standards (Choi, 1987, pp. 180-191).

III. Current Professional Ethical Standards

a. United States

The AICPA Code of Professional Conduct, as amended May 20, 1991, consists of two main parts: Principles and Rules. The Principles provide the framework for the Rules. The Rules provide specific guidance in the performance of professional services by AICPA members.

The Principles are set out in six Articles and a Preamble. The Preamble articulates the role that the Principles play. The Principles

> "... express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and profession conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage."

(American Institute, 1991, Preamble).

The first Article discusses the responsibilities of AICPA members. Article I requires members to act with sensitive professional and moral judgment in all endeavors. This Article admonishes members as a group to carry out the special responsibility of self-governance.

Article II states that the accounting profession has a duty to serve the public interest. The public interest is defined as "the collective well-being of the community of people and institutions the profession serves." The public being served consists of clients, state and national government, creditors, investors, employers, as well as the business community at large. The interests of the various groups can sometimes conflict. When a conflict arises, the AICPA member is expected to discharge his or her responsibilities with integrity. The Code of Conduct states that clients' and employers' best interests are served when the responsibilities to the public are fulfilled. Because the public relies on accountants, the accountant has a reciprocal obligation to be dedicated to professional excellence.

Article III calls for an accountant to act with integrity. This requires the accountant to be completely honest and without deception. Integrity is a fundamental trait of a professional. Accountants have an obligation to maintain client confidentiality. The honesty exhibited by a person acting with integrity can never compromise that obligation of client confidentiality. However, personal gain can never be put ahead of client or public interest. Persons acting with integrity can have honest differences of opinion. Persons acting with integrity can make honest mistakes. Persons acting with integrity will never be deceitful or unprincipled. According to Article III, integrity is measured "in terms of what is right and just." Integrity requires both the form and the spirit of various standards to be followed. Integrity requires an accountant to be objective, independent and to exercise due care.

Article IV specifically addresses the two traits of objectivity and independence. Objectivity and independence are the hallmarks of an accountant. These two traits distinguish the accounting profession from all others. Attorneys are required to be advocates for their clients. Objectivity requires a freedom from conflicts of interest, honesty and impartiality. Independence requires freedom from relationships that may compromise objectivity. The unique service that accountants render to society, that no one else is permitted to perform, is to attest to the financial position of an entity. If an accountant is related to the entity, the accountant will not be able to be impartial. Independence is required for performance of attestation services. Accountants perform many services that are not attestations. Independence is still required of all accountants in all services. Independence may be more or less strictly defined if the service rendered is not an attestation service. Independence in fact and in appearance is required when the attest function is performed.

Article V sets out the standard for services rendered as "due care." In rendering due care, a member must exercise diligence and competence in providing professional services. Competence is achieved through technical proficiency, which is obtained through education and experience. Each person is expected to evaluate his or her own competence and to obtain the advice of others when necessary. Diligence means that the person will be thorough, prompt, careful and timely. A diligent person will be aware of, and apply, appropriate technical and ethical standards. Appropriate planning and supervision will be done by one who is diligent.

Article VI requires that each person will consider all the ethical principles in deciding whether to accept or reject a request for services, and in determining the breadth of services to be rendered. This article suggests that several devices can be used to insure the application of the ethical principles to each job decision. These devices include a system of internal controls, and a determination of actual or potential conflicts of interest.

The second section of the Code of Professional Conduct consists of a series of eleven Rules related to each of the above stated principles.

The Principles are stated in the form of a sentence or two summarizing the principle, followed by one or a few paragraphs of prose around a single theme, e.g., independence or due care. The prose discussion is not divided into subparts. The Principles are deontological in nature, i.e., they are moral guides that have an intrinsic value of their own.

The Rules are organized in five sets of three digit numbers, e.g., the 100 series, the 200 series, etc. The Rules section also contains definitions of important terms, such as "practice of public accounting" and "client."

The Rules are very specific in their application. While the Principles can be thought of as "shoulds", i.e., what one should do, the Rules are thought of as "should nots", i.e., what one must not do. For example, Rule 201-General Standards, requires that members comply with four standards: professional competence, due professional care, planning and supervision, and sufficient relevant data.

Failure to comply with a rule can result in sanctions that can be quite severe. The maximum penalty for violation of the Rules is expulsion from the AICPA. This can lead to a State Board of Accountancy's suspension of the license to practice. The Rules are utilitarian in nature, i.e., they should be followed because the greatest good will result from adherence to them.

The AICPA Code of Conduct is primarily drafted by a voluntary professional organization. The members of the AICPA must follow the Code of Conduct. However, the practice of accountancy is regulated by each of the fifty states, not by the national government. Each state develops its own rules for regulating the practice of accounting. If a state has adopted the AICPA Code of Conduct as its own set of ethical standards, then those persons licensed to practice in that state must follow the same rules as the AICPA members. In practice most CPAs will be obligated to follow the AICPA rules. This obligation does not result from the fact that the AICPA is a national professional organization. CPAs in the U.S. must follow AICPA ethical standards because (1) the CPA is a member of the AICPA or (2) the state in which the CPA is licensed to practice has adopted the AICPA rules as its own.

b. Japan

In Japan auditors will follow the same code of ethics because all CPAs are required to belong to the same national society. The Japan Institute of Certified Public Accountants (JICPA) is not a voluntary organization, as is the AICPA in the United States. The Certified Public Accountants Law, and ministerial ordinances under both the Security Exchange Law and the Commercial Law all impact on accounting standards, especially in the area of independence. These laws and ministerial ordinances provide very specific guidelines in very specific areas of accounting. The JICPA code, on the other hand, offers broad guidelines in all areas of accounting.

The theoretical framework of accounting ethics in Japan has three aspects:

technical competency, relational competency, and personal character. Technical competency insures that professional skills will be maintained at an appropriate level. This is accomplished through learning, i.e., through higher education and the CPA exam. At the moment, there is no requirement in Japan to continue education beyond the formal university training and the one year of lectures taken in preparation for the third CPA exam. However, JICPA is considering a continuing education requirement. In the United States, there is a continuing education requirement. Every year U.S. CPAs in public practice must obtain an average of approximately forty hours of courses on technical subjects.

Technical competency is also maintained through experience. The experience is obtained in the three year work requirement between the second and third CPA examinations and the experience obtained during the lifelong career of the CPA. Learning and experience are the sources of professional competency.

Relational competency emphasizes the independent relationship between the auditor and the client. The auditor must be both subjectively and objectively independent. The subjective independence is closely related to personal competency. The objective independence is measured by an absence of economic and kinship ties. Personal competency requires the auditor to exercise sensitive professional and moral judgments in all aspects of the auditor's life, not only those aspects relating to the audit. Even in aspects of the auditor's private life, the auditor is held to a higher standard of behavior than the ordinary person. This notion of personal competency extending to the auditor's private life is different from that in the United States. The U.S. auditor's private life is not subject to extraordinary scrutiny. Only the professional life of the U.S. auditor is subject to a higher standard than the ordinary person.

The framework of accounting ethics in Japan serves to establish the limitations of the auditor's responsibilities. This is a fundamental aspect of accounting and an area that deserves to be researched.

IV. Independence

Independence has been defined by one author "... in a professional context as a state in which one is self-reliant and not easily influenced by others." (Cottell, 1990, p. 29) The independent CPA must never substitute the client's wishes for his or her own professional judgment. The importance of independence to the profession of accounting was stated by the Supreme Court of the United States, the highest court in America. In *United States v. Arthur Young* (1984), Chief Justice Burger, speaking for the Court, said

> "By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust."

(*U.S. v. Arthur Young*, 1984, p.1503.)

The CPA must be independent primarily for the sake of third parties, not the client. A third party is anyone who is not the client and who reads and relies on the financial statements on which the CPA has rendered an opinion.

Independence has two aspects that can be regulated : independence in fact and in appearance. Not only must the auditor actually be independent, but the auditor must also appear to the public as independent. Independence in fact has two levels. On the first level the character of the auditor is at issue. The auditor must have honesty, integrity and objectivity. The second level of independence in fact deals with the relationship of the auditor and the client. There must not be a connection between them that could cause the CPA to compromise his or her judgment. A CPA having a direct financial interest in the entity being audited might not be able to render an objective professional opinion. Instead the CPA might put his or her own or the client's interest first. Rule 101 requires a CPA in public practice to be independent. Interpretation 101-1[3] lists several prohibitions during the audit or at the time an opinion is expressed. Neither the CPA nor the firm can have a direct or material indirect financial interest in the entity being audited. Neither the CPA nor the firm can be a trustee of a trust or executor of an estate if the trust or estate has a direct or material indirect financial interest in the audited company. Neither the CPA nor the firm can invest in a closely held business being audited, if the investment is material to the CPA or the firm. Both the CPA and the firm cannot have unsecured loans to or from the entity being audited. Either the CPA or the firm may have an unsecured loan from the audited lender if the loan is not material to the net worth of the borrower, or if it is a home mortgage loan.

During the audit, during the time covered by the financial statements, and at the time the opinion is rendered, neither the CPA nor the firm may be a promoter, underwriter, voting trustee, director, officer, part of management or employee of the firm being audited. In addition the CPA and the firm will not be independent if either were the trustee for a pension or profit-sharing plan of the firm being audited. These prohibitions preserve independence in fact and independence in appearance.

Independence in appearance is concerned with how the auditor is viewed by the public. Even if the auditor is independent in fact, if the public who uses the financial statements thinks that there is some bias on the part of the auditor, the value of the auditor's work is lost. The attest function is what makes CPAs valuable to society. No one else is permitted to attest to the financial condition of a company. If the public perceives that the auditor is not acting independently, but instead is acting on behalf of someone, e.g., the client or the auditor himself or herself, then the public will disregard the auditor's work. The profession's value to society depends to a large extent on maintaining independence in appearance (Cottell, 1990, pp. 29-40).

The collapse of the stock market in 1929 and the creation of the SEC in 1933 resulted in a reexamination of the standard of independence. In the decade of the thirties the independence standard was significantly overhauled. By 1940 independence was impaired if the auditor was a director or officer of the corporation while engaged to audit that corporation, or was acting in any management or employee capacity or connected as a promoter, trustee or underwriter.

V. Conclusion

The ethical standards of accounting in Japan and the United States have been compared. Although there are differences that relate to the laws that govern the practice of accounting in each country, there are many similarities and shared concerns. Each country can learn much from other.

APPENDIX 1

AICPA
Code of Professional Conduct

as amended May 20, 1991

Composition, Applicability, and Compliance

The Code of Professional Conduct of the American Institute of Certified Public Accountants consists of two sections—(1) the Principles and (2) the Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members. The Council of the American Institute of Certified Public Accountants is authorized to designate bodies to promulgate technical standards under the Rules, and the bylaws require adherence to those Rules and standards.

The Code of Professional Conduct was adopted by the membership to provide guidance and rules to all members—those in public practice, in industry, in government, and in education—in the performance of their professional responsibilities.

Compliance with the Code of Professional Conduct, as with all standards in an open society, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.

Other Guidance

The Principles and Rules as set forth herein are further amplified by interpretations and rulings contained in *AICPA Professional Standards* (volume 2).

Interpretations of Rules of Conduct consist of interpretations which have been adopted, after exposure to state societies, state boards, practice units and other interested parties, by the professional ethics division's executive committee to provide guidelines as to the scope and application of the Rules but are not intended to limit such scope or application. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary hearing.

Ethics Rulings consist of formal rulings made by the professional ethics division's executive committee after exposure to state societies, state boards, practice units and other interested parties. These rulings summarize the application of Rules of Conduct and interpretations to a particular set of factual circumstances. Members who depart from such rulings in similar circumstances will be requested to justify such departures.

Publication of an interpretation or ethics ruling in the *Journal of Accountancy* constitutes notice to members. Hence, the effective date of the pronouncement is the last day of the month in which the pronouncement is published in the *Journal of Accountancy*. The professional ethics division will take into consideration the time that would have been reasonable for the member to comply with the pronouncement.

A member should also consult, if applicable, the ethical standards of his state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental agency which may regulate his client's business or use his report to evaluate the client's compliance with applicable laws and related regulations.

Section I ——Principles

Preamble

Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a certified public accountant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

Article I——Responsibilities

In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.

As professionals, certified public accountants perform an essential role in society. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.

Article II——The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

Article III——Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust shoud not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

Integrity also requires a member to observe the principles of objectivity and independence and of due care.

Article IV——**Objectivity and Independence**

A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services.

Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest.

Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services. Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.

Article V——Due Care

A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.

The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the memebr's services meets the high level of professionalism required by these Principles.

Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

Article VI——Scope and Nature of Service

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be devloped to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

In order to accomplish this, members should

- Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
- Detemine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the

performance of the audit funcion for that client.

- Assess, in their individual judgments, whether an activity is consistent with their role as professionals (for example, Is such activity a reasonable extension or variation of existing services offered by the member or others in the profession ?).

APPENDIX 2

DEVELOPMENT OF ETHICAL STANDARDS IN U. S. ACCOUNTING

DATE	ORGANIZATION	CODE OF ETHICS
1887	AAPA organized	
1902	Federation organized	
1905	AAPA and Federation merge New name: AAPA	2 rules in AAPA bylaws
1916/7	AAPA name changed to AIA	8 rules issued by AIA
1921	ASCPA organized (Competitor to AIA)	no code
1936	AIA and ASCPA merge New name: AIA	Retain AIA code
1956		AIA issues stand—alone code with 5 broad areas of rules (no principles)
1957	AIA name changed to AICPA	
1973		Major revision. Conceptual framework (principles) included for first time.
1991		Revision of contingent fees (Rule 302)——FTC impetus

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FOOTNOTES

(1) For a good discussion of ethical realism as applied to accounting practice, see Cottell, 1990, especially chapter 1.

(2) "The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people."

(3) An Interpretation is an official explanation of a Rule. It often includes specific examples of the application of the Rule.