



Practice aid

# Conceptual framework toolkit for members in business

June 2022

Member enrichment

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# Introduction

At times, you may find yourself in a situation that is not directly addressed by a rule or interpretation in the AICPA® Code of Professional Conduct (code).

This is when you'll want to apply the "Conceptual Framework for Members in Business" (framework) (ET sec. 2.000.010).

The framework incorporates a "threats and safeguards" approach, which will assist you in analyzing relationships and circumstances that the AICPA code does not specifically address and in determining whether such relationships or circumstances may result in the violation of any of the rules in the AICPA code.

The toolkit includes the following to help you implement the conceptual framework approach:

- Steps of the conceptual framework to provide detailed guidance on what to do when applying the conceptual framework approach
- A flowchart that serves as a visual aid for breaking down the steps of the conceptual framework approach
- Examples of relationships or circumstances that are not addressed in the AICPA code and how the conceptual framework may be applied in such situations
- A worksheet to help apply the steps of the conceptual framework along with an example for using it

# Steps of the conceptual framework

The conceptual framework approach requires that you take these steps:

- (a) Identify threats that could compromise your compliance with the rules in the AICPA Code of Professional Conduct (code) or be perceived by a reasonable and informed third party who is aware of the relevant information as compromising your compliance with the rules.
- (b) Evaluate the significance of the identified threats.
- (c) Identify and apply appropriate safeguards, when necessary.
- (d) Evaluate whether such safeguards have been effective to eliminate or reduce significant threats to an acceptable level.

## Professional judgment

You must apply professional judgment to make informed decisions about the courses of action available, and to determine whether such decisions are appropriate under the circumstances.

Professional judgment is the application of your training, skill, and experience to the facts and circumstances.

Consider whether your professional training, skill and experience are sufficient to reach an appropriate conclusion or if consultation is necessary.

It's important to evaluate threats and safeguards with an inquiring mind. This means considering the source, relevance and adequacy of the information being used along with the nature, scope and results of the professional service you are providing.

Examples include the emergence of new information, inconsistencies in the information you have, a new client subsidiary or a new user of the financial statements.

Be open to a need for further investigation or action and be aware of the effects of conscious or unconscious bias that could affect your professional judgment.

Here are some examples of bias that can affect you when identifying, evaluating and addressing threats:

- **Anchoring bias** — Using an initial piece of information as an anchor against which subsequent information is inadequately assessed
- **Automation bias** — Favoring output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose
- **Availability bias** — Placing more weight on events or experiences that immediately come to mind or are readily available than on those that are not
- **Confirmation bias** — Placing more weight on information that corroborates an existing belief than on information that contradicts or casts doubt on that belief
- **Groupthink** — The tendency for a group of people to discourage individual creativity and responsibility and as a result reach a decision without critical reasoning or consideration of alternatives
- **Overconfidence bias** — The tendency to overestimate one's ability to make accurate assessments of risk or other judgments or decisions
- **Representation bias** — The tendency to base an understanding on a pattern of experiences, events, or beliefs that is assumed to be representative
- **Selective perception** — The tendency for a person's expectations to influence how the person views a particular matter or person

Seeking advice from experts, consulting with others to obtain additional input, and training on how to identify bias may help mitigate the effects of bias.

With this approach, if you can't apply appropriate safeguards to eliminate the threats or reduce them to an acceptable level, you should (if possible) change the circumstance or relationship so that the threats are at an acceptable level or decline or discontinue the professional engagement.

The following sections provide detailed guidance on steps you should take when applying the conceptual framework approach.

### Step 1 – Identify threats.

Threats are relationships or circumstances that could compromise your compliance with the rules. The code's rules and interpretations address many situations; however, they cannot address all relationships or circumstances that may arise.

Paragraphs .09–.14 of the framework identify the following threats: *adverse interest*, *advocacy*, *familiarity*, *self-interest*, *self-review* and *undue influence*.

When no specific guidance exists, the code requires you to evaluate that situation from the perspective of a reasonable and informed third party using the conceptual framework approach.

You should use professional judgment when evaluating a situation for potential threats. In addition, be alert to whether

- the information being used might be influenced by bias or self-interest.
- there might be other conclusions that could be reached from the information obtained.
- there have been changes in facts and circumstances, especially for continuing engagements.

Members in public practice need to be aware of the following rules in the code:

- [Integrity and Objectivity Rule](#)

- [General Standards Rule](#)
- [Compliance With Standards Rule](#)
- [Accounting Principles Rule](#)
- [Acts Discreditable Rule](#)



When evaluating the significance of a threat, you should determine whether the threat is at an acceptable level.

### Step 2 – Evaluate the significance of a threat.

If you have identified a threat, you'll need to evaluate its significance.

Because threats can have a cumulative effect on your compliance with the rules, you should evaluate identified threats both individually and in the aggregate

When evaluating the significance of a threat, determine whether the threat is at an acceptable level; that is, would a reasonable and informed third party who is aware of the relationship or circumstance conclude that the threat identified would not compromise your compliance with the rules?

In addition, consider both qualitative and quantitative factors, including whether any existing safeguards are in place that already reduce the threat to an acceptable level.

If, after evaluating the significance of the threat, you conclude that the threat is at an acceptable level, you aren't required to evaluate the threat any further and you may proceed with the professional service.

However, if you conclude that the threat is not at an acceptable level, proceed to step 3, "Identify and Apply Safeguards."

### Step 3 – Identify and apply safeguards.

If you have concluded that the threat is not at an acceptable level, you'll need to identify safeguards that may be applied to eliminate the threat or reduce it to an acceptable level.

You may identify safeguards that already exist, or you may need to identify new safeguards. You may need to apply only one safeguard to eliminate or reduce multiple threats.

In other cases, you may need to apply multiple safeguards to eliminate or reduce one threat to an acceptable level.

Safeguards may be created by the profession, legislation or regulation, or may be implemented by the employing organization. Examples of various safeguards within each category are presented in *paragraphs .19–.20* of the framework.

After you identify and apply the safeguards, proceed to step 4, "Evaluate the effectiveness of safeguards," and use your professional judgment to evaluate whether the safeguards will be effective in eliminating the threat or reducing it to an acceptable level.

### Step 4 – Evaluate the effectiveness of safeguards.

If you conclude that threats are at an acceptable level after applying the identified safeguards, proceed with the professional service.

Sometimes, no safeguards can eliminate the threat or reduce it to an acceptable level. It is also possible that there may be effective safeguards you are unable to implement.

At such times, you'll need to change or eliminate the circumstance or relationship creating the threat, or decline or discontinue the professional services or resign from the employing organization.

If you provide services under such circumstances, you will compromise your compliance with the rules. Refer to *paragraph .17* of the framework for examples of some factors that may aid in determining the effectiveness of a safeguard.

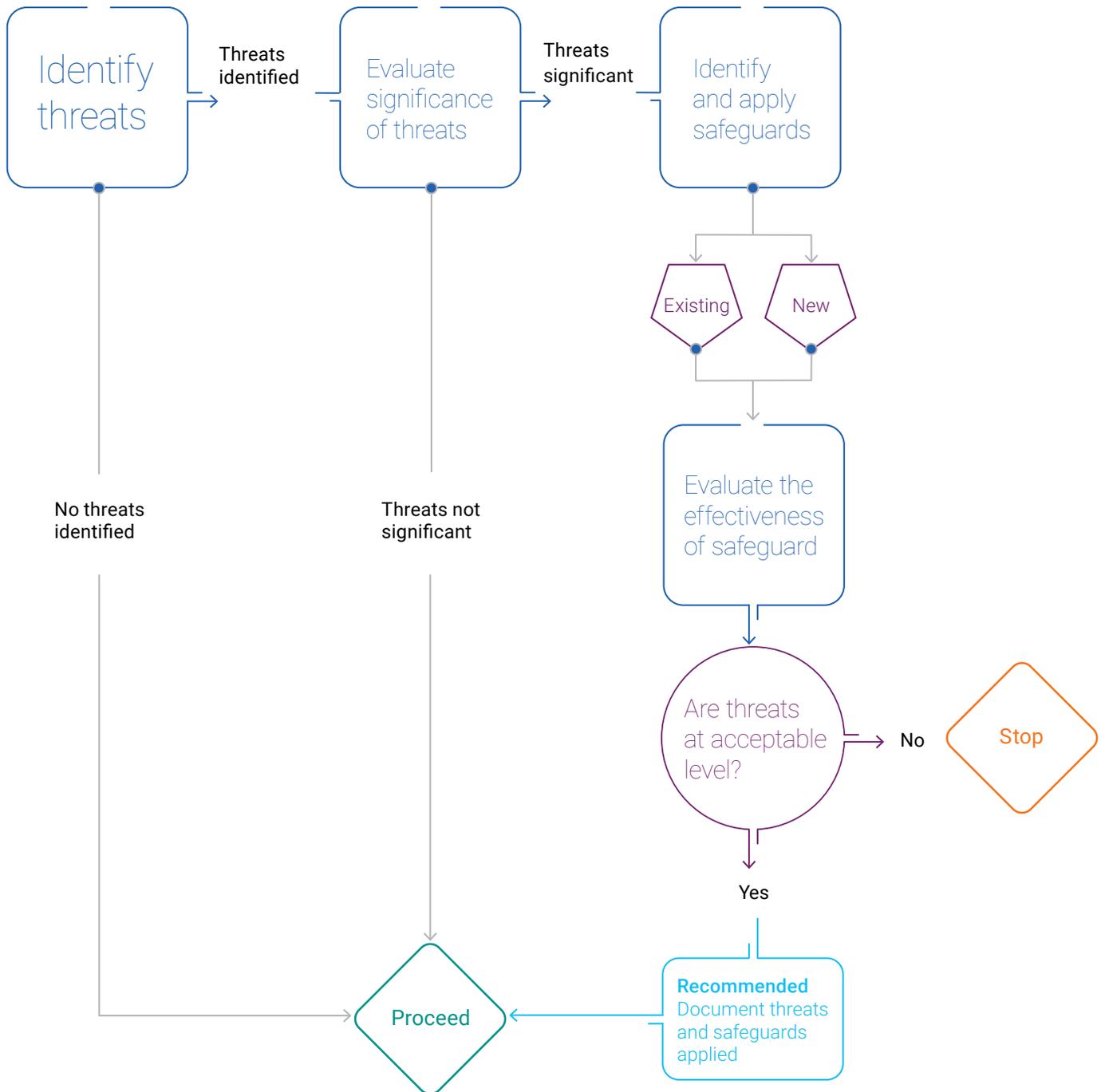
If you become aware of new information or changes in facts and circumstances that might affect whether a threat has been eliminated or reduced to an acceptable level, reevaluate and address that threat accordingly.

### Step 5 – Document threats and safeguards (recommended).

When you apply safeguards to eliminate or reduce significant threats to an acceptable level, documenting your analysis and conclusion is a best practice.

# Conceptual framework flowchart

Figure 1: This flowchart illustrates the steps of the conceptual framework



# Conceptual framework examples

The following are examples of situations you may encounter that the AICPA code does not address. These threats and safeguards are not authoritative positions; rather, they demonstrate the use of the conceptual framework approach for members in business.

Use professional judgment in determining whether threats are significant and, if so, determining whether safeguards will effectively reduce those threats to an acceptable level or eliminate them.

If you're also working in public practice, see the "[Conceptual Framework Toolkit for Members in Public Practice](#)" and the "[Conceptual Framework Toolkit for Independence](#)."

## Potential lack of competence

You are the CFO of a closely held company. The owner's nephew just graduated with an accounting degree and has no prior experience working in an accounting role. The owner is pressuring you to hire his nephew as the controller.

You decide to consider the matter under the conceptual framework to determine what threats may exist if you hire the nephew. You review the description of the threats that are in the conceptual framework (paragraphs .09–.14) and believe the description of an *undue influence* threat is on point and is, in fact, example d:

*A member is pressured to hire an unqualified individual.*

Because the description of the threat explains that it is the threat that "a member will subordinate his or her judgment to that of an individual associated with the employing organization ..." you review the "[Subordination of Judgment](#)" interpretation (ET sec. 2.130.020).

However, you note that this interpretation applies only when there is a difference of opinion that relates 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.

After further review of the conceptual framework, you identify the following possible threat and safeguard to evaluate.

**Identified threat** — The undue influence threat to compliance with the "[General Standards Rule](#)" (ET sec. 2.300.001) is present.

Specifically, you believe the nephew does not have the appropriate level of competence to function as a controller. If you concede to the pressure and hire the nephew to keep the owner of the company satisfied, you will have violated the code.

**Possible safeguards** — If you conclude that the threats to compliance with the rules are significant, you may consider putting controls in place that will allow you to train the nephew and closely supervise his work.



If the situation is modified and the owner appointed the nephew to the board instead of hiring him as controller, the "[Subordination of Judgment](#)" interpretation could be applicable if you later determine that the nephew was promoting a position that results in a material misrepresentation of fact or a violation of applicable laws or regulations.

## Investment in employing organization

You graduate from college and secure an entry-level accounting position with a company. Your mother is so excited and proud that she tells you she purchased a small amount of stock in the company.

You recall your accounting professor stressing that auditors should steer clear of investing in their clients and that even members in business could threaten their compliance with the code under certain circumstances. You take a look at the code to refresh your memory.

After assessing the threat, though, you believe there could be an appearance of the *self-interest* threat. You do not believe it to be significant because the investment is immaterial to your mother and, because your mother's investment results in insignificant ownership, she cannot influence management.

You conclude that no safeguards need to be applied. If your mother makes further investments causing the investment to become material to her, you should reassess.

## Lucrative bonus program

You are a manager in the finance department of a private company owned by investors. The investors control the board of directors. A lucrative but complicated stock option program is in place for upper management who are not owners. Though the company is profitable, the program stipulates that certain thresholds must be met before upper management can earn stock options. One requirement is that actual sales must exceed the company's projected sales.

You are responsible for developing the sales projections that an independent third party uses to value the company's stock options. As a control, the individual who develops these projections is not eligible to participate in the stock option program and must provide a copy of the projections to the nonowner members of the board.

You believe that the company will enter into between 10 and 20 major sales contracts in the upcoming year. You decide to include only 10 major sales contracts in your projection to maximize the potential for upper management's stock option earnings. This will result in increased compensation to your direct superior.

While preparing the projections, you attend a CPE course that discusses the conceptual framework. You are surprised to learn that the framework applies to you as a member in business. The course also reminds you that when carrying out responsibilities as a professional, the "Responsibilities Principle" (ET sec. 0.300.020) calls for exercising sensitive professional and moral judgments in all activities.

During a break, you review the description of the threats in the conceptual framework (paragraphs .09–.14) and it occurs to you that the sales projections you are preparing might be a situation that you should analyze with the conceptual framework. You identify the following possible threats and safeguard to evaluate.

**Identified threats** – You could be viewed as promoting the employing organization upper management's interests or position to the point that your objectivity is compromised and you might benefit by receiving a bonus or raise from your direct superior. This indicates that the *advocacy* and *self-interest* threats to compliance with the "Integrity and Objectivity Rule" are present.

**Possible safeguard** – If you conclude that the threats to compliance with the rules are significant, one safeguard you might consider is providing the board and third party with a full report detailing how the projections submitted were calculated, including information such as the projection methodology and assumptions, the ranges you considered, the probability of each, and why you selected the low end of the range.

# Conceptual framework worksheet

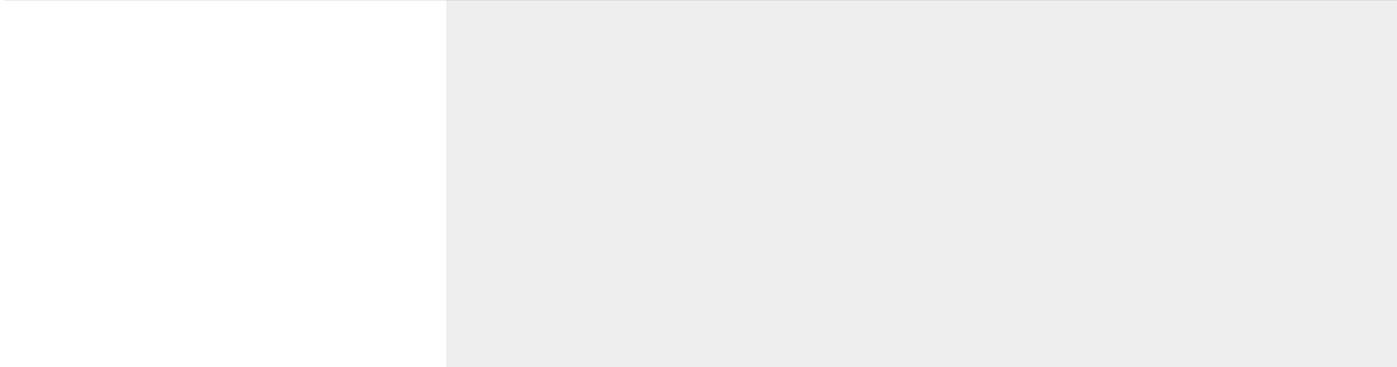
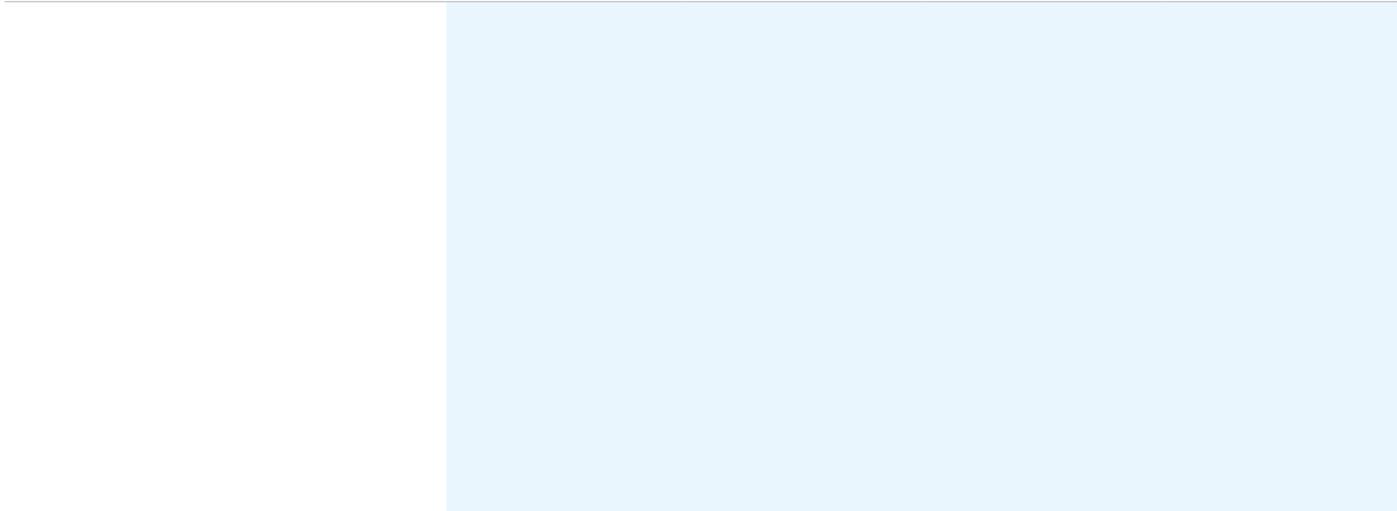
When you identify a relationship or circumstance that may create threats to your compliance with the rules, you may wish to use the conceptual framework worksheet to fulfill your compliance obligation under the AICPA code. You can add additional relationships or circumstances to the worksheet as you identify them. Use the tab key to navigate through the fields.

(Instructions for completing this worksheet are on page 12 of this toolkit.)



**Table 1: Conceptual framework worksheet**

| <p><b>Summary of the relationship or circumstances</b></p>   | <p><b>Step 1<br/>Identify threats.</b></p>   | <p><b>Step 2<br/>Evaluate the significance of threats.</b></p>         | <p><b>Step 3<br/>Identify and apply safeguards.</b></p>  | <p><b>Step 4<br/>Evaluate the effectiveness of safeguards.</b></p>   |
|--|--|--|--|--|
| <p>Provide a description of the relationship or circumstance that may create threats to compliance with the rules.</p> | <p>Describe the threat (<b>adverse interest, advocacy, familiarity, self-interest, self-review and undue influence</b>) associated with this relationship or circumstance.</p> | <p>Describe why the identified threats are or are not significant.</p> | <p>Describe the safeguards identified that will be applied to eliminate threats or reduce them to an acceptable level.</p> | <p>Describe whether the safeguards applied would or would not eliminate threats or reduce them to an acceptable level. If you conclude that threats are not at an acceptable level, then document whether you can change or eliminate the circumstance or relationship creating the threat or will decline or discontinue the professional services or resign from the employing organization.</p> |



# Conceptual framework worksheet example

## The worksheet example below is based on the following situation

Kathleen graduated 10 years ago with a business degree and is employed at a large international company.

Though she enjoys her position in the risk management department, she is fascinated with the vast knowledge the staff of the internal audit department has about the inner workings of the company. So, for the past three years, she attended night school and spent her weekends doing classwork. She earned her master's in accounting three months ago and passed her last section of the CPA Exam last month.

During lunch, she hears that a staff auditor from the internal audit department is leaving. She contacts the director of that department and he tells her that the position will be posted shortly. Kathleen applies and is hired.

The company lost three lawsuits recently and though this outcome was expected, the reserves booked were not adequate. When working in the risk management department, Kathleen provided the accounting department with estimates regarding the potential losses for these lawsuits. Because of her background with the company's risk management function, the director of internal audit assigns her to the team that will audit the accounting department's methodology for calculating reserves as well as auditing whether there was any deviation from that methodology in connection with the inadequate reserves that were booked.

Although Kathleen understands the reasoning for her assignment (she worked closely with the accounting department in calculating the reserves), she decides to review the AICPA code for guidance on how to deal with this conflict. Kathleen did not find any guidance that specifically described this situation. However, she decides to consult the conceptual framework and emails the director the following analysis for his input.

**Table 2: Conceptual framework worksheet example**

| Summary of the relationship or circumstances   | Step 1<br>Identify threats.  | Step 2<br>Evaluate the significance of threats.  | Step 3<br>Identify and apply safeguards.  | Step 4<br>Evaluate the effectiveness of safeguards.   |
|--|--|--|---|---|
| Provide a description of the relationship or circumstance that may create threats to compliance with the rules.  | Describe the threat ( <i>adverse interest, advocacy, familiarity, self-interest, self-review and undue influence</i> ) associated with this relationship or circumstance.  | Describe why the identified threats are or are not significant.  | Describe the safeguards identified that will be applied to eliminate threats or reduce them to an acceptable level.   | Describe whether the safeguards applied would or would not eliminate threats or reduce them to an acceptable level. If you conclude that threats are not at an acceptable level, then document whether you can change or eliminate the circumstance or relationship creating the threat or will decline or discontinue the professional services or resign from the employing organization. |
| I prepared information used by the accounting department in connection with its reserve calculation for pending lawsuits. I have now been assigned to the team that will audit the adequacy of the methodology used by the accounting department and to audit whether there were any deviations from that methodology for the three inadequate reserves. | The self-review threat is present.<br><br>The <i>familiarity</i> threat is present.  | The threat may be significant because of my prior involvement with the reserve calculations.<br><br>The threat is significant because I could be too sympathetic to my employer’s interests or too accepting of the accounting and risk management department’s work or product. | I will have another member of the internal audit team review the testing to determine whether there was any deviation from the methodology for the three reserves that were deemed inadequate.<br><br>I will disclose in the internal audit report my past involvement with the reserve calculations. | Requiring another member of the internal audit team to review the testing to determine whether there was any deviation from the methodology for the three services that were deemed inadequate combined with disclosure of my prior involvement with the reserve calculation will enable me to maintain the appropriate level of integrity and objectivity.                                 |
| Conclusion   | I have evaluated the identified threats and the safeguards applied to eliminate threats or reduce any significant threats to an acceptable level as documented in this worksheet. Based on my evaluation, I have concluded that, by implementing these safeguards, threats to compliance with the “Integrity and Objectivity Rule” are at an acceptable level. |  |   |   |

# Instructions for completing the conceptual framework worksheet

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|                |  |
|----------------|--|
| <b>Field A</b> | In this field, type in a summary of the relationship or circumstance that you believe may create a threat to complying with the rules. Press the tab key to move to field B.   |
| <b>Field B</b> | In this field, identify the threats that you believe exist and describe why you believe they exist. Press the tab key to move to field C.  |
| <b>Field C</b> | In this field, describe why you believe the threats you have identified in field B are or are not significant. If you believe the threats are not significant, then you can stop here. If you believe they are significant, then proceed to field D.   |
| <b>Field D</b> | In this field, describe which existing and new safeguards you applied. Examples of possible safeguards are included in <i>paragraphs .19–.20</i> of the “Conceptual Framework for Members in Business.” Press the tab key to move to field E.  |
| <b>Field E</b> | <p>In this field, describe why you believe the safeguards applied do or do not eliminate the threats or reduce the threats to an acceptable level. If you conclude that threats are not at an acceptable level, document your plan of action. For example, do you plan to change the relationship or circumstance so that the threats no longer exist or are not significant, or do you plan to not perform the professional services or resign from the employing organization? Consider consulting <i>paragraph .17</i> of the framework for examples of factors that may aid in determining the effectiveness of a safeguard.</p> <p>When you are done entering content into this field press the tab key and you will be asked if you are finished with this table. You should select “No” if you have identified another relationship or circumstance that you believe may create a threat to comply with the rules. After selecting “No” another row will appear in the table for you to complete. If you select “Yes” a “Conclusion” row (field F) will appear.</p> |
| <b>Field F</b> | In this field, document your conclusion about whether threats identified that may compromise compliance with the rules are at an acceptable level. When you are completing this field, you can save the worksheet page as a separate file.   |

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## Authors:

**Sarah Brack, CPA, CGMA, CGFM**  
Manager  
AICPA Professional Ethics Division

**Michele Craig**  
Senior Manager  
AICPA Professional Ethics Division

**Ellen T. Gorla, CPA, CGMA**  
Associate Director  
AICPA Professional Ethics Division

## Contributors:

**Catherine Allen, CPA**  
Audit Conduct, LLP

**Chris Cahill**  
Retired

**Robert Denham, Esq.**  
Partner  
Munger, Tolles & Olson, LLP

**Dr. Raymond Johnson, CPA**  
Professor Emeritus  
Portland State University

**Brian Lynch, CPA**  
Partner  
EY LLP

**Linda McAninch**  
Retired

**Elizabeth McKneely**  
Senior Manager  
Formerly of Deloitte LLP

**Nancy Miller, CPA**  
Managing Director  
KPMG LLP

**Alan Steiger, CPA**  
Retired

**Lisa Snyder, CPA, CGMA**  
National Assurance Managing Partner — Independence  
BDO LLP

**Wes Williams, CPA**  
Retired

**Shannon L. Ziemba, CPA, CGMA**  
Manager  
AICPA Professional Ethics Division

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