AUDIT CONDUCT NEWS

Vol. 8 | Issue 3 | ISSN 2151 - 0857

New & revised AICPA independence rules become effective in 2023

Part 3: Unpaid Fees

By Cathy Allen

12/13/22

The AICPA's Professional Ethics Executive Committee (PEEC)[1] adopted the following changes to the independence interpretations in the *Code of Professional Conduct* (Code), which will go into effect on January 1, 2023:

- Information system services
- Loans, Acquisitions, and Other Transactions
- Unpaid fees
- Assisting Clients with Implementing Accounting Standards

In this third article in a four-part series, I will briefly discuss changes to the Code for *Unpaid Fees*. (See Part 1 for a discussion of *Information System Services* and Part 2 on *Loans, Acquisitions, and Other Transactions*.)

Background

In February 2022, the PEEC adopted revisions to the *Unpaid Fees* interpretation (ET sec. 1.230.010) under the *Independence Rule,* a provision in the Code that has existed since 1991. Under the interpretation, independence was impaired if an attest client owed fees to its auditor for *any* professional services performed more than one (1) year prior to the issue date of the current attest report. Unpaid fees included both billed and unbilled amounts and fees converted to a note receivable. The interpretation did not apply to unpaid fees from an attest client in bankruptcy.

The Committee's rationale for revisiting this rule were to: (i) move toward a more principles-based approach; (ii) converge to the extent possible with the SEC Rule 2-01 and international independence standards; and (iii) determine whether given the COVID-19 pandemic, the one-year "bright-line" test was still appropriate.

A description of the revised interpretation follows:

[1] I have been a member of the PEEC since May 2020; all views expressed in this article are my own and do not represent official positions of either PEEC or the AICPA.

Unpaid Fees

Under the revised interpretation, unpaid fees may create self-interest or undue influence threats to a covered member's independence. The old rule also identified the advocacy threat as a possibility, however, PEEC believed this threat was generally not applicable to unpaid fee situations and removed it.

As before, unpaid fees exist when an attest client owes fees (whether billed, unbilled, or a note receivable) to a *covered member* for previously rendered professional services. The term *covered member* means: attest engagement team members and those able to influence the engagement; partners or managers who provides 10 or more hours of nonattest services to the attest client within the fiscal year; partners in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement; the firm; and, entities whose operating, financial, or accounting policies can be controlled by one or more covered members.

Though more principles-based, the revised interpretation does include a "bright-line" test:

Independence is impaired

When fees are *both* significant to the covered member as of the date of the attest report *and* relate to professional services a covered member provided more than one (1) year ago, threats are *not* at an acceptable level and would impair independence. This situation can occur when the covered member does not address the unpaid fee situation before issuing the attest report.

Independence is not impaired

On the other hand, threats are at an acceptable level and independence *not impaired* if, when the current year report is issued, unpaid fees are clearly insignificant to the covered member *and* less than one (1) year old.

What if you fall into the "gray zone," e.g. – unpaid fees are significant but outstanding for only eight (8) months? Or the fees are clearly insignificant but have been outstanding for two (2) years? In those cases, you should evaluate whether threats to independence are at an acceptable level. The interpretation provides the following factors to consider:

- Significance of the threats to the covered member
- Length of time fees have been due from the attest client
- Whether the attest client has agreed to pay the fees
- The covered member's assessment that the client can pay the fees as promised

If threats to independence are significant (i.e., not at an acceptable level), you should apply one or more safeguards to eliminate or at least reduce threats to an acceptable level. Examples of actions that might be safeguards are:

- Review of the current year attest work (before the current year report is issued) by an appropriate professional who has not provided any attest or nonattest services to the attest client
- Attest client partially pays its fees before the attest report is issued, reducing the unpaid fees balance to an amount that is insignificant to the covered member
- Attest client agrees to a payment schedule before the attest report is issued
- Firm suspends further work on the current attest engagement and does not accept new attest engagements from this attest client

The firm may also discuss its evaluation of unpaid fees and the safeguards applied with the client's governance body (e.g., board of directors or audit committee); however, this alone would not qualify as a safeguard that could reduce significant threats to an acceptable level.

The interpretation retained the caveat that these requirements do not apply to unpaid fees from an attest client in bankruptcy.

Nonauthoritative Guidance

The Code is the only authoritative source of AICPA ethics rules and interpretations; however, the Professional Ethics Division (Division) often publishes nonauthoritative guidance to help members and others understand and implement new and revised interpretations. To date, the Division has published the following guidance:

Frequently Asked Questions: Nonattest Services

The Online Ethics Library, Q&A section 125 includes three (3) new frequently asked questions (FAQs) that address certain aspects of the revised interpretation, which are described below.

The term "covered member" and the significance of unpaid fees. This FAQ clarifies that you should evaluate the significance of fees - both qualitatively or quantitatively – to covered members such as the firm and the engagement partner. While unpaid fees may be significant to both parties, it is also possible that fees are clearly insignificant to the firm but significant to the engagement partner. For example, a firm's compensation structure may depend on fee collection, which would have a direct impact on the partner's compensation.

Comparison of safeguards related to unpaid fees for small and large firms. This FAQ discusses the sample safeguard in par. .04(a) of the interpretation, *have an appropriate reviewer who has not provided attest or nonattest services to the attest client review the attest work performed before the current-year attest report is issued.* The FAQ describes an "appropriate reviewer" as a professional with relevant technical and specialty expertise to review the attest work. In a sole proprietorship, the owner would likely employ a professional from outside the firm while a larger firm might employ a professional in the firm who serves in a quality control or national office role.

Other situations with unpaid fees that require judgment about independence. This FAQ provides an example of a situation in which the covered member must evaluate threats to independence, i.e., an audit client needs to obtain financing to pay its fees and the financing depends on issuance of the firm's unmodified audit report. In this case, the covered member should evaluate threats and if they are not at an acceptable level, apply safeguards. If safeguards do not eliminate or sufficiently reduce the threats, the covered member should not complete the audit engagement.

The revisions to the *Unpaid Fees interpretation* become effective on December 31, 2022, and early implementation is allowed.
