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2000

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Independence Standards Board

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Recommended Citation

Johnson, Manuel H. and Independence Standards Board, "Testimony of Manuel H. Johnson, SEC Hearings on Proposed Rule Regarding Auditor Independence July 26, 2000" (2000). *Association Sections, Divisions, Boards, Teams*. 643.

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Testimony of
Manuel H. Johnson
Member, Independence Standards Board
SEC Hearings on Proposed Rule Regarding Auditor Independence
July 26, 2000

I would like to thank the Securities and Exchange Commission for the opportunity to testify on this important subject. Also, I applaud the SEC and Chairman Levitt for focusing on the issue of auditor independence at this time. The U.S. capital markets are the strongest globally by far because investors trust our system relative to all others. It would be impossible for the U.S. to finance this unprecedented economic expansion while running a huge trade deficit unless foreign investors were confident that their hard earned savings would be protected and the financial information they were provided regarding prospective investments was accurate and comparable across the economy. One of the foundations of this successful system is the independent audit of business financial statements. This is the element of our system that reassures investors that the financial data they receive from companies conforms to a common set of accounting standards.

It is critical that the audits of business financial statements not only be independent but be perceived as independent by the investing public. Perception and reality must be the same for confidence in our financial system to be maximized and allow the economy to reach its full potential. Over the years, changes in technology and the workplace environment have made it possible for individuals to vastly expand their investment options as well as pursue job opportunities throughout the economy at all possible levels. Two worker/two investor families have become common. Also, large accounting firms have grown even larger and much more diversified as they have sought to provide an array of technical assistance to business firms across the economic spectrum. While much of this trend (especially in the area of worker and

investor opportunities) is obviously good, the growing complexity of financial and employment relationships and the extent of non-audit services provided to audit clients by the major accounting firms has significantly increased the perception and the potential for conflicts of interest and threatens the integrity of the independent audit function.

One of the measures to deal with this problem was the establishment of the Independent Standards Board, of which I am a member, by the SEC and AICPA in 1997. The purpose was to create an institution that would modernize and streamline a series of old rules and guidelines with new principle-based standards for the determination of auditor independence. Chairman Allen has described the efforts of the ISB so I won't repeat them here except to say that considerable progress has been made in addressing many of the problem areas we are all concerned with.

However, I do feel it is important that the SEC undertake a new rule-making not only to strengthen the standards and guidance of the ISB, but also to directly address in a timely fashion the difficult policy issues surrounding the proper scope of services appropriate for accounting firms charged with the trust of performing independent audits.

Let me endorse what most of the other ISB members have said here. I am pleased that the SEC in its proposed rule-making has adopted the approach followed by the ISB in its deliberations on employment with audit clients, family relationships and financial interests. However, I do not see the need to develop, separately from the ISB, a completely different set of guidance and definitions that support such similar rules in these particular areas. The ISB has developed a deep infrastructure to deal with the details of guidance and implementation which can be relied upon by the SEC.