According to Rule 102 of the AICPA Code of Professional Conduct, “in the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.” Rule 102 thus prohibits a member from knowingly misrepresenting facts or subordinating judgment when performing professional services for a client and employer.

Interpretation 102-4, “Subordination of Judgment by a Member,” was revised (effective August 31, 2013) to provide additional guidance on the scope and application of Rule 102, with respect to extending the subordination of judgment provision. Interpretation 102-4 now includes guidelines for situations where differences of opinion exist between a CPA and a supervisor or other individual. (This is in addition to, and separate from, the independence requirements of Rule 101.)

Integrity is a fundamental character trait that enables a CPA to prevail in the face of a client or superior’s influence, which might otherwise lead to the subordination of individual judgment. A person of integrity will act out of moral principle and will reject act-

Maintaining Integrity and Objectivity

Avoiding Subordination of Judgment When Threats Exist

By Steven Mintz
ing for the sake of expediency. In some circumstances, refusing to suborn one’s judgment could result in the loss of a client, the loss of a promotion, or the loss of employment. But CPAs should always place the public interest (i.e., that of investors and creditors) ahead of their own self-interest or the interests of others, including superiors or clients. In accounting, “integrity” means that a person acts on principle—that is, a conviction that there is a right way to act when faced with an ethical dilemma—and upholds the public trust.

Threats to Integrity and Objectivity

A common challenge to integrity occurs when CPAs, whether working in public practice or performing internal accounting or auditing services, are pressured by a supervisor (internal accountant) or a client (external auditor) to concur with potentially materially misstated financial statements. Common explanations for such coercion include meeting financial analysts’ earnings expectations, meeting or exceeding budgeted amounts, or increasing earnings over a prior period. In some cases, bonuses and stock option values depend upon a higher level of earnings each reporting period. The rationalization that it is a “one-time request” is typically given to convince an accountant to go along with the fraud, but rarely does it actually work that way. Once a company starts to manipulate its earnings, it begins the slide down the proverbial ethical slippery slope, and often there is no turning back. A misstatement of earnings in one year creates pressure to maintain the illusion of higher earnings the next year, and so on, until the bubble bursts.

The WorldCom fraud represents a good example of financial fraud resulting from subordinating professional judgment to a superior in violation of the integrity rule. In that case, Betty Vinson was a midlevel internal accountant pressured by her superiors to record expenditures for annual costs to access telecommunications capacity from other providers as capital costs and to amortize them over a period of years, rather than expense them annually, which would have reduced earnings in full each year. In its investigation of Vinson, the SEC found that she and other WorldCom employees caused the company to materially overstate its earnings in violation of GAAP [Accounting and Auditing Enforcement Release (AAER) 1686, http://www.sec.gov/litigation/admin/33-8158.htm].

Integrity can also be compromised when providing nonattest services. For example, assume that a taxpayer fails to inform a tax preparer about an amount of earned income for the current year. The tax preparer confronts the client on this issue, based on the fact a similar item was included in taxable income in the previous year. The client tells the tax preparer not to record it this year because of the excessively high level of earned income and reminds the preparer there is no Form W-2 or Form 1099 evidencing the earnings. The taxpayer adds that the advisor will not get to audit the company’s books anymore if she does not give in to the client’s wishes. To avoid subordination of judgment, the tax preparer should not allow the client to dictate how the tax rules will be applied. A tax professional should never lose sight of the integrity standard or allow pressure to compromise objective judgment.

Clarification of Scope: Rule 102 and Interpretation 102-4

Prior to August 31, 2013, most people believed that Interpretation 102-4 applied only to internal accountants and auditors and did not provide specific guidance for external auditors in client-service situations. But the Interpretation has been broadened in scope to include external auditor-client disagreements, as well as differences of opinion within the external auditor CPA firm over proper accounting. In addition, the integrity and objectivity standard now includes considerations of self-interest, familiarity, and undue influence threats to compliance with Rule 102.

A violation of integrity and objectivity would occur when there is no internal disagreement (i.e., the external auditor CPA firm unanimously supports a client position because the CPA firm subordinated its collective judgment). Interpretation 102-4 provides express guidance to minimize or avoid subordination of judgment when differences exist on accounting matters that would be material information to users of the financial statements. Such differences of opinion could arise:

1. between subordinates and superiors in the company issuing financial statements,
2. within the external auditor CPA firm, or
3. between the company’s management and the external auditor. This rule applies to CPAs employed as accountants or internal auditors in industry as well as those serving in an external audit function at CPA firms.

This discussion will explain the rules under revised Interpretation 102-4 and explore the recommended safeguards to avoid or reduce to an acceptable level subordination of judgment in violation of the integrity rule. CPAs should be aware of these changes because they require new considerations that go beyond previous guidance.

Confidentiality Considerations

When contentious differences of opinion with management occur and management refuses to make the required adjustments, the CPA should consider whether safeguards exist, similar to the original Interpretation 102-4, in order to ensure that threats to compliance with Rule 102 are eliminated or reduced to an acceptable level. In doing so, a CPA should determine whether internal reporting requirements exist to report differences of opinion (i.e., the audit committee) and any responsibilities that might exist to communicate with third parties, such as regulatory authorities or the employer’s (former employer’s) external accountant. These are important steps because of the implications of such actions for any possible violation of the confidentiality rule (Rule 301) of the AICPA Code of Professional Conduct. CPAs should seek legal advice with regard to this matter.

If a CPA concludes that safeguards cannot eliminate or reduce the threats to integrity and objectivity to an acceptable level, or if other appropriate action has not been taken, then the CPA should consider whether the relationship should be terminated, including possible resignation. These steps are necessary to eliminate exposure to subordination.

CPAs’ Obligations to Third Parties

Nothing in Interpretation 102-4 precludes an individual from resigning from a CPA firm or other employer; however, resignation does not negate a CPA’s disclosure responsibilities to third parties. Although Rule 301 states that “a member in public practice shall not disclose any confidential client information without the specific consent of the client,” it also provides that the
confidentiality requirement should not be construed to prohibit a member’s “compliance with applicable laws and government regulations.” Application of the exception to Rule 301’s disclosure prohibition provisions is appropriate when, for example, an auditor reports an illegal act, such as fraudulent financial statements, to client management and management takes no action. The auditor should then report the matter to the board of directors; if the board fails to inform the SEC within the prescribed time period (one day from notification), the auditor must report its conclusions directly to the SEC as required by section 10A of the Securities Exchange Act of 1934.

Responsibilities under the Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 describes conditions pursuant to which CPAs employed by an independent auditor of a public company can make a whistleblower submission, alleging that 1) the auditor/audit firm failed to assess, investigate, or report wrongdoing in accordance with section 10A of the Securities Exchange Act of 1934, or 2) the auditor failed to comply with other professional standards. Although the provisions of the Dodd-Frank Act are beyond the scope of this article, it is worth men-

EXHIBIT 1
CPAs’ Ethical Responsibilities to Avoid Subordination of Judgment

<table>
<thead>
<tr>
<th>Does the supervisor’s opinion at the reporting entity or external audit firm fail to comply with professional standards, create a material misrepresentation of fact, or violate applicable laws or regulations?</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
</tr>
<tr>
<td>No action required</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>Discuss concerns with supervisor about the significant threats to integrity and objectivity</td>
</tr>
<tr>
<td>No Adjustment</td>
</tr>
<tr>
<td>Bring concerns to higher levels of management of reporting entity (i.e., senior management/board of directors) or audit firm</td>
</tr>
<tr>
<td>Still No Adjustment</td>
</tr>
<tr>
<td>Consider the following safeguards to ensure that threats to compliance with Rule 102 are eliminated or reduced to an acceptable level:</td>
</tr>
<tr>
<td>Determine whether internal reporting requirements exist to report differences of opinion</td>
</tr>
<tr>
<td>Determine whether any responsibilities exist to communicate with third parties (i.e., regulatory authorities, employer’s or former employer’s external accountant)</td>
</tr>
<tr>
<td>Seek legal advice</td>
</tr>
<tr>
<td>Document understanding of the facts, accounting principles, auditing standards, and applicable laws and regulations</td>
</tr>
<tr>
<td>No safeguards exist to eliminate or reduce the threats to an acceptable level or appropriate action was not taken</td>
</tr>
<tr>
<td>Consider continuing relationship with organization</td>
</tr>
<tr>
<td>Take appropriate steps to eliminate exposure to subordination of judgment</td>
</tr>
<tr>
<td>Consider resigning position (this may not negate disclosure responsibilities to regulatory authorities or external accountant)</td>
</tr>
</tbody>
</table>

Note: Exhibit 1 was developed by the author from revised Interpretation 102-4.
tioning that action taken under the act by an employee of an external audit CPA firm would fall within the exception to the confidentiality provisions of Rule 301, permitting disclosures when required by applicable laws and government regulations.

**Expanded Requirements under Revised Interpretation 102-4**

**Applicability to external auditors.** Revised Interpretation 102-4 now applies to external CPA auditors, as well as internal CPA accountants and auditors, when differences of opinion exist between external auditors and senior client management or between subordinate internal accountants or auditors and senior management on material accounting issues. The revision recognizes that such differences, previously restricted to internal client matters, might lead to pressures imposed by accounting firm superiors on an engagement team member because firm management is unwilling to reexamine its own conclusions regarding an accounting position that would result in a materially different result.

The following are other provisions of Interpretation 102-4 that expand the requirements to external auditor–CPA firm differences. (Most were applicable to internal accountants and auditors prior to the revision of Interpretation 102-4.)

- Requirement to document understanding of the facts, accounting principles, auditing or other professional standards, applicable laws and regulations, and discussions with relevant parties on differences of opinion
- Inclusion of auditing standards and other relevant professional standards applicable to tax and consulting services and applicable laws or regulations, in addition to consideration of differences on accounting and financial reporting matters
- Consideration of threats to integrity and objectivity, including those resulting from self-interest, familiarity, and undue influence
- Application of appropriate safeguards to avoid subordination of judgment when a CPA concludes that the difference of opinion creates significant threats to integrity and objectivity
- Assessment of the significance of identified threats that occur as a result of a position taken by a supervisor or other member of management (whether at the client company or external auditor) with respect to applicable standards, laws, or regulations
- Evaluation of whether such a position results in a material misrepresentation of fact or violation of applicable laws and regulations; if so, the internal accountant or staff external auditor should seek to resolve the significant threat by discussing concerns with a supervisor or relevant member of management or with those charged with governance
- Documentation of the CPA’s conclusion on whether appropriate action was taken to resolve the concern and, if not, whether consideration of safeguards was given to ensure that threats to integrity and objectivity are eliminated or reduced to an acceptable level
- Determination of any additional steps required under the internal policies and procedures of the client company or the external auditor to report differences of opinion
- Determination of reporting responsibilities to third parties, if applicable, and whether any communication of confidentiality to the internal accountant/auditor or external accountant is required
- Determination of whether conduct, absent express communications, constitutes acts discreditable to the profession or “unprofessional conduct” (see, for example, section 29.10 of the New York State Board of Regents’ rules)
- Consider whether to continue the relationship with the organization
- Take appropriate steps to eliminate exposure to subordination of judgment
- Consider resigning position; this may not negate disclosure responsibilities to regulatory authorities or the external accountant.

**Applicability to nonattest services.** The differences of opinion identified in Interpretation 102-4 go beyond accounting and auditing services and include tax and consulting services. As previously mentioned, when there is a difference of opinion between a tax advisor and a client (notwithstanding the realistic possibility of success standard in Interpretation 1-1 of the Statements on Standards for Tax Services), a CPA should consider whether threats to integrity and objectivity might exist because of undue influence by a client who threatens to replace the audit firm unless the firm reports the tax item as desired.

A consulting engagement involves the following steps.

**Identify and evaluate threats to integrity and objectivity.** When threats are identified, the first step should be to evaluate whether the threats would materially compromise the CPA’s professional judgment if they were not addressed. If the threat is at an acceptable level, then consideration of safeguards by the CPA staff is not necessary. Safeguards are considered to be at an acceptable level if it is not reasonable to expect that the threats would compromise professional judgment; if threats might compromise professional judgment, safeguards should be implemented.

**Determine whether safeguards already eliminate or sufficiently mitigate identified threats.** If sufficient safeguards exist to mitigate the potential effects of threats to integrity and objectivity, then these threats are not considered a potential influ-

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**Exhibit 1**

The conceptual framework for AICPA independence standards provides a risk-based approach to considerations of whether independence has been impaired (ET section 100-1). Interpretation 102-4 follows the same approach to evaluate threats and safeguards related to integrity and objectivity; therefore, the basics of the approach are important to ensure the accountant or auditor does not subordinate judgment. Exhibit 1 depicts the decision-making process under revised Interpretation 102-4 in order to assist CPAs in understanding and applying the complexities of the guidance. The approach involves the following steps.

**Identify and evaluate threats to integrity and objectivity.**
ence on the ability of a CPA to act with integrity and objectivity, even in situations when legitimate differences of professional judgment and interpretation exist on an accounting, auditing, or other matter of professional standards.

**Determine whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards.** Threats that exist and are not mitigated by existing procedures require additional safeguards to deal with the possible impairment of integrity and objectivity. Such safeguards are not enumerated in the AICPA’s conceptual framework or Interpretation 102-4, but could include an anonymous hotline to report differences of opinion that might be resolved internally. These threats have been sufficiently mitigated if, after application of the safeguards, it is reasonable to expect that they would not compromise professional judgment. If no safeguards are available or if appropriate safeguards cannot be applied to eliminate an unacceptable threat or reduce it to an acceptable level, integrity and objectivity would be impaired.

### EXHIBIT 2
**Examples of Threats to Integrity and Objectivity**

<table>
<thead>
<tr>
<th>Threat</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-Interest Threat</td>
<td>The CPA or CPA firm might be influenced by a business relationship that exists with the client that creates a mutuality of interests.</td>
</tr>
<tr>
<td>Familiarity Threat</td>
<td>The CPA or CPA firm might be influenced by a close personal relationship with the client—for example, if a member of the engagement team has an immediate family member who serves in a financial reporting role with the client entity.</td>
</tr>
<tr>
<td>Undue Influence Threat</td>
<td>The CPA is coerced by the client or senior management of the CPA firm to accept the client’s position on an accounting, auditing, or regulatory matter.</td>
</tr>
</tbody>
</table>

### EXHIBIT 3
**Examples of Safeguards That Eliminate or Reduce Threats to an Acceptable Level**

**Created by the profession/legislation/regulation**
External review of a CPA firm’s quality control system.

**Implemented by the attest client**
A governance structure (i.e., audit committee) to ensure appropriate decision making, oversight, and communications regarding a CPA firm’s services.

**Implemented by the firm**
Documented independence policies regarding the identification of threats, evaluation of their significance, and identification and application of safeguards to eliminate the threats or reduce them to an acceptable level.

### Self-Interest, Familiarity, and Undue Influence Threats

Under Interpretation 102-4, if differences of opinion on accounting, auditing, or regulatory matters exist between a CPA and a supervisor, member of top management at the reporting organization, or member of senior management at the CPA firm, the CPA should consider whether threats exist that might compromise integrity and objectivity. Although threats can materialize in many forms, those recognized in Interpretation 102-4 are generally characterized as self-interest, familiarity, and undue influence.

**Relationship of threats to integrity and objectivity to independence.** Threats to independence are recognized in the conceptual framework for AICPA independence standards (ET section 100-1). The framework uses a risk-based approach to assess whether a relationship between the CPA and client management imposes an unacceptable risk to independence in violation of Rule 101. The framework also helps to evaluate whether differences of opinion that relate to the application of accounting principles, auditing standards, or other relevant professional standards (including standards applicable to tax and consulting services or applicable laws or regulations) create a threat to the CPA’s compliance with Rule 102. Interpretation 102-4 extends the notion of threats to independence to integrity and objectivity. This makes sense, because if integrity and objectivity are impaired, it is virtually impossible to be independent—at least in appearance, if not substance.

Similar to the independence standard, the assessment of whether integrity and objectivity are impaired depends upon the nature of the threat; whether it would be reasonable to expect that the threat would compromise the CPA’s professional judgment; and, if so, whether the specific safeguards applied and their effectiveness reduce or eliminate the threat.

The threats to integrity and objectivity have one common element: the attempt by a superior to influence the professional judgment of subordinates. For example, if a difference of opinion exists between a CPA (controller) and her supervisor (CFO), then it is possible that the CFO will threaten to withhold the bonus allocated for the controller unless she defers to the CFO’s
designed to meet its objectives. Interpretation 102-4 would characterize this threat as a self-interest threat. The CFO might go further and try to coerce the controller into compromising her integrity by threatening to fire her if she refuses to defer to his proposed accounting—an undue influence threat to integrity and objectivity.

Examples of threats to integrity and objectivity. Exhibit 2 characterizes differing hypothetical examples of threats to integrity and objectivity that can result from differences of opinion between a subordinate CPA and a superior. The examples, derived from ET section 100-1, could apply to internal accountants and auditors, as well as to external auditors.

Safeguards to Protect against Subordination of Judgment

The AICPA’s conceptual framework identifies safeguards that might help mitigate threats to independence. Because such threats can compromise independence, it makes sense for CPAs to consider some of the same safeguards that exist when there is a difference of opinion on an accounting matter and when threats exist to integrity and objectivity.

According to the conceptual framework in ET section 100-1, safeguards are controls that eliminate or reduce threats to independence. To be effective, safeguards should eliminate the threatening behavior or reduce the threat’s potential to impair independence and, by extension, integrity and objectivity, to an acceptable level. The conceptual framework indicates that a variety of factors should be considered when assessing the effectiveness of safeguards. While Interpretation 102-4 does not expressly extend the independence safeguards to integrity and objectivity threats, the application of the safeguards to issues of integrity and objectivity enable a CPA or CPA firm to consider whether a safeguard sufficiently reduces or eliminates the potential for the threat to lead to a subordination of judgment.

According to the conceptual framework, the effectiveness of a safeguard depends upon many factors, including the following:

- The facts and circumstances specific to a particular situation
- The proper identification of threats
- Whether the safeguard is suitably designed to meet its objectives
- The parties that will be subject to the safeguard
- How the safeguard is applied
- The consistency with which the safeguard is applied
- Who applies the safeguard (i.e., by professional standard, legislation, or regulation; by the attest client; or by the CPA firm).

The appropriateness of safeguards identified in ET section 100-1 depends upon the facts and circumstances. Safeguards are implemented by three sources: 1) the profession, legislation, or regulation; 2) the attest client; and 3) the CPA firm, all of which provide policies and procedures to implement professional and regulatory requirements. Exhibit 3 provides an example of a safeguard in each category.

The safeguards most appropriate when evaluating threats to independence are those instituted by the company itself and the ones adopted by the CPA firm. ET section 100-1 builds on AICPA Statement on Quality Control Standards (SQCS) 8, A Firm’s System of Quality Control, which addresses engagement quality control review criteria and that is identified as a safeguard. SQCS 8 requires a procedure to resolve differences within the engagement team; with those consulted; and, when applicable, between the engagement partner and the engagement quality reviewer. The procedures should enable a CPA to document disagreements, conclusions reached and their implementation, and the release of the audit report only after the matter has been resolved. The safeguards that can be implemented by the firm, as identified in ET section 101-1, include policies and procedures designed to implement and monitor quality control in an attest engagement and the designation of someone from senior management to oversee adequate functioning of the firm’s quality control system.

The effectiveness of a safeguard depends upon the internal controls and corporate governance system in place. When differences exist between a controller and CFO, internal controls should provide a mechanism to deal with such situations—for example, taking the matter to the audit committee. When the difference is between an individual CPA and firm management (i.e., partner in charge of the engagement), quality controls should be in place to handle the matter, such as by taking it to a reviewing partner.

A Threats and Safeguards Approach

The AICPA’s Professional Ethics Executive Committee (PEEC) revised the AICPA Code of Professional Conduct in March 2013, effective for attest engagements covering periods beginning on December 15, 2014. The revised code uses a “threats and safeguards” approach—the conceptual framework approach discussed above.

The revised code sections also are separated into two conceptual frameworks—one for members in public practice and one for members in industry. The conceptual framework approach included in these two frameworks is a way of identifying, evaluating, and addressing threats to compliance with the rules that result from a specific relationship or circumstance that is not otherwise addressed in the code.

The threats and safeguards approach helps to identify, evaluate, and address threats to compliance, with ethics rules that result from specific relationships between CPAs and their superiors, whether in public practice or industry. This approach can serve as a foundation for making ethical decisions, when possible threats to independence and integrity and objectivity exist, in cases where there are differences of opinion on an accounting or financial reporting matter.

Upholding Ethics

Integrity and objectivity go hand in hand. CPAs lose their objectivity when they allow threats imposed by a superior or influence them to go along with accounting and financial reporting treatments that do not conform to GAAP. Integrity and objectivity represent the backbones of CPAs’ ethical value systems and enable them to withstand the pressure to acquiesce against their better judgment. Interpretation 102-4 now provides the guidance necessary to help CPAs identify threats to integrity and objectivity, as well as to apply safeguards to eliminate or reduce such threats to acceptable levels.

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