AICPA

Professional Ethics Division

Exposure draft: Proposed new and revised interpretations related to fees

Revised "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010)
Revised "Client Affiliates" interpretation (ET sec. 1.224.010)
New "Determining Fees for an Attest Engagement" interpretation (ET sec. 1.230.030)
New "Fee Dependency" interpretation (ET sec. 1.230.040)

March 15, 2023

Comments are requested by June 15, 2023

ethics-exposuredraft@aicpa.org

Standards-setting

Invitation to comment

March 15, 2023

Are you interested in the ethics of accounting? If so, we want to hear your thoughts on this ethics exposure draft. Your comments are integral to the standard-setting process, and you don’t need to be an AICPA member to participate.

This proposal is part of the AICPA’s Professional Ethics Executive Committee (PEEC) project to converge with ethics standards promulgated by the International Ethics Standards Board for Accountants (IESBA).

This exposure draft explains the proposed revisions to the AICPA Code of Professional Conduct and includes the full text of the guidance under consideration.

At the conclusion of the exposure period, PEEC will evaluate the comments and determine whether to publish the new and revised interpretations.

Again, your comments are an important part of the standard-setting process — please take this opportunity to comment. We must receive your response by June 15, 2023. All written replies to this exposure draft will become part of the public record of the AICPA and will be available at www.aicpa.org/peecprojects.

Please email your comments to ethics-exposuredraft@aicpa.org.

Sincerely,

Brian S. Lynch, Chair
Professional Ethics Executive Committee

Toni Lee-Andrews, Director, CPA, PFS, CGMA
Professional Ethics Division

Contents

Explanation of the new and revised interpretations

As part of our convergence efforts, the Professional Ethics Executive Committee (PEEC) is exposing for comment two new interpretations and revisions to two interpretations of the "Independence Rule" (ET sec. 1.200.001):

- New "Determining Fees for an Attest Engagement" interpretation (ET sec. 1.230.030)[1]
- New "Fee Dependency" interpretation (ET sec. 1.230.040)
- Revised "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010)
- Revised "Client Affiliates" interpretation (ET sec. 1.224.010)

If adopted as final, the new and revised interpretations will be applicable to members in public practice.

Overview

1. The objective of the International Ethics Standards Board for Accountants' (IESBA's) Fees project was to review the provisions in the IESBA Code of Ethics for Professional Accountants pertaining to fee-related matters. See links to the final standard and basis for conclusions. The IESBA Fees project responded to a public interest need for IESBA to deal with fee-related matters, including those that affect or are perceived to affect auditor independence — both independence of mind and independence in appearance. IESBA's revisions to the fee-related provisions of the Independence section of its code include the following:

    - A prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client
    - A requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period
    - For firms auditing public interest entities (PIEs), communication of fee-related information to those charged with governance (TCWG) and to the public to assist their judgments about auditor independence
    - Enhanced guidance on identifying, evaluating, and addressing threats to

[1] All ET sections can be found in AICPA *Professional Standards*.

independence

2. PEEC appointed a task force to evaluate these amended rules and determine whether revisions to the AICPA Code of Professional Conduct (AICPA code) are required. The task force met several times to evaluate the differences between the new IESBA guidance and the AICPA's extant guidance, beginning with a gap analysis. Using that analysis, the task force determined where convergence was possible.

3. Based on that evaluation, PEEC is proposing two new interpretations to

    a. prohibit a covered member responsible for determining fees for an attest engagement from allowing those fees to be influenced by the provision of other services to that attest client.

    b. require that a covered member determine whether the fees the firm receives from an attest client are at a level where self-interest and undue influence threats are significant enough that safeguards must be applied (that is, fee dependency exists).

4. PEEC is also proposing

    a. a revision to an existing example of a self-interest threat and the addition of a new example of an undue influence threat to the "Conceptual Framework for Independence" interpretation to clarify and highlight fee-related threats that are described in the new interpretations.

    b. a new exception in the application of the "Client Affiliates" interpretation to specify the affiliates that need not be included in the calculation of the fees generated from a financial statement attest client pursuant to the proposed "Fee Dependency" interpretation.

5. PEEC is not addressing revisions that are specifically for PIEs. Rather, PEEC will determine what, if any, PIE provisions need to be added to the AICPA code based on the PIE convergence project.

Determining fees for the attest engagement

6. Consistent with IESBA's requirements, PEEC acknowledges that determining fees is a business decision; cost savings achieved because of experience derived from the provision of other services to the client can be considered; and fees should not be dependent on whether additional services are provided to the entity or any of its affiliates.

7. PEEC's proposal does differ from the IESBA standard in that the proposal applies to all attest engagements, not just financial statement audits and reviews. PEEC determined that the relevant threats could be present in any attest engagement; therefore, applying the

requirements to all attest engagements is in the public interest.

8. PEEC's proposed scope also differs from IESBA's. Specifically, IESBA's requirements extend to firms, whereas PEEC's proposal extends to covered members who are responsible for determining the fees for the relevant attest engagement. PEEC's scope is consistent with other provisions of the AICPA code and how the code is enforced. Further, firms are included in the definition of *covered member*.

Fee dependency

9. Consistent with the IESBA's requirements, PEEC proposes that safeguards be applied when fee dependency extends for five consecutive years.

10. PEEC's proposal differs from the IESBA's guidance. In lieu of using the 30% threshold from the IESBA standard, PEEC proposes a principles-based approach, which will allow members to use professional judgment to determine when specific facts and circumstances create threats.

11. The principle proposed is that fee dependency exists when "total fees generated from an attest client by the firm represent a large proportion of the total fees of that firm." When fee dependency exists, threats are created that could be significant. When fee dependency extends for more than five years, threats are significant and PEEC proposes specific safeguards to reduce threats to an acceptable level.

12. When evaluating whether fees represent a large proportion, qualitative and quantitative factors such as the following may be helpful:

    a. The size of the attest client, in terms of the percentage of fees or the dollar amount of fees versus total revenue of the firm, engagement partner, office, or practice unit of the firm.

    b. The significance of the attest client to the firm, engagement partner, office, or practice unit of the firm in light of the following:

    i. The amount of time the firm, partner, office, or practice unit devotes to the attest client

    ii. The effect on the partner's stature within the firm due to the partner's relationships with the attest client

    iii. The manner in which the partner, office, or practice unit is compensated

    iv. The effect that losing the attest client would have on the firm, partner, office, or practice unit *c.* The importance of the attest client to the firm's growth strategies (For example, the firm is trying to enter a particular industry.)

   d. The stature of the attest client, which may enhance the firm's eminence in the marketplace

   e. Whether the firm also provides services to related parties (For example, the firm also provides professional services to affiliates or owners of the attest client.)

   f. Whether the engagement is recurring

   g. The operating structure of the firm

   h. Whether the firm is expected to diversify such that any dependence on the attest client is reduced

13. When the factors indicate that an attest client may represent a large proportion of the firm's total fees, the following are examples of actions that might reduce the proportion:

   a. Reducing the extent of nonattest services provided to the attest client

   b. Increasing the client base of the firm to reduce dependence on the attest client

   c. Increasing the extent of services provided to other clients

14. As noted earlier, when fee dependency extends for more than five years, threats are significant and PEEC is proposing that specific safeguards be applied. When fee dependency exists prior to the fifth year, actions such as the following may be helpful:

   a. Having 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

   b. Ensuring that the compensation of the partner is not significantly influenced by the fees generated from the attest client

   c. Implementing policies and procedures for identifying and monitoring significant client relationships, including the following:

      i. Considering client significance in the planning stage of the engagement.

      ii. Basing the consideration of client significance on firm-specific criteria or factors that are applied on a facts-and-circumstances basis.

iii. Periodically monitoring the relationship. What constitutes “periodic” is a matter of judgment, but assessments of client significance that are performed at least annually can be effective in monitoring the relationship. During the course of such a review, a client previously deemed to be significant may cease to be significant. Likewise, clients not identified as significant could become significant whenever factors the firm considers relevant for identifying significant clients arise. (For example, additional services are contemplated.)

d. Assigning a second (or concurring) review partner who is not otherwise associated with the attest engagement and who practices in an office other than the office of those who perform the attest engagement.

e. Subjecting the assignment of engagement personnel to approval by another partner or manager.

f. Periodically rotating engagement partners.

g. Subjecting significant client attest engagements to internal firm monitoring procedures.

Fees from affiliates

15. The proposed “Fee Dependency” interpretation states that fees charged to entities described under items (*a*) and (*b*) of the *affiliate* definition should be included in the determination of total fees generated from an attest client. PEEC believes that fees from entities that the attest client does not control or exert significant influence over are less likely to create significant threats to independence.

16. Although this scope is consistent with that of IESBA in that it includes fees from downstream entities, and not upstream or sister entities, the proposed scope does go beyond IESBA’s. Specifically, the proposed scope includes entities the financial statement attest client has significant influence over that are material to the financial statement attest client. IESBA includes controlled entities.

Fees from network firms

17. Consistent with IESBA’s requirements, PEEC proposes that the fees generated by network firms be excluded in the calculation of total fees generated by an attest client. PEEC believes that revenue sharing and access to fee information between firms in a network is not common, so the potential for threats to independence from fees of other firms in a network is low.

Threat examples in the “Conceptual Framework for Independence”

18. PEEC discussed whether the “Conceptual Framework for Independence” interpretation (conceptual framework) alone is sufficient to ensure that members will identify and evaluate the threats identified by IESBA’s fees standard (self-interest and undue influence) without additional authoritative guidance.

19. Though use of the conceptual framework alone can help members determine that threats do exist, in practice, these threats may not be apparent. Therefore, PEEC is proposing revisions to the examples of threats in the conceptual framework to highlight that it can assist members with identifying fee-related threats.

20. To align with the proposed “Fee Dependency” interpretation, the example of a self-interest threat in paragraph .16*c* of the conceptual framework interpretation has been revised to clarify that the threat stems from reliance on “fees from attest and nonattest services” instead of just on “revenue.”

21. IESBA adopted application guidance addressing the impact on the level of the undue influence threat when a large proportion of fees charged by the firm to an audit client is generated by providing services other than audit to the client, due to concerns about the potential loss of either the audit engagement or other services. This is an important consideration for covered members, similar to the way that the cumulative effect of providing multiple nonattest services must be evaluated.

22. To highlight this potential threat, PEEC proposes a new example of an undue influence threat that is present when a large proportion of fees charged to an attest client by the firm is generated by nonattest services. Considerations such as the following could assist with determining if threats exist and how significant the threats are to independence:

    a. The ratio of fees for nonattest services to the attest engagement fee

    b. The length of time during which a large proportion of fees for nonattest services to the attest engagement fee has existed

    c. The nature, scope, and purposes of the nonattest services, including

        i. whether they are recurring services

        ii. whether law or regulation mandates the services to be performed by the firm

23. When such threats are not at an acceptable level, the following are examples of actions that might help reduce the level of threats:

    a. Having an appropriate reviewer who does not take part in the attest engagement assess the reasonableness of the fee proposed

b. Having an appropriate reviewer who did not take part in the attest engagement review the work performed on the attest engagement

Effective date

24. PEEC recommends an effective date of January 1, 2025, and allowing for early adoption.

Request for comments

25. PEEC welcomes comments on all aspects of the proposed revisions to the AICPA code. In addition, PEEC is seeking feedback on the following specific aspects of the proposed interpretations and revisions:

    a. Do you agree with the use of *covered member* in the proposed new interpretations? If you disagree, please explain why.

    b. Do you agree with the engagement scope in the proposed new interpretations, especially where the proposed scope goes beyond IESBA's? If you disagree, please explain why.

    c. Is it clear that threats related to fee dependency should be considered each year, not just at year five?

    d. Do you believe the considerations in paragraphs 12–14, 22, and 23 of the explanation should be included either in the proposed interpretations or as nonauthoritative guidance? If so, please explain why.

    e. Do you agree that total fees from an attest client should include fees received from entities described under items (*a*) and (*b*) of the definition of *affiliate*? If you disagree, please explain why.

    f. Do you agree that the effective date provides adequate time to implement the proposals? If you disagree, please explain why.

Terms defined in the AICPA Code of Professional Conduct are italicized in this document. If you'd like to see the definitions, you can find them in "Definitions" (ET sec. 0.400).

1.230.030 Determining Fees for an Attest Engagement

.01 Determining the fees to be charged to an *attest client, whether for attest or other services, is a business decision taking into account the facts and circumstances relevant to that specific engagement, including the requirements of technical and professional standards.*

.02 The provision of other services to an *attest client* is not an appropriate consideration in determining the attest engagement fee, except as provided for in paragraph .03. If a *covered member* responsible for determining the attest *engagement* fee allows the *attest engagement* fee to be influenced by the *firm's* provision of other services to an *attest client*, the self-interest and undue influence *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards.* Accordingly, *independence* would be *impaired.*

.03 When determining the *attest engagement* fee, the *covered member* responsible for determining the *attest engagement* fee may take into consideration the cost savings achieved as a result of experience derived from the provision of other services to an *attest client*.

1.230.040 Fee Dependency

.01 When the total fees generated from an *attest client* by the *firm* represent a large proportion of the total fees of that *firm,* the dependence on, and concern about the potential loss of, fees from attest and other services from that *client* affect the level of the self-interest *threat* and create an undue influence *threat* to a *covered member's independence.*

.02 In calculating the total fees of the *firm,* the *covered member* should include fees from attest and nonattest services and might use financial information available from the previous financial year and estimate the proportion based on that information, if appropriate. For purposes of this calculation, the *covered member* is not required to include fees from attest and nonattest services of other *network firms* within the *firm's network.*

.03 When the *attest client* is a *financial statement attest client,* the *covered member* should include fees from entities described under items (*a*) and (*b*) of the definition of *affiliate.*

.04 When for each of five consecutive years total fees from an *attest client* represent, or are likely to represent, a large proportion of the total fees received by the *firm, threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and *independence* would be *impaired* unless one of the following *safeguards* is applied*:*

a. Prior to the attest report being issued for the fifth year, an appropriate reviewer, who is not a member of the *firm* issuing the report, reviews the fifth year's attest work.

b. After the attest report for the fifth year has been issued, and before the attest report is issued for the sixth year's *attest engagement*, an appropriate reviewer, who is not a member of the *firm* issuing the report or a professional body, reviews the fifth year's attest work.

.05 If the total fees described in paragraph .04 continue to represent a large proportion, the *covered member* shall, each year, apply one of the *safeguards* in paragraph .04*.*

.06 When two or more *firms* are engaged to conduct an *attest engagement,* the involvement of the other *firm* in the *attest engagement* may be regarded each year as an action equivalent to that in paragraph .04*a* if

a. the circumstances addressed by paragraph .04 apply to only one of the *firms* performing the *attest engagement* and

b. each *firm* performs sufficient work to take full individual responsibility for the report.

Additions appear in ***boldface italic***. Deletions appear in ~~strikethrough~~.

1.210.010 Conceptual Framework for Independence

[Paragraphs .01–.15, .17, and .19–.23 are unchanged.]

.16 *Self-interest threat.* The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, an *attest client* or persons associated with the *attest client*. Examples of self-interest *threats* include the following:

a. A *member* has a *direct financial interest* or material *indirect financial interest* in the *attest client*. [1.240.010]

b. A *member* has a *loan* from the *attest client*, an officer or a 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*. [1.260.010]

c. A *member* or his or her *firm* relies excessively on ~~revenue~~ ***fees from attest and nonattest services*** from a single *attest client*. ***[1.230.040]***

d. A *member* or *member's firm* has a material joint venture or other material joint business arrangement with the *attest client*. [1.265]

.18 *Undue influence threat.* The *threat* that a *member* will subordinate his or her judgment to that of an individual associated with an *attest client* or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

a. Management threatens to replace the *member* or *member's firm* over a disagreement on the application of an accounting principle.

b. Management pressures the *member* to reduce necessary audit procedures in order to reduce audit fees.

c. The *member* receives a gift from the *attest client*, its management, or its significant shareholders. [1.285.010]

d. A large proportion of fees charged by the* firm *to an* attest client *is generated by providing nonattest services.

1.224.010 Client Affiliates

[Paragraph .01 is unchanged.]

.02 When a *client* is a *financial statement attest client*, *members* should apply the "Independence Rule" [1.200.001] and related *interpretations* applicable to the *financial statement attest client* to their *affiliates*, except in the following situations:

a. During the *period of the professional engagement*, a *covered member* may have a *loan* to or from an

i. officer or director of an *affiliate* of a *financial statement attest client*, unless the officer or director has the ability to affect the decision-making at the *financial statement attest client.*

ii. individual with a *beneficial ownership interest* (known through reasonable inquiry) in an *affiliate* of a *financial statement attest client*, unless the ownership interest gives the individual *significant influence* over the *financial statement attest client.*

b. A *member* or the *member's firm* may provide prohibited nonattest services to entities described under items (*c*)–(*l*) of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided that it is reasonable to conclude that the services do not create a self-review *threat* with respect to the *financial statement attest client* because the results of the nonattest services will not be subject to *financial statement* attest procedures. For any other *threats* that are created by the provision of the nonattest services that are not at an *acceptable level* (in particular, those relating to management participation), the *member* should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*.

c. A *firm* will only have to apply the "Subsequent Employment or Association With an Attest Client" interpretation [1.279.020] of the "Independence Rule" if the former employee, by virtue of his or her employment at an entity described under items (*c*)–(*l*) of the definition of *affiliate*, is in a *key position* with respect to the *financial statement attest client*. *Individuals in a position to influence the attest engagement* and on the *attest engagement team* who are considering employment with an *affiliate* of a *financial statement attest client* will still need to report consideration of employment to an appropriate person in the *firm* and remove themselves from the *financial statement attest engagement*, even if the position with the *affiliate* is not a *key position*.

d. A *covered member's immediate family* members and *close relatives* may be employed in a *key position* at an entity described under items (*c*)–(*l*) of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided they are not in a *key position* with respect to the *financial statement attest client*.

e. A *covered member* who is an individual on the *attest engagement team*, an individual in a position to influence the *attest engagement*, or the *firm* may have a lease that does not meet the requirements of the "Leases" interpretation [1.260.040] under the "Independence Rule" with an entity described under items (*c*)–(*l*) of the definition of *affiliate* during the period of the professional engagement. The *covered member* should use the "Conceptual Framework for Independence" to evaluate whether any *threats* created by the lease are at an *acceptable level*. If the *covered member* concludes that *threats* are not at an *acceptable level*, the *covered member* should apply *safeguards* to eliminate the *threats* or reduce them to an *acceptable level*.

f. A *member* or *member's firm* may enter into a staff augmentation arrangement with entities described under items (*c*)–(*l*) of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*. The *member* should use the "Conceptual Framework for Independence" to evaluate whether any *threats* created by the staff augmentation arrangement are at an *acceptable level*. If the *member* concludes that threats are not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threats* or reduce them to an *acceptable level*. If *safeguards* are not available or cannot be applied to eliminate or reduce the *threats* to an *acceptable level*, the *member* should not enter into the staff augmentation arrangement.

g. For purposes of applying the "Fee Dependency" interpretation [1.230.040], fees from entities described under items **(c)*–(*l*) of the definition of* affiliate *are not required to be included when calculating the total fees generated from a*** **financial statement attest client*.***

[Paragraphs .03–.14 are unchanged.]

Acknowledgments

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Many thanks

The Professional Ethics Division and PEEC are grateful for the input we received from observers and stakeholders while drafting these proposed changes to the Code of Professional Conduct.

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