Woman C.P.A.

Volume 52 | Issue 4 Article 5

Fall 1990

Recent Changes in the AICPA Code: What They Mean for CPAs and Clients

S. Douglas Beets

Dale R. Martin

Recent Changes in the AICPA Code

What They Mean for CPAs and Clients

By S. Douglas Beets and Dale R. Martin

In the past two years, several changes have been made in the Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA). These revisions are partially due to the influence of the Federal Trade Commission (FTC). The FTC maintained that the changes would result in greater public benefit through increased competition among accounting firms. While the revisions may result in more revenue-generating opportunities for public accountants, CPAs may also face forms of competition and ethics decisions that they have not encountered before.

Rule Changes Resulting from the AICPA Referendum

In early 1988, members of the AICPA voted in favor of a revision to their ethics code. Two of the resulting rule changes are likely to have a significant impact on public accounting. First, Rule 201, General Standards, no longer addresses the topic of forecasts. Formerly, Rule 201 specified that a member could not vouch for the achievability of a forecast. Second, the code no longer discourages members from practicing under a fictitious firm name. Revised Rule 505, Form of Practice and Name, allows members to practice under a fictitious firm name or under a name indicating specialization, provided that the name or specialization is not misleading.

Two other Rules of Conduct were deleted from the code because of their redundancy. Rule of Conduct 504, Incompatible Occupations, was dropped from the code because Rule 102, Integrity and Objectivity, already required members to avoid such conflicts of interest. Also deleted was Rule of Conduct 204, Other Technical Standards. It was considered unnecessary after Rule 202, Compliance With Standards, was revised to include standards related to auditing, review, compilation, management advisory, tax, or other professional services.

Perhaps the most comprehensive difference between the former and revised rules is the broadening of their applicability. In the past, many of the Rules of Conduct applied only to AICPA members in public practice. Most of the revised rules, however, apply to all members, including those in industry, government, and education.

Two years later, the Commission concluded that certain ethics rules were in violation of the Federal Trade Commission Act because they interfered with competition.

Other Revisions and Their Motivation

Much of the motivation for the revisions brought about by the AICPA referendum relates to the concerns of the FTC. In 1985, the FTC began an investigation into the AICPA Code and its effect on public accounting. Two years later, the Commission concluded that certain ethics rules were in violation of the Federal Trade Commission Act because they interfered with competition. The FTC suggested that the AICPA alter the code to allow members to accept commissions and contingent fees, use fictitious names, pay for referrals, and vouch for the achievability of forecasts [Journal of Accountancy, September 1987].

The revised code that resulted from the 1988 referendum brought about the requested rule changes concerning fictitious names and forecasts. No revisions were made, however, in the rules regarding referrals, commissions, and contingent fees. The AICPA intended, at that time, to legally defend its right to continue to impose these restrictions on its members.

Upon legal advice and consideration of possible litigation, however, the AICPA Council approved a compromise with the FTC in August 1988. This agreement allows commissions and contingent fees but only under certain circumstances. First, a CPA may now pay others to recommend the CPA's services as long as potential clients are aware of the referral arrangement. Second, the agreement allows contingent fee engagements except with clients for whom the CPA performs attest services. These services are defined by the agreement as audits, reviews, compilations that will be used by third parties, or examinations of prospective statements. Third, a CPA may now accept a commission for recommending the goods and services of others. This new freedom, however, has two limitations: (1) a CPA may only accept commissions from businesses for whom the CPA performs no attest services, and (2) the parties to whom recommendations are made must be informed of the commission arrangement [The CPA Letter, 1988].

New Freedoms and Their Consequences

Since the code revisions have resulted in fewer restrictions, many formerly-prohibited actions of accounting practitioners are now allowed. Contingent fee arrangements, for example, are now permitted except with clients for whom the CPA performs attest engagements. This means that for a non-attest engagement, such as tax preparation or management advisory services, the CPA's fee may be a function of the tax reductions or the client benefit realized. Potentially, this relaxation of Rule 302 could result in greater revenues from new and existing clients. Rather than charging an hourly rate or a flat fee, practitioners may negotiate a percentage of the savings or benefit, an arrangement that lawyers have enjoyed for years.

Unfortunately, this rule modification may also result in greater temptation to artificially or illegally inflate savings or benefits to maximize billings. Before modification of Rule 302, fees were essentially based on hours of work performed. Consequently, the fee structure of the engagement afforded a degree of professional impartiality since the magnitude of client savings did not provide a direct financial benefit for he CPA.

In addition, the revision of the contingent fee rule may introduce a new form of competitive bidding by accounting firms. One CPA, for example, may offer to design and implement improvements to a client's accounts payable system for a flat fee plus 20 percent of the estimated cost savings. A competing practitioner may offer the same services for a flat fee plus only 10 percent of the savings.

Changes in the rule regarding commissions similarly provide the potential for significantly higher revenues and ethics temptations. Since the revision of Rule 503, an AICPA member may accept a commission for referring a product or service of a business for whom the CPA performs no attest services. The business to whom the recommendation is made, however, must be aware of the commission arrangement. A possible problem created by this rule modification relates to CPAs' promotion of inferior goods or services. If, for example, a CPA receives a commission for recommending a certain brand of computer software to clients, he or she may be tempted to promote that product rather than suggest a superior alternative. Further, the credibility and perceived professionalism of a CPA's opinion may suffer when the client realizes that a commission is paid for the recommendation.

Since its revision, Rule 503 allows CPAs to make payments to obtain clients as long as the potential clients are aware of the referral arrangements.

Accounting firm revenues may also increase as a result of the relaxation of another restriction concerning commissions. Since its revision, Rule 503 allows CPAs to make payments to obtain clients as long as the potential clients are aware of the referral arrangements. Consequently, CPAs may now pay their employees, lawyers, real estate agents, insurance agents, current clients, and others to refer potential clients to them. This change could provide a substantial increase in a CPA's client base. Again, however, the modification may foster difficult ethics decisions. When asked by a client for the name of a qualified public accountant, a lawyer may be tempted to recommend a CPA who is willing to pay for the referral, rather than suggest the most competent.

The code changes resulting from the AICPA referendum may not have the same potential for increased revenues or ethics problems as the revisions regarding commissions and contingent fees. As a result of the referendum, accounting firms are now free to select whatever trade name they consider appropriate as long as the name is not misleading. A firm that specializes in international tax planning and preparation, for example, may wish to operate under the firm name, "International Tax Professionals." Such a choice, however, might limit clients' perceptions regarding he scope of the firm's competence.

Last, revised Rule 201, General Standards, no longer prohibits AICPA members from vouching for forecasts' achievability. Currently, however, CPAs are still constrained from this activity because of the wording of the standard reports suggested by the AICPA's Auditing Standards Board in its Statement on Standards for Accountants' Services on Prospective Financial Information. The standard reports for an accountant's examination or compilation of a forecast include the phrase: ... there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. As a consequence, use of the standard report prevents an AICPA member from vouching for the achievability of a forecast although the AICPA Code no longer restricts the practice.

Use of the standard report prevents an AICPA member from vouching for the achievability of a forecast although the AICPA Code no longer restricts the practice.

Since the constraint against vouching for a forecast's achievability was one of the restrictions that the FTC specifically asked the AICPA to repeal, the Institute may eventually revise the wording of the forecast reports. If such a revision does occur, clients may ask CPAs who assist in the preparation or review of financial forecasts to indicate that forecasted results will be achieved. While such a statement could bring short-term financial rewards and favorable client relations, a CPA that vouches for a forecast's achievability certainly assumes a greater degree of risk and increases the potential for litigation.

Current Reaction and Opinions of Former Rules

With regard to the changes resulting from the AICPA referendum and the Institute's compromise with the FTC, much of he initial practitioner reaction has been negative. While some public accountants may be pleased that new freedoms are allowed and new sources of revenue have been approved, others are opposed to the new forms of competition and the ethical decisions that they and their fellow practitioners now face.

Currently, accounting boards and accounting societies in several states disagree about the implementation of the recent revisions. Practitioners in four states (California, Florida, Iowa, and Oregon) have successfully encouraged their state governments to pass laws restricting commissions and contingent fees for CPAs. In several other states, practitioners are rallying to influence their legislatures to pass similar regulations.

Insight into reaction to the code revisions is provided by a survey of CPAs and clients that the authors conducted during the debate over the changes and the AICPA's "vote excellence" campaign to solicit members' support for the revisions. The survey questionnaire presented several case situations and indicated whether a hypothetical CPA did or did not act in accordance with the AICPA Code. The respondents were then asked whether they believed the code, as it applied to the case situation, was appropriate or inappropriate.

While some public accountants may be pleased that new freedoms are allowed and new sources of revenue have been approved, others are opposed to the new forms of competition and the ethical decisions that they and their fellow practitioners now face.

Table I
Survey Results - Recent Code Revisions

Case Description	Percentage who considered the rules appropriate CPAs	Clients
1. A CPA agreed to prepare a client's taxes for a fee that would increase as the amount of tax liability decreased [violation of former Rule of Conduct 302, Contingent Fees].	97.5	94.4
2. A CPA paid a fee to a lawyer to refer potential tax clients to him [violation of former Rule of Conduct 503, Commissions].	91.0	85.4
3. A CPA assisted in the development of a financial forecast for a client that he had audited for several years and stated that he was confident that the forecast could be achieved [violation of former Rule of Conduct 201, General Standards].	88.6	77.5
4. Four AICPA members conducted their partnership under the firm name, "Tax Professionals" [violation of former Rule of Conduct 505, Form of Practice and Name].	73.4	40.5

The questionnaire was mailed to a random sample of CPAs in one geographical area of the United States. Questionnaires were also mailed to a random sample of accounting firm clients in the same area. Of 125 survey questionnaires mailed to CPAs, 79 usable questionnaires were returned, yielding a response rate of 63.2 percent. Clients returned 90 usable questionnaires of 150 mailed to them, for a response rate of 60 percent.

Table One summarizes the respondents' opinions as they relate to the recent AICPA Code changes. Cases 1 though 4 presented actions that were considered code violations until the recent modifications. In each of these four cases, the majority of CPAs indicated their support of the former rules that prohibited fictitious firm names, contingent fees, commissions, and vouching for a forecast's achievability. The latter three of these actions were considered inappropriate by approximately 90 percent or more of the CPA respondents.

A majority of clients similarly indicated their beliefs that contingent fees, commissions, and vouching for a forecast's achievability should not be permitted by the AICPA Code. The former restriction, however, on fictitious firm names was not considered appropriate by the majority of clients.

In addition to cases related to the recent revisions of the AICPA Code, three other cases were presented in the survey questionnaire that relate to ethics rules that were dropped from the code in the late 1970's. As summarized in Table 2, these former rules restricted (1) encroachment of other CPAs' clients, (2) employment offers to other CPAs' employees, and (3) advertising.

Most of the survey respondents supported the deletion of these former rules from the AICPA Code. More than 60 percent of the surveyed CPAs believed that such restrictions were inappropriate. Clients were even less supportive of the former restrictions; less than 15 percent of the client respondents thought that ethics rules regarding client encroachment, employment offers, and advertising were necessary.

Table 2
Survey Results - Earlier Code Revisions

Case Description	Percentage who considered the rules appropriate CPAs	Clients
5. A CPA informed a corporation's directors that he could provide auditing services for a smaller fee than was being charged by their current auditor, another CPA [violation of former Rule of Conduct 401, Encroachment].	38.0	13.3
6. A CPA's full-page newspaper advertisement included an explanation of the services offered and the associated fees [violation of former Rule of Conduct 502, Solicitation and Advertising].	34.6	11.2
7. A CPA offered a job to an employee of another CPA without consulting the current employer [violation of former Rule of Conduct 402, Offers of Employment].	16.5	2.2

Several factors may contribute to the difference between the perceived appropriateness of rules that were recently revised and those modified a decade ago. First, practitioners and clients may tend to support existing rules that they understand and consider adequate. Therefore, they may initially oppose any threatened changes. With the passage of time, however, opinions regarding modifications may change as potential benefits are recognized and appreciated.

Second, new accountants and clients may not be aware of controversies regarding rules that were modified before their education and entry into professional careers. Recent accounting graduates, for example, may not consider advertising inappropriate because it is permitted by the version of the code which they learned in college and which currently affects the practice of accounting. A more experienced practitioner, however, might be more likely to consider advertising inappropriate because it was prohibited by the code which governed the profession early in the practitioner's career. Consequently, the eventual replacement of retiring profession members with recent accounting graduates may partially explain the different reactions to recently-revised rules and those modified years ago.

Third, in contrast to the first two possibilities, many CPAs and clients may have genuinely considered the code revisions of the 1970s necessary and recent changes unnecessary. Client encroachment, employment offers, and advertising may have been acceptable to many CPAs and clients regardless of the position of the AICPA. Correspondingly, many CPAs and clients may oppose fictitious firm names, contingent fees, commissions, and vouching for a forecast's achievability regardless of the Institute's repeal of prohibitions of these actions.

Summary and Conclusion

The survey results provide evidence that the recent revisions in the AICPA Code may not be accepted without reservations and protests. Most of the surveyed CPAs indicated support for the former rules regarding contingent fees, commissions, fictitious firm names, and forecasts. With the exception of the restriction on fictitious names, clients also considered these former rules appropriate.

As mentioned previously, if practitioner disapproval of the revisions is widespread, CPAs may encourage their state legislatures to enact regulations to control the related practices. Practitioners may also act to discourage similar revisions in state ethics codes are very similar, if not identical, to the AICPA Code, and modifications that the Institute considers necessary are often adopted by the individual states. Practitioner disdain for these changes however, may result in the refusal of some states to repeal the restrictions in question.

If some states refuse to revise the controversial rules, CPAs will have to adhere to the code of the state in which they are licensed for fear of losing their certification. They may have to compete, however, with practitioners from neighboring states whose state codes and regulations are not as restrictive.

There may be some consolation for the AICPA, however, with regard to eventual practitioner and client acceptance of the rule changes. Former restrictions that were repealed in the 1970's are now widely accepted. Consequently, practitioners and clients may be more supportive of the modifications as they understand the AICPA's motives and become accustomed to the new freedoms that the changes afford.

To an extent, the current Code of Professional Conduct is the result of negotiations between the AICPA and government regulatory agencies, such as the FTC. Although the Institute has acted to preserve the autonomy of the accounting profession and minimize its regulation, practitioners now have fewer restrictions on their ethical behavior. These code revisions will provide new opportunities to increase accounting firm revenues but practitioners will also have to contend with ethics decisions that they have not faced before. As the survey results suggest, many CPAs and clients may not be enthusiastic about the new freedoms effected by the changes.

S. Douglas Beets *is an Assistant Professor of Accounting at Wake Forest University. He is also a CPA.*

Dale R. Martin *is an Associate Professor of Accounting and Coordinator of the Accountancy Department at Wake Forest University.*

Journal of Accountancy, "AICPA to Fight FTC Consent Order on Ethics Code," September 1987, pp. 87-88.

Supplement to The CPA Letter, "Agreement Containing Consent Order to Cease and Desist," September 23, 1988.