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Independence Issues Committee - Minutes of Meetings
Independence Issues Committee Minutes of July 14, 1998
Meeting Public Session

Independence Standards Board. Independence Issues Committee

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July 14, 1998

Independence Issues Committee - Minutes of Meetings

Independence Issues Committee
Minutes of July 14, 1998 Meeting
Public Session

The Independence Issues Committee (IIC, or the Committee) held a public meeting on Tuesday, July 14, 1998.

The meeting began at approximately 10 AM and was attended by:

Committee Members

Barry Barber
Edmund Coulson
Kenneth E. Dakduk
Charles A. Horstmann
Robert J. Kueppers
Edward W. O'Connell
Frank J. Pearlman
Gerald W. Ward

Arthur Siegel, Executive Director of the Independence Standards Board (ISB, or the Board), served as Chairman.

Others present by invitation were:

W. Scott Bayless - SEC Staff
John M. Guinan*
John Hegarty - Federation des Experts Comptables Europeens (FEE)
Susan McGrath - ISB Staff
Richard Regal - International Federation of Accountants (IFAC)
Richard H. Towers - ISB Staff

* Mr. Guinan was sitting in for Mr. Claiborne.

Federation des Experts Comptables Europeens

Mr. Siegel introduced John Hegarty, Secretary General of the Federation des Experts Comptables Europeens (FEE), and invited him to discuss his organization's activities. Mr. Hegarty briefly described his organization, a coalition of accounting bodies from 26 countries, with 400,000 members. He noted FEE's interest in following independence developments in the United States, as some of

the organization's members audit SEC registrants.

In 1995, FEE issued a paper on auditor independence and objectivity. These issues are being studied again, however, with the advent of the common currency (the Euro); as European countries will be operating in a single market, the adequacy of each individual country's standards governing accountants examining financial statements has become more important to all member countries. FEE has been charged with the task of, among other things, developing common rules for auditor independence and objectivity. A detailed document of principles of auditor independence and objectivity, developed from the 1995 paper, will be exposed for public comment at the end of the summer.

Mr. Hegarty hopes that ultimately there will be no substantive differences between U.S. and European independence requirements, as worldwide standards are desirable. As such, he believes that the ISB and FEE should communicate and coordinate with each other, to the extent possible, as each develops its own independence standards.

International Federation of Accountants (IFAC)

Mr. Siegel invited Richard Regal to discuss IFAC's activities. Mr. Regal briefly described his organization, and explained that it represented 2 million accountants throughout 100 countries. IFAC is currently working with the International Organization of Securities Commissions (IOSCO) to gain worldwide acceptance of a central core of international auditing standards.

Mr. Siegel stated that both FEE and IFAC had agreed to provide representatives to join the ISB's project task force on the conceptual framework for auditor independence.

Minutes

The minutes of the IIC's last meeting, a telephonic meeting held on June 15, 1998, were approved unanimously.

Staff Report

Invitation to Comment - Proposed Recommendation to SECPS - Annual Auditor Independence Confirmation

Mr. Siegel stated that the Staff had received six responses so far on its proposed recommendation to SECPS that it require member firms to confirm their independence annually to the audit committees (or Boards) of their public company clients, and that they offer to meet with the audit committee to discuss auditor independence. He stated that five respondents supported the recommendation, while one did not. He reminded those present and those listening by telephone to comment before the July 23rd deadline, so that the Board would have the benefit of their thoughts when concluding on the efficacy of the confirmation recommendation. The invitation to comment is available in hardcopy and on the ISB website (www.cpaindependence.org).

Status of Board Projects

Mr. Siegel provided a report on the status of Board projects. All three of the Board oversight task forces have met (the conceptual framework, family relationships, and employment with audit clients). Project task forces, composed of people from a wide variety of backgrounds, are being assembled and a good response has been received so far from individuals asked to join and from organizations that have been asked to nominate representatives.

Mr. Siegel stated that the members of the IIC Family Relationships and Employment with Audit Clients Task Forces, representing practicing auditors, have been invited to join the corresponding ISB project task forces on these topics. The remaining three IIC members will be invited to join the ISB project task force on the conceptual framework project.

Four individuals have been approached as possible candidates to draft the conceptual framework discussion memorandum. Three expressed active interest, while the fourth had to decline because of a heavy workload. Interviews of these individuals have been scheduled for August.

Staff Consultation Activity

At Mr. Siegel's request, Mr. Towers briefly summarized Staff consultation activity. He stated that there was quite a bit of activity in the informal consultation arena, and that approximately 35 informal inquiries had been received to date. Mr. Towers offered that the volume of questions received was encouraging, and indicative of awareness of the ISB and the inquiry process within the profession.

In response to a question, Mr. Bayless stated that this level of activity was comparable to the level experienced by the SEC Staff when they were fielding independence inquiries, but that the volume of questions usually rose during the audit "busy season."

Agenda Subcommittee Discussions

Mr. Siegel stated that several potential issues for IIC deliberation had been raised at the telephonic Agenda Subcommittee meeting held on June 29th. The SEC, however, did not believe that these should be discussed by the IIC, as the SEC had addressed the issues in the transition period during the ISB's formation, and "no action" letters were forthcoming.

Task Force Reports

Materiality Task Force

Mr. Horstmann reported on the activities of the Materiality Task Force. He reminded the Committee that he had presented a comprehensive report on the structure and contents of a materiality paper drafted by the Task Force at a previous meeting (the paper suggests possible guidance on applying materiality considerations to certain independence issues); the Task Force is awaiting comments from the SEC Staff. This document is expected to be formally adopted at the IIC's August 11th meeting, in anticipation of Mr. Horstmann's possible presentation of the paper to the ISB at its August 31st meeting. Mr. Horstmann also welcomed any additional comments on the paper from the IIC members.

Outsourcing Task Force

Mr. Dakdduk discussed his Task Force's paper on independence concerns surrounding outsourcing engagements, which had been distributed to IIC members in advance of the meeting. The document outlines common outsourcing engagements, the potential independence issues they pose, and possible mitigating controls that could be used to protect auditor independence. The group's charge was to capture the issues that the Board should consider if it undertakes a study of these engagements, as well as to express some preliminary views of the Committee on this subject. Mr. Dakdduk encouraged the Committee members to forward him any comments they may have on the paper.

Mr. Guinan offered that significant U.S. case law exists on contract labor situations - the definitional terms used might be helpful to the Task Force in answering such questions as:

- what is an "employee?" and
- who is ultimately responsible in an outsourcing engagement for the work performed?

Mr. Guinan agreed to forward relevant case law material to the Task Force.

Mr. Ward stated that he was concerned that principles with widespread applicability would be hard to develop for outsourcing engagements, since these could range from the loan of a single employee to do bookkeeping at a client, to very large outsourcing engagements for a number of companies in the same industry.

In response to a suggestion by Mr. Guinan, Mr. Dakdduk agreed to contact The Outsourcing Institute to obtain this organization's views on the future and direction of outsourcing.

Alternative Practice Structures

Mr. Pearlman provided the Committee with a brief overview of the AICPA Professional Ethics Executive Committee's (PEEC) April 15, 1998 exposure draft on "alternative practice structures," *Proposed Interpretation under Rule 101, The Effect of Alternative Practice Structures on the Applicability of Independence Rules*. Mr. Pearlman described the basic structure of these alternative practices, and the proposed application of the independence rules to these situations. In response to a question from Mr. Ward, Mr. Pearlman confirmed that under the proposed guidance, a firm could conceivably separate its consulting and other businesses from its attest business, relinquish control of the non-attest business by selling a 51% interest in it, and then perform audits of companies unfettered by many of the independence rules governing consulting services performed for (or financial interests in) audit clients.

Mr. Horstmann noted that the proposal relates to a "live" structure that would have to be dealt with by the IIC or the ISB, as several companies had acquired the non-attest business of firms auditing SEC registrants, and employees of these companies were now also partners of and professionals serving attest firms auditing public companies. When asked whether the PEEC proposal was drafted with firms auditing private, as opposed to public companies in mind, Mr.

Horstmann stated that the AICPA does not distinguish between audits of public versus private companies in its rulemaking.

Mr. Bayless stated that he anticipated that the SEC would be commenting on the PEEC exposure draft.

The Agenda Subcommittee will discuss whether this issue should be put on the IIC's agenda as a new and emerging issue; independence issues related to the control of a firm by an outside entity are not covered in the existing independence literature. The IIC will not formally comment on the PEEC exposure draft at this time, as the Committee decided that firms and companies involved in these structures should be allowed to express their views to the Committee before it concludes on these issues. On the other hand individual firms were encouraged to comment, as the Staff of the ISB is likely to do.

Other Matters

Mr. Bayless stated that Lynn Turner, the SEC's new Chief Accountant, had been brought up-to-date on ISB/IIC activities, and planned on attending the next ISB meeting. Mr. Turner was looking forward to working with the Committee.

Next Meeting

The Committee's next meeting will be held on Tuesday, August 11, 1998 at 10 AM, in the New York offices of the AICPA.

* * * * *

Having no further business, the meeting was adjourned at approximately 11:25 AM.

Respectfully submitted,

Susan McGrath

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