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Independence Issues Committee - Minutes of Meetings Meeting of May 12, 1998 Public Session

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May 12, 1998

Independence Issues Committee - Minutes of Meetings

Meeting of May 12, 1998 Public Session

The Independence Issues Committee (IIC, or the Committee) held a meeting in the offices of the AICPA in New York on Tuesday, May 12, 1998.

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

Committee Members

Barry Barber
Jerry W. Claiborne
Edmund Coulson
Kenneth E. Dakdduk
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
Susan McGrath — ISB Staff
Richard H. Towers — ISB Staff

Minutes

The minutes of public and executive sessions of the IIC's last meeting, held on March 17, 1998, were approved by the Committee members.

Staff Report

At the request of Mr. Siegel, Ms. McGrath solicited comment from the Committee on the Staff's draft proposal to the Board to develop a neutral discussion memorandum, to be exposed for public comment, on various issues integral to the development of the conceptual framework for auditor independence. Ms. McGrath stated that the draft proposal includes a timeline extending through completion of the conceptual framework, that illustrates how the discussion memorandum fits into the process.

Committee members agreed that international harmonization of independence

concepts was an important goal, where possible. Mr. Ward suggested that the Task Force formed to assist in the conceptual framework project include a member working in the international standards area to enhance harmonization. Mr. Barber offered that any differences between U.S. and international standards should be reasoned and rationalized. Mr. Pearlman suggested a possible member from the National Association of State Boards of Accountancy.

Responding to a question on the composition of the Task Force proposed by the Staff to assist in the conceptual framework project, Mr. Siegel stated that the Staff proposed that the Task Force include practitioners, academics, analysts and other users, and preparers of financial statements. It was the consensus of the Committee that this Task Force should also include some IIC members. Mr. Ward suggested that Audit Committee members who are not employed full-time might be included to represent user groups, as these individuals might have the time to devote to the project.

There was concern that users / investors might not comment, in sufficient number, on a discussion memo. Mr. Siegel replied that the Board would be asked if certain user groups should be solicited for input.

The Committee also supports research, and Mr. Siegel announced that Katherine Schipper, a professor at the University of Chicago, had been hired to advise the Board and the Staff on research matters. In response to an earlier question, Mr. Siegel briefly noted that the Board's Research Task Force projects were on hold and mentioned the April 27th forum for analysts.

The proposal to develop a discussion memo, for public comment, on the conceptual framework will be presented by the Staff to the ISB at its May 26, 1998 meeting.

Possible ISB Recommendation to SECPS to Require Firms to Confirm their Independence to Clients

Mr. Siegel called on Mr. Kueppers, Chairman of the Independence Confirmation Task Force, to update the IIC members on the possible ISB Recommendation to the Executive Committee of the AICPA's SEC Practice Section to require member firms to confirm their independence to clients. Mr. Kueppers stated that the Task Force had drafted an invitation to comment on the proposed recommendation, with the assistance of the Staff. He briefly discussed the specific questions on which the public would be asked to comment, and the flexibility in the timing of the confirmation provided in the recommendation.

The invitation to comment will be presented to the ISB at its May 26, 1998 meeting.

ISB's Consideration of Specific Projects for Potential Standard-Setting

Mr. Siegel reminded the Committee that the Board would consider specific issues, such as family relationships and auditors going to work for clients, to explore whether standard-setting was needed, concurrent with the development of a conceptual framework.

Family Relationships

Mr. Siegel called on Mr. Ward, Chairman of the Task Force on Family Relationships, to update the IIC on Task Force activities.

Mr. Ward solicited comment from the Committee on the draft neutral discussion memo prepared by his task force on family relationships and auditor independence. The discussion memo highlights the concerns surrounding auditors with family members at clients, summarizes the existing rules and the difficulties in applying them, and outlines various alternatives. The discussion memo was prepared to assist the Board in its consideration of these issues, and will be presented to the Board at its May 26, 1998 meeting. The consensus of the Committee was that the IIC, through its Task Force, should suggest possible solutions to the problems arising under the existing rules to the Board at its next meeting.

Employment with Audit Clients

Mr. Siegel asked Mr. Barber, Chairman of the Task Force on Employment with Audit Clients, to update the Committee on Task Force activities. Mr. Barber provided an overview of a neutral discussion memo, prepared by his Task Force with the assistance of the Staff, on the independence concerns that arise when auditors go to work for audit clients. The discussion memo was prepared to assist the Board in its consideration of these issues, and will be presented to the Board at its May 26, 1998 meeting. The discussion memo covers the pros and cons of the two alternate approaches generally suggested to protect independence when auditors go to work for clients — safeguards or a mandated "cooling-off" period.

It was the consensus of the Committee that research should be commissioned by the Board on both the family relationships and employment with audit clients issues, with the aim of developing new standards for public exposure. The Committee did not think that exposure of a neutral discussion memorandum, prior to the development of standards on family relationships, would be necessary.

Other Task Force Reports

Materiality

In response to Mr. Siegel's request, Mr. Horstmann provided a report on the activities of the Materiality Task Force. He stated that the Task Force has made progress in thinking through some of the issues, and had adopted a working definition of materiality that did not include quantitative definitions. He outlined the Task Force's approach, and stated that materiality had been studied with respect to bookkeeping services, appraisal and valuation services, cooperative arrangements, and financial interests. The work of this task force cuts across many topics, and thus may be used when considering other issues.

Mr. Horstmann stated that a discussion memo would be available for the Committee's review prior to its June meeting.

Outsourcing

Mr. Dakdduk delivered an update on the activities of the Working Group formed

to provide input to the Task Force on Outsourcing. The Working Group had identified a list of common outsourcing services or arrangements, and developed a working definition of an outsourcing engagement. A paper discussing the independence issues surrounding outsourcing services has been drafted. The Working Group will report to the Task Force on its progress in the next few weeks.

Other Independence Issues

Mr. Siegel stated that the Committee had originally been scheduled to discuss a current independence question regarding the definition of a "member." The question was whether, for example, employees of an accounting firm providing administrative-type services to an audit client (perhaps on an "outsourcing" basis), were "professionals providing professional services" as described by Rule 2-01(b) of Regulation S-X (and thereby required to be independent).

Mr. Siegel asked if the question was important and pervasive enough to develop into an IIC consensus. The Committee agreed that the problem was not pervasive at this time, and decided to defer development of an issue summary.

Mr. Dakdduk asked whether it would appropriate for the Agenda Committee to report to the IIC on its activities. Mr. Siegel responded that he believed that such a report was indeed appropriate, and summarized the Agenda Committee discussion that took place in May. He stated that a question had been posed as to whether in-process R&D; appraisals performed by an audit firm in conjunction with an APB 16 purchase price allocation impaired independence. The SEC Staff noted that this issue was pending at the Commission when the ISB was formed. Therefore, and pursuant to the agreement between the SEC and the ISB, the SEC Staff will make the decision in this particular case. In addition, there are other issues relating to this matter which need to be resolved by the Commission before it can be adequately considered. Consequently, the SEC Staff suggested that the IIC defer consideration of the generic issues involved until these matters could be resolved.

In response to a question, Mr. Towers indicated that the ISB Staff had completed one formal and about a dozen and a half informal consultations on independence issues. Several more were currently in process.

Mr. Siegel asked Committee members to forward current independence issues/future topic recommendations to the staff for consideration by the Agenda Subcommittee.

Mr. Pearlman, who also chairs the AICPA's Professional Ethics Executive Committee (PEEC), agreed to arrange for a presentation at the June meeting on PEEC's proposal on alternative firm structures, which is currently being exposed for public comment. Mr. Siegel stated that the Staff would probably comment on the proposal, as the Staff had been instructed by the Board to comment on matters of interest emanating from other groups. Mr. Siegel agreed to solicit IIC input at the June meeting on the Staff's planned comments.

Next Meeting

The date of the Committee's next meeting was changed to June 15, 1998, and

will be held at 10 A.M. in the AICPA's New York offices.

* * * *

The public meeting was adjourned at approximately 12:30 PM.

Respectfully submitted,

Susan McGrath

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