

# NAVIGATING CLIENT NEEDS *and the* LAW



- TAX ETHICS -

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## **INTRODUCTION**

Under the Treasury Department Circular No. 230, CPAs are eligible to practice before the Internal Revenue Service (IRS) without any additional qualifications, provided the CPA is not currently under suspension or disbarment from practice before the IRS. Practice before the IRS includes tax planning and advice, the preparation or filing or assisting in the preparation or filing of returns or claims for refund or credit, and all matters connected with the presentation to the IRS or its officers or employees relating to a taxpayer's rights, privileges, or liabilities under the laws or regulations administered by the IRS.

CPAs who are members of the AICPA are bound by the Code of Professional Conduct and Statements on Standards for Tax Services. The Code specifies the following principles of professional conduct:

- **Responsibilities principle.** In carrying out their responsibilities, members should exercise sensitive professional and moral judgments in all their activities.
- **Public interest principle.** Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate a commitment to professionalism.
- **Integrity principle.** To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.
- **Objectivity and independence principle.** Members should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. Members in public practice should be independent in fact and appearance when providing auditing and other attestation services.
- **Due care principle.** Members 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.
- **Scope and nature of services principle.** Members in public practice should observe the principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

Last revised effective December 15, 2014, the Code of Professional Conduct introduced the Conceptual Framework for its members. There are two frameworks, one for members in public practice and another for those in business. The frameworks provide a way for members to identify, evaluate, and address threats to compliance with the rules that result from a specific relationship or circumstance not otherwise addressed.

One such threat occurs when members are faced with ethical conflicts. The Code defines ethical conflicts as those situations when a member encounters one or both of the following:

- Obstacles to following an appropriate course of action due to internal or external pressures.
- Conflicts in applying relevant professional standards or legal standards.

The Code is broad and covers more than just tax practice. AICPA's Statements on Standards for Tax Services (SSTS) are specific and provide standards of practice for tax professionals. They are intended to complement the other provisions, particularly Circular 230, that govern tax practice.

The current SSTS were revised in 2010 and at the time of this course, there is a revision project to reflect current tax practice by CPAs. Possible revisions may include quality control and data security as discussed later.

[Title 54.1, Subtitle VI, Chapter 44](#) of the Code of Virginia governs the regulation of CPAs in the Commonwealth.

[Section 54.1-4413.3](#), Standards of Conduct and Practice, requires that persons using the CPA title in Virginia conform to the following:

1. Exercise sensitive professional and moral judgment.
2. Serve the public interest, honor public trust, and act in a professional manner.
3. Perform responsibilities with integrity, objectivity, and free of conflicts of interests, and avoid misrepresenting facts or inappropriate subordination of judgement.
4. Follow the AICPA Code of Professional Conduct.
5. Follow technical standards and related interpretive guidance issued by AICPA groups who promulgate technical standards.
6. Follow standards and related interpretive guidance issued by the Comptroller of the United States, FASB, FAF, GASB, PCAOB, SEC, comparable international standard-setting authorities, or any successor standard-setting authorities.

### **DUE DILIGENCE**

Exercising due diligence — from the acceptance of a client to the delivery of the return and beyond — is a core component of tax practice. It begins with having the necessary competence to perform the service. Circular 230 requires that tax practitioners have the knowledge, skill, thoroughness, and preparation for the matter for which the practitioner is engaged. The AICPA Code similarly requires competency in its due care and scope and nature of services principles. The due care principle specifically “requires a member to discharge professional responsibilities with competence and diligence.” Safeguards, such as continuing education, are to be implemented by the member and the member’s firm to eliminate the threat that the lack of competency presents.

Both Circular 230 and the AICPA Code require the practitioner to consider conflicts of interest, as discussed later, before accepting a client.

Practitioners are required by Circular 230 to exercise due diligence in the accuracy of preparing and filing returns and in the correctness of oral or written representations made to the IRS or to clients. Further, it requires a practitioner must advise a client promptly of the existence of noncompliance, errors, or omissions, including the consequences of such.

Statements on Standards for Tax Services #3 *Certain Procedural Aspects of Preparing Returns* explains the CPA may in good faith rely, without verification, on information provided by the client or third parties. However, the CPA should make reasonable inquiries if the information appears incorrect, incomplete, or inconsistent with the CPA’s knowledge or judgment.

As noted in the principles above, a member in public practice is required to be independent. Generally, independence is not impaired when offering non-attest services, such as tax services. However, the Code notes that performing multiple non-attest services without safeguards could impair a member’s independence. For firms that provide both attest and non-attest services, it is important to ensure that safeguards are implemented to avoid impairment. The AICPA Code provides specific safeguards that firms can adopt. The Code specifically states that if a member represents an attest client in court to resolve a tax dispute, independence is impaired.

In addition, the Code requires that, prior to performing non-attest services for an attest client, the member should document in writing the understanding established with the client. Failure to do so is considered a violation of the Compliance with Standards Rule.

CPAs must also be aware of client advocacy. An advocacy threat to compliance may exist when a member or the member's firm is engaged to perform services, such as tax and consulting, that involve acting as an advocate for the client or to support a client's position. According to the AICPA Code of Conduct 1.140.010.03, it is possible that such advocacy "may stretch the bounds of performance standards, go beyond sound and reasonable professional practice, or compromise credibility, thereby creating threats to the member's compliance with the rules and damaging the reputation of the member and the member's firm." Prior to undertaking such services, the member and the member's firm should determine if it is appropriate.

Note: IRS Publication 4687 states a tax preparer claiming any of the five tax benefits below must meet four due diligence requirements.

If these tax benefits are claimed:

1. Earned income tax credit (EITC)
2. Child tax credit (CTC)
3. Additional childcare credit (ACTC)
4. American opportunity tax credit (AOTC)
5. Head of household filing status (HOH)

Then preparer must meet these due diligence requirements:

1. Compute the credits based on the fact
2. Complete and submit Form 8867
3. Keep records
4. Ask questions

Throughout this course, recommended procedural best practices that enable the tax professional to be effective in making good ethical decisions are provided. In addition, case studies will be presented, if applicable, that are based on enforcement cases from the Virginia Board of Accountancy (VBOA) published under disciplinary actions on the VBOA website.

***Best practices to exercise due diligence:***

- Have a client engagement policy and checklist. The checklist could include questions as follows:
  - Does the tax professional have the competence to perform the tax service requested?
  - Does the tax professional have any conflicts of interest by accepting the engagement?
  - How did the potential client hear about the tax professional? Referral? Internet search?
- Use engagement letters for tax planning and tax compliance services.
- Use client organizers and checklists to obtain pertinent information needed for accuracy.
- The tax CPA should request documentation and ask the client questions for support and clarification of unusual items. Obtain continuing education annually for changes in tax law and to maintain competency.

***Due diligence case study***

Licensee A represented a client as a business advisor and tax preparer and was negligent in reporting net operating losses twice in two years. In addition, Licensee A deducted hundreds of thousands of dollars in expenses on investment properties as they were incurred (instead of capitalized) which, under audit, were disallowed. Sanctions included a reprimand, monetary penalties, CPE and an essay on best practices for client-related correspondence and documentation.

## **CONFLICTS OF INTEREST**

CPAs must use professional judgment, considering whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists. Before accepting a new client relationship, engagement, or business relationship, Circular 230 and the AICPA Code require that reasonable steps be taken to identify circumstances that might create a conflict of interest. Code of Virginia [54.1-4413.3](#) specifically states CPAs “maintain objectivity and freedom from conflicts of interest in discharging professional responsibilities.”

Circular 230 and the AICPA define conflicts of interests similarly. A conflict exists:

- If the representation of one client will be averse to another client, or
- If there is a significant risk that the representation of one or more clients will be materially limited by the practitioner’s responsibility to another client, a former client or a third person, or by a personal interest of the practitioner.

The Code contains several examples of situations in which conflicts of interest may arise for the tax practitioner, including:

- Representing two clients at the same time regarding the same matter who are in a legal dispute with each other, such as during a divorce proceeding or the dissolution of a partnership.
- Advising a client to invest in a business in which, for example, an immediate family member of the professional has a financial interest in the business.
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a competitor of the client.
- Providing tax or personal financial planning services to several members of a family whom the professional knows to have opposing interests.
- Referring a personal financial planning or tax client to an insurance broker or other service provider, which refers clients to the professional under an exclusive arrangement.
- Providing tax or personal financial planning services to a client’s executives, and the services could result in the professional recommending to the executives actions that may be adverse to the company.

The AICPA Code recommends firms enact a conflict identification process to assist professionals in identifying actual or potential conflicts of interest. Further, it provides a framework for evaluating conflicts of interest. In general, CPAs must consider both qualitative and quantitative factors when evaluating the significance of the threat created by a conflict.

If the practitioner determines they can reasonably provide competent and diligent representation to each, both Circular 230 and the AICPA Code permit them to proceed provided the conflict is disclosed,

each affected party waives the conflict and gives written consent. Circular 230 requires the consent to be given no later than 30 days after the event.

The Code notes that disclosure and consent may take different forms, depending on the circumstances. For example, the practitioner may use a general disclosure in its standard terms and conditions for the engagement that states that the practitioner does not provide services exclusively for any one client, such as in a particular market sector. A more specific disclosure is required when the conflict affects specific clients. In that case, it is recommended that the disclosure include an explanation of the situation and any planned safeguards, and any other information sufficient to enable the affected clients to make an informed decision on the matter and to provide specific consent.

### ***Best practices to identify and resolve conflicts of interest***

AICPA Tax Practice Responsibilities Committee (TPRC) Tax Advisor Article May 1, 2020 Updated 7/15/20

#### **Identifying a conflict of interest**

1. Conflicts among current clients:
  - Transactional conflicts.
  - Relational conflicts.
  - Adversarial conflicts.
2. Conflicts with former clients.
3. Conflicts with a professional's own interests.

#### **Resolving a conflict of interest**

1. Implementing safeguards:
  - a. Separate engagement teams.
  - b. Separate areas of practice.
  - c. Establish policy and procedures to limit access to client files.
2. Regularly review the application of safeguards.
3. Have a professional of the firm not involved in the engagement review work and assess key judgments and conclusions.
4. Consult with third parties, including a regulatory body, legal counsel, or another CPA.

#### ***Conflict of interest case study***

Licensee B had a long-term relationship with a married couple. Licensee B was aware that they were separated and getting divorced. Their engagement and therefore their client was the couple, not the individuals themselves. At the request of the husband, Licensee B filed a "married filing separately" return for the husband without prior consultation with the wife. Since these clients normally filed extensions, the wife was unaware of the filing until after the original due dates and incurred substantial debt to the IRS and Virginia Department of Taxation. No conflict of interest document was provided or signed by the husband or wife. A monetary penalty was assessed for the violations of conflict of interest, failure to communicate with the clients and due professional care.

#### **QUALITY CONTROL AND MANAGEMENT**

Circular 230 requires those who have principal authority and responsibility for overseeing a firm's practice take reasonable steps to ensure adequate procedures in place for all members, associates, and

employees to ensure compliance with the regulations set forth. This is consistent with the requirements of the scope and nature of services principle in §0.0300.070.01 of the AICPA Code that requires members practice “in firms that have in place internal quality control procedures to ensure that services are competently delivered and adequately supervised.”

Some of the specifics required in this area include:

- Confidentiality of client information. Generally, no confidential client information can be disclosed without the specific consent of the client. The AICPA considers two spouses as one client, even if in the process of a divorce.
- False, misleading, or deceptive solicitations. Circular 230 specifically prohibits this in any form of communication. For AICPA members, this is covered under the integrity principle as well as under the Integrity and Objectivity Rule.
- Fees. Circular 230 prohibits “unconscionable” fees and generally prohibits contingent fees, with exceptions for certain services. The AICPA Code notes that a contingent fee generally cannot be charged for the preparation of an original or amended tax return or a claim for refund, also with exceptions which closely match those of Circular 230.

While the AICPA has established principles of quality control for a firm’s accounting and auditing practice, the current SSTs do not include a quality control standard. As mentioned earlier, a recommended quality control document may be included in the revised standards.

#### ***Best practices for quality control and management***

Document a tax practice quality control system to include the following elements:

- Leadership responsibilities for quality within the firm.
- Relevant ethical requirements.
- Acceptance and continuance of client relationships and specific engagements.
- Human resources.
- Engagement performance.
- Monitoring of the quality control system.

#### **RECORD RETENTION**

Practitioners are likely aware of the general rules on the retention of tax return records, which are tied to the expiration of the statute of limitations (three years from the date the return is filed or two years from the date the tax is paid, whichever is later). If no return has been filed or a fraudulent return was filed, the statute remains open indefinitely.

In addition, it is recommended that client/taxpayer:

- Keep records for six years if income is not reported that is more than 25% of the gross income reported for that year.
- Keep records for seven years after filing a claim for a loss from worthless securities or a bad debt deduction.
- Keep records relating to property until the statute of limitation expires for the year in which the property is disposed of in a taxable transaction.



- Keep employment tax records for at least four years after the tax is due or paid, whichever is later.

Although the AICPA Code is silent, Circular 230 requires a written consent related to conflicts of interest be retained at least 36 months from the date of the conclusion of the representation.

For firms, maintaining records requires consideration of several factors. “Keep or toss? A guide to CPA firm record retention”, a Journal of Accountancy article (Yoo, 2020) mentions a few considerations for determining how long to keep records:

- Type of service offered.
- Statute of limitation and the discovery rule.
- Regulatory or contractual requirements.

This may result in different retention periods for different clients and/or services. Once a retention policy is adopted, firms should apply it consistently for both paper and electronic records.

For clients with outstanding fees, Circular 230 requires that at the request of the client, “any and all records of the client that are necessary for the client to comply with his or her Federal tax obligations must be returned promptly.” Note there is no distinction between client-provided records and those that are CPA-prepared. “The existence of a dispute over fees generally does not relieve the practitioner of his or her responsibility” to provide these records.

However, if state law allows the practitioner to retain a client’s records due to a fee dispute, Circular 230 permits the practitioner to only return those records that must be attached to the return. Virginia follows the AICPA Code on this issue. The AICPA Code distinguishes between client-provided records and CPA-prepared records. Members should return client-provided records “in the member’s custody or control to the client at the client’s request.”

For CPA-prepared records or work product, the records may be withheld if:

- Fees are due to the member for that specific work product; or
- The work product is incomplete; or
- For purposes of complying with professional standards; or
- Threatened or outstanding litigation exists concerning the engagement or member’s work.

A CPA may:

- Charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records.
- Require the client pay the fee before the member provides the records.
- Provide the records in any format useable by the client. If the client requests the records in a specific format and they are available in that format, the request should be honored. The member is not required to convert records that are not in electronic format to electronic format.

A member who is required to return or provide records to the client should comply with the client’s request as soon as possible but no later than 45 days after the request is made.

Note that the AICPA Code has specific rules on the transfer of files and return of client records in the event of a sale, transfer, discontinuance, or acquisition of a practice.

***Best practices for record retention***

- Establish a firm record retention and destruction policy and adhere to it. A sample may be obtained from a malpractice insurance carrier or the AICPA.
- Provide the policy to clients with the reminder that they are responsible for keeping records to support their tax returns. Consider including this information in the engagement letter.
- In compliance with confidentiality rules, information may not be disclosed to third parties without specific written permission or required by law, i.e. a subpoena.
- *Under no circumstances will any records, files, or electronic data be destroyed, regardless of the retention periods identified in this policy, if there are any pending regulatory investigations, disciplinary actions, or legal actions, or if the firm has knowledge of the intent by a regulatory agency to launch an inquiry or knowledge of a potential legal claim.*

***Types of records requested in a Virginia Board of Accountancy enforcement cases:***

- Engagement Letter
- Correspondence with client and taxing authorities
- Tax return checklists and organizers
- Tax returns

***Record retention case study***

Licensee C violated IRS Circular 230, subsection 10.28, by failing to provide his client with copies of the client's files in that a practitioner must, at the request of a client, promptly return any and all records of the client that are necessary for the client to comply with federal tax obligations.

Licensee D had a practice continuation agreement with a non-CPA. During a tax season, Licensee D encountered some medical issues and turned all client files over to the new tax preparer without prior notification or consent of the client. Client contacted Licensee D numerous times to check on the status of his returns and when no response was received, he requested the returns of his records. Since Licensee D had turned records over to the non-CPA, the records could not be returned. Therefore, Licensee D violated the Code of Virginia when they failed to comply with AICPA Code of Professional Conduct § 1.400.001.01 AICPA by failing to return all the client's records when requested by the client.

**DATA SECURITY**

At the time of the development of this course, Circular 230, the AICPA Code of Professional Conduct, and the Statements on Standards of Tax Practice do not have specific requirements in regard to data security. However, the SSTS revision task force is discussing data security for inclusion in the revised standards.

Please note the Preparer Tax Identification Number (PTIN) form W-12 requires paid preparers to check the box on line 11 stating "I am aware that paid preparers must have a data security plan to provide data and system security protections for all taxpayer information."

Tax practitioners should visit the IRS website for the following:

- Data Security Resource Guide for Tax Professionals <https://www.irs.gov/pub/irs-pdf/p5293.pdf>.
- IRS Publication 4557, Safeguarding Taxpayer Data <https://www.irs.gov/pub/irs-pdf/p4557.pdf>.

Under the [Gramm-Leach-Bliley Act's \(GLBA\) Safeguards Rule](#), a tax return preparer is required to create and enact an Information (Data) Security Plan to protect client data. The plan should be appropriate to the firm's size and complexity, the nature and scope of its activities, and the sensitivity of the clients' information it handles. Accordingly, a firm's efforts to comply with the GLBA Safeguards Rule is an organization-specific initiative.

A Data Security Plan should include the following safeguards:

Firm Governance & Compliance – responsible for overseeing & updating safeguards

- Anti-virus and anti-malware software
- Firewalls for hardware and software
- Multi-factor authentication
- Back-up of software/services
- Encryption
- Virtual Private Network (VPN)
- Passwords
- Firm policies including record retention, confidentiality, incident response (data breach)
- Cyber insurance coverage
- Third-party service providers

U.S. Federal Trade Commission safeguards:

- Employee management and training
- Information systems
- Detecting and managing system failures

## **CONCLUSION**

There are numerous areas with which the CPA tax professional must be familiar. All tax professionals must adhere to the regulations in Circular 230. Persons who use the CPA title in Virginia are ethically bound to adhere to the principles of professional conduct contained in the Code and to the standards of practice provided in the SSTS.

## Appendix

### ***COMMON ACRONYMS and ABBREVIATIONS***

- AICPA — American Institute of CPAs
- ASU — Accounting Standards Update
- CAQ — Center for Audit Quality
- CPA — Certified Public Accountant
- CPE — Continuing Professional Education
- DOJ — U.S. Department of Justice
- EBPAQC — AICPA Employee Benefit Plan Audit Quality Center
- ET — Ethics (topical index of the AICPA Professional Code of Conduct)
- FAF — Financial Accounting Foundation
- FASB — Financial Accounting Standards Board
- FRF — Financial Reporting Framework
- FTC — U.S. Federal Trade Commission
- GAO — U.S. Government Accountability Office
- IESBA — International Ethics Standards Board for Accountants
- IFAC — International Federation of Accountants
- IQAB — International Qualification Appraisal Board
- IQEX — International Qualification Examination
- IRC — U.S. Internal Revenue Code
- IRS — U.S. Internal Revenue Service
- GAAP — Generally Accepted Accounting Principles
- GAAS — Generally Accepted Auditing Standards
- GAGAS — Generally Accepted Government Auditing Standards
- GAPP — Generally Accepted Privacy Principles
- NASBA — National Association of State Boards of Accountancy
- PCAOB — Public Company Accounting Oversight Board
- PCC — Private Company Council

- PEEC — AICPA Professional Ethics Executive Committee
- PIOB — Public Interest Oversight Board
- PTIN — Preparer Tax Identification Number
- SHRM — Society for Human Resource Management
- SME — Small- and Medium-Sized entities
- SPF — Special Purpose Framework (previously Other Comprehensive Basis of Accounting)
- SSAE — Statements on Standards for Attestation Engagements
- SSARS — Statements on Standards for Accounting and Review Services
- SQCS — Statement on Quality Control Standards
- SSTS — Statements on Standards for Tax Services
- VAC — Virginia Administrative Code (“Regulations”)
- VBOA — Virginia Board of Accountancy (“the Board”)
- VSCPA — Virginia Society of CPAs

### **COMMON GLOSSARY TERMS**

Assurance means any form of expressed or implied opinion or conclusion about the conformity of a financial statement with any recognition, measurement, presentation, or disclosure principles for financial statements.

Attest services means audit, review, or other attest services for which standards have been established by the Public Company Accounting Oversight Board (PCAOB), by the Auditing Standards Board, or the Accounting and Review Services Committee of the American Institute of CPAs (AICPA), or by any successor standard-setting authorities.

Circular 230, also known as TD 230, is the common name given to the body of regulations promulgated under the enabling statute found at Title 31, United States Code § 330. This statute and the body of regulations are the source of the OPR’s authority. Circular 230 defines “practice” and who may practice before the IRS; describes a tax professional’s duties and obligations while practicing before the IRS; authorizes specific sanctions for violations of the duties and obligations; and describes the procedures that apply to administrative proceedings for discipline.

Compilation services means compiling financial statements in accordance with standards established by the AICPA or by any successor standard-setting authorities.

Financial reporting framework (FRF) is the set of standards used to measure, recognize, present, and disclose all material items within an entity’s financial statements. Examples include U.S. Generally Accepted Accounting Principles (GAAP), International Financial Reporting Standards (IFRS), and special purpose frameworks (formerly OCBOA).

Financial Reporting Framework for Small- and Medium-Sized Entities (FRF-SME) is a principle-based special purpose framework for preparing financial statements of privately held small- and medium-sized entities. It was developed under the guidance of the AICPA FRF for SMEs task force and is therefore nonauthoritative.

Financial Statement means a presentation of historical or prospective information about one or more persons or entities.

Licensee means a person or firm holding a Virginia license or the license of another state.

Mobility means a practice privilege that generally permits a licensed CPA in good standing from a substantially equivalent state to practice outside of his or her place of business without obtaining another license. Source [www.cpamobility.org](http://www.cpamobility.org)

ANet Operating Loss (NOL) is the result when a company's allowable deductions exceed its taxable income within a tax period. The NOL can generally be used to offset the company's tax payments in other tax periods through an Internal Revenue Service (IRS) tax provision called a loss carryforward.

Owner-managed entities are closely held companies run by the individuals who own a controlling ownership interest, a stark contrast to public companies, which by definition have an obvious separation between ownership and the management. Source: AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQs.

Peer Review means a review of a firm's attest services and compilation services conducted in accordance with the monitoring program.

Practice of public accounting means the giving of an assurance other than by the person or persons about whom the financial information is presented or by one or more owners, officers, employees, or members of the governing body of the entity or entities about whom the financial information is presented.

Providing services to the public using the CPA title means providing services that are subject to the guidance of the standard setting authorities listed in the Standards of Conduct and Practice in subdivisions 5 and 6 of § 54.1-4413.3.

§ 54.1-4413.3. Standards of Conduct and Practice. (5 and 6 only listed below.)

5. Follow the technical standards, and the related interpretive guidance, issued by committees and boards of the American Institute of Certified Public Accountants that are designated by the Council of the American Institute of Certified Public Accountants to promulgate technical standards, or that are issued by any successor standard-setting authorities.

6. Follow the standards, and the related interpretive guidance, as applicable under the circumstances, issued by the Comptroller General of the United States, the Federal Accounting Standards Advisory Board, the Financial Accounting Standards Board, the Governmental Accounting Standards Board, the Public Company Accounting Oversight Board, the U. S. Securities and Exchange Commission, comparable international standard-setting authorities, or any successor standard-setting authorities.

Providing services to an employer using the CPA title means providing to an entity services that require the substantial use of accounting, financial, tax, or other skills that are relevant, as determined by the Board. Source: Small- and Medium-Sized Entities (SME). There is no standard definition in the United States or under the AICPA. AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQs.

Qualified Business Income (QBI) is the net amount of qualified items of income, gain, deduction and loss from any qualified trade or business, including income from partnerships, S corporations, sole proprietorships, and certain trusts. Generally this includes, but is not limited to, the deductible part of self-employment tax, self-employed health insurance, and deductions for contributions to qualified retirement plans (e.g. SEP, SIMPLE and qualified plan deductions).

Special purpose framework is a financial reporting framework for use in those situations where GAAP may not be required. Examples include tax and modified cash bases. The former term, OCBOA, was replaced with this term under SAS No. 122 section 800, effective Dec. 15, 2012. Source: AICPA's Financial Reporting Framework for Small- and Medium-sized Entities FAQs. Substantial equivalency means that the education, CPA exam, and experience requirements contained in the statutes and administrative rules of another jurisdiction are comparable to, or exceed, the education, CPA Exam, and experience requirements contained in Chapter 44 of Title 54.1 of the Code of Virginia and the Board of Accountancy Regulations. (18VAC5-22).

Using the CPA title in Virginia means using "CPA," "Certified Public Accountant" or "public accountant" in any form or manner of verbal communication to persons or entities located in Virginia or in any form or manner of written communication to persons or entities located in Virginia, including but not limited to the use in any abbreviation, acronym, phrase, or title that appears in business cards, the CPA wall certificate, internet postings, letterhead, reports, signs, tax returns, or any other document or device.

### **COMMON RESOURCES**

[U.S. Comptroller General](http://gao.gov/cghome/index.html)  
[gao.gov/cghome/index.html](http://gao.gov/cghome/index.html)

Federal Deposit Insurance Corporation  
fdic.gov  
<https://www.fdic.gov/regulations/compliance/manual/8/VIII-1.1.pdf>

[Financial Accounting Foundation \(FAF\)](http://accountingfoundation.org)  
[accountingfoundation.org](http://accountingfoundation.org)

[Federal Accounting Standards Advisory Board \(FASAB\)](http://fasab.gov)  
[fasab.gov](http://fasab.gov)  
[\(2 02\) 512-7350](tel:(202)512-7350)

Financial Accounting Standards Board (FASB)

[fasb.org](http://fasb.org)

(203) 847- 070 0

Codification: [asc.fasb.org/](http://asc.fasb.org/)

U.S. Government Accountability Office (GAO)

[gao.gov](http://gao.gov)

(202) 512-3000

Government Accounting Standards Board (GASB)

[gasb.org](http://gasb.org)

(203) 847- 070 0

U.S. Internal Revenue Service (IRS)

[irs.gov](http://irs.gov)

(866) 255- 0654

Circular 230

[irs.gov/pub/irs-pdf/pcir230.pdf](http://irs.gov/pub/irs-pdf/pcir230.pdf)

Statement on Standards for Tax Services

[aicpa.org/interestareas/tax/resources/standardsethics/statementsonstandardsfortaxservices.html](http://aicpa.org/interestareas/tax/resources/standardsethics/statementsonstandardsfortaxservices.html)

IRS Publication 5293

[irs.gov/pub/irs-pdf/p5293.pdf](http://irs.gov/pub/irs-pdf/p5293.pdf)

IRS Publication 4557

[irs.gov/pub/irs-pdf/p4557.pdf](http://irs.gov/pub/irs-pdf/p4557.pdf)

International Accounting Standards Board (IASB)

[ifrs.org+44](http://ifrs.org+44)

(0)20 7246 6410

Public Company Accounting Oversight Board (PCAOB)

[pcaobus.org](http://pcaobus.org)

(202) 207-9100

Independence and Ethics Rules and Standards (including AICPA Code of Professional Conduct references): [tinyurl.com/PCAOBStandards](http://tinyurl.com/PCAOBStandards)

U.S. Securities and Exchange Commission (SEC)

[sec.gov](http://sec.gov)

(888) 732-6585

AICPA Technical Hotline

[aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx](http://aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx)

(877) 242-7212

[Link to Code of Virginia](#)



[Link to Regulations](#)

[Link to VBOA](#)

[Link to VBOA Policies](#)

[Link to Virginia Town Hall](#)

[Link to Providing Volunteer Services as a Virginia CPA](#)

[Link to AICPA](#)

[Link to Code of Professional Conduct](#)

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## **Appendix II**

### **Journal of Accountancy Article**

*Keep or toss? A guide to CPA firm record retention - June 1, 2020*

## Keep or toss? A guide to CPA firm record retention

By Jamie Yoo

June 1, 2020



Practitioners often find themselves with years, even decades, of records, and ask themselves, "Do I really need all of this?" If your file cabinet is ready for some overdue spring cleaning, consider the role of record retention before you purge.

### WHY IS RECORD RETENTION IMPORTANT?

"If it's not documented, it didn't happen." This phrase is often cited by peer reviewers and others to convey the importance of documenting procedures performed or judgment applied to support a CPA firm's deliverable.

Appropriate record retention can help:

- **Facilitate future engagements:** Workpapers may include the practitioner's understanding of client processes or tax carryover information, which can be helpful in the execution of future engagements for the same client.
- **Respond to requests from regulators, authorities, and inspectors:** Appropriate documentation facilitates the response to audits and inquiries from regulators, taxing authorities, or quality inspections such as peer review.
- **Defend against a professional liability claim:** The records of a CPA firm, or lack thereof, can be its best friend or worst enemy in the event of a professional liability claim. Engagement workpapers are often critical to the defense of professional liability claims, helping to support the scope of the engagement, services delivered, and work product issued by the firm.

### WHAT SHOULD I RETAIN?

CPAs, commonly known for being risk averse, may not want to dispose of their records. But at what point does retaining records to err on the side of caution turn into records hoarding? When determining which records should be kept or purged, consider retaining items that document or support the firm's:

- **Client/engagement evaluation process:** Such as signed engagement letters, client acceptance checklists, engagement acceptance approvals, and client disengagement letters.
- **Administrative records:** Such as fee and billing records, firm and individual licensing information, and CPE attendance records.
- **Engagement delivery:** Records retained by the practitioner should establish a clear and complete documentation trail of the service the practitioner was engaged to provide and be of sufficient detail to enable reperformance by a similarly experienced professional. Workpapers may include analyses performed, evidence

and explanation provided by the client, or correspondence that supports the practitioner's conclusions or findings.

- **Engagement closure:** Such as the firm's deliverables, including reports issued, management's representations, and assertions relied upon by the CPA, or work product transmittal letters.

The final version of documentation should be retained, rather than any superseded drafts.

## HOW LONG SHOULD I RETAIN DOCUMENTATION?

One of the most dreaded, but satisfying, parts of spring cleaning is discarding long-neglected household items. Unfortunately, determining an appropriate retention period is not as straightforward as checking the expiration date of food items to clear out a refrigerator. How long records should be retained depends on a variety of factors including, but not limited to:

- **Type of service:** The firm's areas of practice, and the professional standards that govern them, should be considered to identify any applicable record-retention requirements. For example, for tax, workpapers that support tax returns prepared should be retained as long as the returns may be audited by a taxing authority. It sounds simple, right? Not necessarily. The audit period can vary between taxing authorities, and other factors may extend the time period.
- **Statute of limitation and the discovery rule:** In the event of a professional liability claim, engagement records and workpapers provide essential evidence of the work performed for clients. This is an important factor to consider when establishing a retention period. The statute-of-limitation period restricts the amount of time within which a plaintiff needs to file a lawsuit. It generally starts to run on the date the negligent act occurred. The discovery rule, however, provides an exception stating that a statute-of-limitation period does not begin to run until the date on which the client discovers or reasonably should have discovered that they were damaged by the negligent act. Statute-of-limitation periods and the applicability of the discovery rule to professional liability claims can vary from state to state. Both can be difficult and complex to identify, interpret, and apply. Accordingly, a CPA firm should *always* consult with an attorney to understand the state laws that govern the firm and its engagement.
- **Regulatory or contractual requirements:** Practitioners whose clients are subject to governmental regulation or those that receive funding from government agencies may be subject to alternative retention periods. A client may request that the firm retain their records for a specified time period. In such cases, firms may be required to retain records for a stipulated period of time as provided by the agency or based on the applicable funding or engagement agreement.

Given the factors described above, a CPA firm may identify different retention periods for different clients and/or services. As a practical matter, it is recommended that CPA firms select the longest retention period and apply it consistently to all records to reduce the administrative complexities associated with maintaining records.

## WHAT SHOULD I DO WITH ELECTRONIC RECORDS?

Whether a record is paper-based or electronic, the firm's record-retention policy should be applied consistently. Electronic documents evidencing work performed should be saved in both client and engagement files rather than as attachments to emails. All relevant client service information should be maintained in the engagement workpapers and other official firm files or storage media.

Additional care should be applied to emails. If necessary to demonstrate procedures performed or conclusions reached, email correspondence with clients or peers should be retained as part of the client engagement files, not in a team member's email folder or on an email server.

Many a professional liability claim defense has been thwarted by an email in which the tone was taken out of context. As such, firms may exercise additional judgment by applying a separate retention period for emails to help guard against this risk. Consult the article "[Professional Liability Spotlight: How Social and Digital Media Can Be a #majorrisk](https://www.journalofaccountancy.com/issues/2016/mar/social-media-risks.html) (<https://www.journalofaccountancy.com/issues/2016/mar/social-media-risks.html>)," *JofA*, March 2016, which discusses the risks that CPAs may encounter with electronic communication and how using it appropriately can help to avoid potential liability exposure.

## **DISPOSE APPROPRIATELY AND RESPONSIBLY**

Disposing of records is not as simple as separating recyclables from other types of refuse. Just because the retention period has passed, it does not mean that the practitioner's duty to protect the confidentiality of client data has also expired. Proper disposal of records is key.

When it comes to destruction and sanitization of paper and electronic records and media, consult best practices defined in reputable sources such as the National Institute of Standards and Technology's Special Publication 800-88, *Guidelines for Media Sanitization*, or ISO 27001 A.8.3.2, *Disposal of Media*.

Many third-party service providers specialize in the collection and destruction of records based on regulatory or technological standards. However, using a vendor does not eliminate the practitioner's responsibility to maintain the confidentiality of client data. If an outside vendor is used, due diligence must be performed on the vendor's processes for keeping the data confidential. Consult the article "[Professional Liability Spotlight: Due Diligence With CPA Firm Subcontractors](https://www.journalofaccountancy.com/issues/2015/jun/subcontractor-due-diligence.html) (<https://www.journalofaccountancy.com/issues/2015/jun/subcontractor-due-diligence.html>)," *JofA*, June 2015, which discusses a firm's legal and professional responsibilities related to third parties.

## **CLOSING THOUGHTS**

It is understandable that a CPA may accumulate client information during the course of providing services. While practitioners are expected to and should retain copies of this information for their own purposes and requirements, clients have the primary responsibility to maintain their own records. To avoid becoming your client's filing cabinet, remind clients of their obligation to keep their own records, and let them know that the firm's workpapers are not a substitute for the client's records.

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