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Summary of Testimony Robert E. Denham Before the Securities and Exchange Commission Hearing Regarding Revision of the Commission's Auditor Independence Requirements July 26, 2000

Robert E. Denham

Independence Standards Board

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Assurance of auditor independence is a critical precondition for the functioning of efficient capital markets. It is the independence of auditors, together with their technical competence, that justifies reliance on audited financial statements by capital markets participants. Given the changes that are occurring in the business of the large accounting firms, and the enormous scale and scope of some of these enterprises, there is a need to focus on independence issues. Chairman Levitt and the Commission should be commended for tackling the difficult issues of independence in the recent rule-making initiative, and the staff of the Commission should be commended for the enormous effort represented by this release.

In my view, by far the most important element of the release concerns scope of services. Here the Commission is uniquely well-suited to making the difficult public policy choices that are required to protect independence in an environment that has become increasingly complex. As a public member of the ISB I have encouraged the Commission to exercise its authority in this area, because the Commission is the only entity able to balance and evaluate the difficult policy issues that are involved. I am comfortable that the rules proposed regarding scope of services represent a rational, coherent and thoughtful set of policies that will substantially improve protection for auditor independence.

Certain other subjects covered in the proposed rules, particularly regarding employment with audit clients and family relationships, have been the subject of a great deal of attention by the ISB and its staff and advisory panels. In these areas, the ISB has developed proposed rules which are broadly similar to the rules proposed in the release, but differ in certain details. Sometimes the ISB proposals are more restrictive and sometimes the Commission's proposals are more restrictive, but the differences generally are not matters of great importance. Where the ISB's work is highly developed, as it is regarding family relationships and employment with audit clients, I would encourage the Commission to adopt the work done by the ISB. If there are important areas of difference, I believe those are few and can be readily resolved, but I do not believe there is any benefit to replacing what the ISB has done.

The Commission and staff have done a great deal already to focus attention on auditor independence. The role of the audit committee is particularly important, and the release appropriately emphasizes this role, just as the ISB has done. Even with the best of rules, independence can only be assured if audit committees take responsibility for assuring that the relationships between a corporation and its auditors do not undermine the ability of the auditor to exercise independent judgment. The proposed rules on scope of services will make it easier for audit committees to perform this important role.

Note: The foregoing testimony represents the views of the author and does not represent the view of the Independence Standards Board or the author's law firm.