

New & revised AICPA independence rules become effective in 2023

Part 2: Loans, Acquisitions, and Other Transactions

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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 second of a four-part series, I will briefly discuss changes to the Code for *Loans, Acquisitions, and Other Transactions*. (See Part 1 for a discussion of [Information System Services](#).)

Loans, Acquisitions, and Other Transactions

In February 2022, the PEEC adopted revisions to the following interpretations and a definition in the Code:

- Definition of “beneficially owned/beneficial ownership interest,” (ET sec. 0.400.06)
- Conceptual Framework for Independence (ET sec. 1.210.010)
- Client Affiliates (ET sec. 1.224.010)
- Loans (ET sec. 1.260.010)
- Loans and Leases with Lending Institutions (ET sec. 1.260.020)
- Immediate Family Members (ET sec. 1.270.010)

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.

Background

In October 2020, the Securities and Exchange Commission (SEC) adopted several changes to Rule 2-01, *Qualifications of Accountants*, of Regulation S-X. As some of the changes made Rule 2-01 less restrictive than the AICPA independence rules, PEEC appointed a task force to evaluate the SEC's amended rules and determine whether to propose revisions to the Code. After going through due process, PEEC adopted several revisions and additions to the independence rules, which are summarized below.

Loans with Attest Clients

PEEC changed certain rules related to loans with attest clients by: (i) adding certain consumer loans to the types of loans that are generally permitted; (ii) adding student loans to the types of loans that may be retained under the rule's "grandfathering" provision; (iii) revising the description of an individual associated with an attest client or a financial statement attest client's (FSAC's) affiliate whose loan with a covered member would impair independence; and (iv) clarifying that when considering materiality of a loan to a covered member's net worth, the covered member should combine their net worth with that of their immediate family.

NOTE: An FSAC is an entity whose *financial statements* are audited, reviewed, or compiled when the *member's* compilation report does not disclose a lack of *independence*.

Officer, Director, or 10 Percent + Owner of Attest Client

To conform to revised Rule 2-01, PEEC replaced the phrase, *individual who is an officer, director, or a 10 percent or more owner of an attest client (or affiliate of an FSAC)* with "*officer or director of the attest client with the ability to affect decision-making, or any individual with a beneficial ownership interest (known through reasonable inquiry) that gives the individual significant influence over the attest client*" where relevant. For example, this phrase is used in the Code when a covered member's loan is with an individual associated with the attest client or an affiliate of an FSAC. In subsequent standard-setting, PEEC made similar changes to the *Conceptual Framework for Members in Public Practice* (examples of advocacy and familiarity threats, ET sec. 1.000.010.11-.12) and *Offering or Accepting Gifts or Entertainment* under the *Integrity and Objectivity* and *Independence* rules (ET sec. 1.210.010 and 2.285.010).

Acquisition or Other Transaction Creates New Affiliate

As stated in the PEEC's October 5, 2021, Exposure Draft, "*A new affiliate relationship can be created because a financial statement attest client or affiliate is involved in an acquisition or other transaction. When this happens, a member may have an interest in or relationship with the new affiliate that will impair independence.*" At that time, the Code included only limited guidance (reflected in scenario 1 below), which addressed an entity's acquisition of a firm's FSAC. The SEC adopted a "transition framework" in Rule 2-01 to allow audit firms and their clients to transition out of services or relationships that will become violations due to a merger or acquisition. Thus, the PEEC added guidance to the Code's [Client Affiliates](#) interpretation to assist members in those situations. Three (3) scenarios and the requirements for maintaining independence are described below:

Scenario 1:

- Company A acquires a member's firm's (Firm's) existing FSAC during the period of professional engagement
- Firm will discontinue financial statement attest services to the FSAC after issuing the current report
- Attest report does not cover periods *after* the effective date of the acquisition

In the above scenario, the Firm's and its personnel's interests or relationships with Company A will not impair independence. For example, a partner who is a covered member may hold stock in Company A, or the Firm may be performing prohibited information systems work for the company. Independence is maintained because the Firm will issue the current attest report, which does not include any periods after the effective date of the acquisition, and cease performing financial statement attest services for the periods after the effective date of the transaction.

Scenario 2:

- Existing FSAC or its affiliate is involved in an acquisition or other transaction with Company A during the period of professional engagement
- Firm expects to continue providing financial statement attest services to FSAC *after* the effective date of the acquisition

To continue performing attest services, the Firm should identify and evaluate previous and current interests in and relationships with Company A (the new affiliate) and address any significant threats to independence. The Firm must terminate any interests or relationships with Company A that would impair independence by the effective date of the acquisition or other transaction. If, however, the Firm cannot reasonably terminate an interest or relationship by the effective date (e.g., assume the Firm is providing expert witness services, a prohibited nonattest service, to Company A), the Firm should meet all of the following conditions:

- Evaluate the significance of the threat created by the nonattest service
- Discuss the matter with the FSAC's governance body (i.e., significance of threat and why the Firm cannot terminate the prohibited nonattest service before the effective date)
- If the governance body directs the Firm to continue attest services, the Firm should:
 - Ensure that prohibited nonattest services are ceased as soon as reasonably possible but no later than six (6) months post-effective date,
 - Not allow a professional who has an interest or relationship with Company A (i.e., persons performing the expert witness services) to be a member of the attest team or be responsible for performing a quality control review of the engagement, and
 - Apply appropriate safeguards, which the Firm also discusses with the FSAC's governance body.

Scenario 3:

- Existing FSAC or its affiliate is involved in an acquisition or other transaction with Company A (new affiliate)

- Firm will complete the current attest engagement but discontinue attest work after issuing the current report
- The current attest report may cover periods *after* the effective date of acquisition or other transaction

To maintain independence, the Firm should meet all of the following conditions:

- The Firm has completed a significant amount of the attest work prior to the effective date and expects to complete the remaining procedures and issue the attest report within a reasonable period of time
- The Firm evaluates the significance of the threat(s) and discusses the results with the FSAC's governance body, which directs the Firm to complete the attest engagement despite the independence impairment
- The Firm applies safeguards and ensures that persons who have an interest or relationship with Company A will *not* be a member of the attest team or be responsible for performing a quality control review of the engagement
- The Firm will cease serving as the auditor no later than the issuance date of the attest report.

Other Considerations

For all three (3) scenarios, members should consider the [Conflicts of Interest for Members in Public Practice](#) interpretation (*Integrity and Objectivity Rule*).

Members should also consider documenting the following:

- Identified interests or relationships that will not be terminated prior to the effective date and the reason(s) why this is the case
- Safeguards applied (if appropriate)
- Results of discussions with the FSAC's governance body
- Reasons that previous and current interests and relationships do not create a threat that would compromise the attest engagement team's objectivity

The revisions described in this article become effective on December 31, 2022, and early implementation is allowed.

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