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Independence Issues Committee - Minutes of Meetings
Independence Issues Committee Minutes of November 17, 1998
Meeting Public Session

Independence Standards Board. Independence Issues Committee

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November 17, 1998

Independence Issues Committee - Minutes of Meetings

Independence Issues Committee Minutes of November 17, 1998 Meeting Public Session

The Independence Issues Committee (IIC, or the Committee) held a public meeting on Tuesday, November 17, 1998.

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

Committee Members

Edmund Coulson
Kenneth E. Dakdduk
John M. Guinan
Charles A. Horstmann
Robert J. Kueppers
Edward W. O'Connell
Frank J. Pearlman

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
Wayne Caviness*
Gary Illiano**
Susan McGrath - ISB Staff
Richard H. Towers - ISB Staff

* Present for part of the meeting.

** Mr. Illiano was sitting in for Mr. Barber.

Assisting Clients in the Implementation of FAS 133 - IIC Issue Summary 98-1

At Mr. Siegel's request, Mr. Horstmann led the discussion that began at the last meeting on the assistance that auditors could provide their audit clients in the implementation of the Financial Accounting Standards Board's Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities*. An Issue Summary had been distributed to the Committee members prior to the last meeting, and posted to the website for the benefit of interested parties. The paper describes the nature and level of services that might be requested, the threats to auditor independence that these might pose, and an analysis of several views as to how the existing rules might be applied. Members provided preliminary reactions to some of the services described, and to their

effect on auditor independence.

Mr. Caviness, an expert in derivatives from KPMG Peat Marwick, responded to questions from the Committee, particularly about the consistency of results produced by different models (or versions of models) used to value derivative instruments, so that the Committee members could better understand the judgments made by the provider of certain systems or valuation consulting services.

Everyone agreed that management must be sufficiently knowledgeable to take responsibility for derivative accounting matters.

The Staff will prepare a draft consensus for review by the Committee at its next meeting, subject to further Committee discussion on providing "generic," or "standardized" valuation packages to audit clients.

The Committee is expected to reach a consensus before year end that could be presented to the Board for ratification at its January 8, 1999 meeting.

Alternative Practice Structures - IIC Issue Summary 98-2

The Committee continued discussion on "alternative practice structures," the potential threats to auditor independence that these may pose, and how the existing independence rules should be applied in these situations. An Issue Summary and Addendum had been distributed to Committee members in prior meetings and posted to the ISB website for the benefit of other interested parties.

As requested at the last meeting, the Staff and a Committee task force (consisting of Mr. Kueppers, Mr. Dakdduk, and Mr. Barber) met prior to the meeting to develop a recommendation, for Committee approval, on how the existing independence requirements would be applied to alternative practice structures. Mr. Kueppers stated that the Committee concluded that if the "dual employment status" of AttestFirm partners was determinative (an indication that the separation between PublicCo. and AttestFirm was not substantive), then View C independence restrictions would apply. The task force was unsure, however, whether this dual employment situation in and of itself, or in combination with other relationships, resulted in a non-substantive separation. As such, the task force asked the Staff to prepare a list of "indicators" (potential illustrative relationships between PublicCo. and AttestFirm), for Committee discussion. The Staff distributed this list of potential indicators to Committee members prior to the meeting.

Mr. Siegel stated that the key issue was whether the auditor, in performing an audit of the financial statements of a client with relationships with PublicCo., might be unduly influenced by his or her PublicCo. employment or other relationships. For example, if the auditor's employer (PublicCo.) had a loan to the attest client, might the auditor fear retribution for issuing a "going concern" opinion that might impinge on the employer's ability to collect on the loan?

After a lengthy discussion of the issues, Mr. Siegel called for a vote on whether View B independence restrictions should be applied in alternative practice situations.

The vote was five in favor, one opposed, and two abstentions. Mr. Siegel noted that there was a Committee consensus on View B, and stated that the Staff would be presenting a dissenting view to the Board when the Committee consensus was presented for ratification.

There was a general discussion on the advisability of submitting, as the Committee's first request for Board ratification, a consensus encumbered by a dissenting ISB Staff view. The Committee decided to rescind its consensus and continue to look for a solution that was palatable to Committee members, the ISB Staff, and the SEC Staff.

Mr. Pearlman suggested that the Committee task force work to develop an alternative that was based on View B restrictions with tightened materiality definitions and additional limits on the scope of services that PublicCo. could provide to AttestFirm clients.

The IIC task force will develop an "indicators" or "factors to consider" approach which will aid in analyzing which independence restrictions should be applied to PublicCo. (or some portion of PublicCo.).

Mr. Siegel stated that he was looking for a solution from the Committee with which he could concur.

The Committee's objective is to reach a consensus on the subject prior to year end, for submission to the Board for ratification at its January 8, 1999 meeting.

Outsourcing Task Force

At Mr. Siegel's request, Mr. Dakdduk updated the Committee on the activities of his task force. He stated that his task force was waiting for comments from the SEC Staff on its outsourcing paper, which eventually will be presented to the Board to aid in its consideration of independence issues related to outsourcing engagements.

Mr. Bayless stated that he would remind Mr. Turner, the Chief Accountant, that the task force was waiting for the SEC Staff's comments.

ISB Staff Report

Coordination with the SEC Staff

Mr. Siegel briefly summarized the discussion at a meeting held between the ISB Staff, the IIC Agenda Subcommittee, and the SEC Staff on October 7th. Mr. Siegel also noted that Mr. Turner stated at the last ISB meeting that he would be forwarding certain open issues at the SEC to the ISB for its consideration and resolution. Certain of these issues may be matters appropriate for IIC handling. The ISB Staff is also waiting for comments from the SEC Staff on its "transition" paper - a paper proposing a framework for determining how new independence guidance should be implemented (i.e., retroactively vs. prospectively, and when and where grandfathering of existing practice might be appropriate).

ISB Staff Consultation Activity

At Mr. Siegel's request, Mr. Towers summarized Staff consultation activity. Mr. Towers stated that Committee members should have received copies of the recent Staff interpretation that was ratified by the Board at its November 3rd meeting; a version of this consultation had been posted to the ISB website that day. The recent interpretation was the second of the Staff's formal, published consultations. As to informal consultations, the Staff received and answered seven since the last meeting, for a total of sixty-two, classified by subject as follows:

Outsourcing	2
Bookkeeping	1
Former partners	1
Broker-dealers	1
Family relationships	1
Other	<u>1</u>
Total	7

Upon request, Mr. Towers agreed to investigate the feasibility of providing the IIC members with generic (i.e., on a "no-name" basis) summaries of selected, informative independence inquiries received along with Staff responses.

Board Task Force Activity

Mr. Siegel stated that the Board's conceptual framework project task force held its first meeting on October 29th, and was scheduled to meet again in the beginning of February to review a draft of a portion of a discussion memo, designed for public exposure, of some of the issues integral to the Board's conceptual framework project.

Mr. Siegel reported that the Board's project task force on family relationships between audit firm personnel and the audit client was scheduled to meet the following day. A task force subcommittee had developed a new proposed standard on family relationships, and the task force will review this and other alternatives based on the existing SEC and AICPA rules. These alternatives are expected to be presented to the Board at its January 8, 1999 meeting.

Mr. Siegel also reported that the Staff had converted the neutral discussion memo on auditors going to work for audit clients into a draft document for public exposure and comment. This draft document had been sent to the Board's employment with clients project task force for comment, and is expected to be presented to the Board at its January 8, 1999 meeting.

ED 98-1 - Discussions with Audit Committees

Mr. Siegel discussed the changes made by the Board to its original proposed recommendation to the SEC Practice Section (SECPS) that it require member firms to confirm their independence annually to the audit committees (or Boards) of their public company clients, and to offer to meet with the audit committee to discuss auditor independence. Mr. Siegel explained that the proposal was now for an ISB standard rather than a recommendation to the SECPS and to the Auditing Standards Board, and mandated discussion with the audit committee on independence matters. The proposed standard would allow flexibility in the timing

of the discussion, and has an effective date for audits of companies with fiscal years ending after June 30, 1999. Earlier application is encouraged.

Mr. Siegel urged those both attending and observing the meeting to comment on the ED, which is available on the ISB website (www.cpaindependence.org). Hard copies can be obtained upon request.

Mr. Pearlman asked if the auditor's independence would be impaired solely because he or she neglected to send the independence confirmation letter to the audit committee and have the mandated independence discussion. Mr. Siegel responded that, under the proposal, the auditor's independence would be impaired in those circumstances, and added that the SEC Staff had been asked to express their views on this matter.

Next Meeting

The Committee's next meeting will be held on Tuesday, December 15, 1998 at 10 AM, in the New York offices of the AICPA.

* * * * *

The meeting was adjourned at approximately 3:10 PM.

Respectfully submitted,

Susan McGrath

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