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Staff Recent Interpretations Issued: AJ.Robbins April 10, 1998

A. J. Robbins

Independence Standards Board

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Staff Recent Interpretations Issued: AJ.Robbins

April 10, 1998

This staff interpretation, unless otherwise indicated, has not been ratified by the Independence Standards Board, and therefore may not be relied upon with the SEC staff by parties other than those directly involved.

Mr. A. J. Robbins
AJ. Robbins, PC
Suite 201
3033 East 1st Avenue
Denver, CO 80206

Dear Mr. Robbins:

The ISB staff has reviewed your letters dated March 9, 18 and 23 requesting an interpretation of the auditor independence rules, and has considered these letters, including through discussions with you and advisors to your firm and, on several occasions, with the staff of the Securities and Exchange Commission. As we have advised you, the ISB staff is required by the ISB Operating Policies to make its determinations and interpretations based upon existing SEC guidance. While the situation you have described has some mitigating aspects, it also raises a number of concerns and, as we informed you by telephone on March 25, for this particular combination of facts and circumstances, we are unable to agree with your conclusion that your firm is independent. A description of our analysis follows.

In your described situation, it is the combination and interplay of concerns for which it is too difficult to overcome a judgment that the appearance of independence would be impaired. This environment of concerns includes that:

1. A former partner, very recently on the engagement (closely connected to it and very knowledgeable about the client) has certain continuing financial relationships with the firm, and in these particular circumstances is viewed as still linked to the firm. (The individual in question is considered as a former partner for independence purposes because prior to termination she had the title and was held out to the public as a partner.) The continuing firm financial relationships include the likely disputed overpaid bonus and unpaid 1997 contributions to, and remaining cumulative vested balances in, a firm discretionary defined contribution plan and a firm money purchase pension plan.
2. The former partner has significant involvement in, and some impact on, the client's current accounting and financial reporting. This relationship is of concern given the above continuing relationship with the accounting firm.
3. There is possible - in one case seemly "contemplated" - litigation between the firm and the former partner. This raises a concern under Codification of Financial Reporting Policies 602.02.i.ii as to whether the situation "might be expected to alter substantially the normal relationship between client and public accountant."

At your verbal request, we also considered and discussed with the SEC staff whether several proposed changes could now be made in order to thereby

consider your firm to be independent for the 1997 calendar year audit, for which you have indicated that most audit procedures already have been completed. However, because various concerns regarding your independence existed when those audit procedures were being performed (and not all those concerns could even now be removed), we do not believe that actions taken now could eliminate the independence impairment. This position is consistent with that expressed, as to litigation, by the SEC staff in Codification section 602.02.i.ii:

"The Commission's staff has also been asked whether once conditions giving rise to a lack of independence are eliminated, it is possible for the independent auditor to report on a client's financial statements that cover a period during which litigation was taking place. While the facts of the particular circumstances must always govern, in general it appears that a report can be independently rendered for such a period as long as no audit field work was done while the circumstances which would have prejudiced independence existed." (emphasis supplied)

Sincerely,

Richard H. Towers
Technical Director

AJ. ROBBINS, PC
Certified Public Accountants
and Consultants

March 9, 1998

Mr. Rick Towers
Independence Standards Board
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Rick:

Thank you for your time and informal guidance last week. This letter will more formally state the facts, issues and conclusions I have drawn regarding an independence issue. I would appreciate both an informal response by you as soon as possible (the client files financial statements with Form 10K by March 29, 1998), and a formal response as soon as feasible regarding these matters.

Facts:
My firm employed an individual (P) from January 1994 until July 1997. She was hired as an audit manager and promoted to "partner" during that period. The "partner" designation was not in the true sense a real partner; that is, she owned no stock or equity in the firm, was not required to make any capital contribution

nor pay for that status, had no financial responsibilities, and was paid a set salary. She was also paid a salary bonus based upon a complex formula related to firm profitability. Upon her discharge, all financial obligations to her were completed except that she is indebted to my firm for being overpaid under the bonus (which she probably disputes). She was not paid for any equity and there are no future benefits due her based on firm profitability.

During her employment, she was the manager in charge of a domestic SEC registrant audit (C), which has a December 31 year-end. During 1997, she wrote the initial planning memo for the year-end audit; however, she did not perform any other audit procedures during the year. After her discharge, she approached C as a consultant and informally in October 1997 was engaged to assist them with preparing analytical work on schedules in order to amend prior 10Q's and prepare the third quarter 10Q. In December 1997, she and C signed a formal engagement letter for consulting services to consist of financial accounting services and accounting systems services for January 1998 through March 1998 for an $8,000 per month retainer.

Under the Contract of Employment P signed with my firm in January 1994, if an employee acquires a client of the employer within 24 months of termination, the employee must pay a specified multiple of the prior annual or average annual fees to the employer. As a result of P's engagement with C, her receiving fees for October 1997 through December 1997 work and her work with C beginning January 1998, I have a further financial claim against her.

During a recent interview of P she expressed the following statements to me:

1. Work prior to December consisted of analytical work on schedules for Forms 10Q.
2. She prepared some schedules for audit workpapers such as equity reconciliations and property, plant and equipment schedules.
3. She engaged in no bookkeeping prior to year-end of after year-end.
4. She has no decision making capacity.

During the fieldwork of the audit we learned that she had made journal entries to the general ledger for the year-end adjustments and she was being considered for Chief Financial Officer position in the future.

Issues

1. P might be construed as a "former partner" and as such, might cause an independenceproblem with the firm and C. There are certain rules under "former partner" which mustbe followed particularly if she is considered a current officer of C.
2. Is P an employee of client management or just an outside contractor? If she is considered part of management this could impair independence.
3. If P is an employee of management the potential prior claim for bonus may impair independence. Furthermore, the current claim for C becoming her client might also impair independence.

Conclusions:

The Codification of Financial Reporting Policies (as promulgated by the SEC) section 600 covers the rules on Matters Relating to Independent Accountants. In summarizing background of certain provisions under this section it provides in the

field of auditing, the CPA is under a responsibility to maintain strict independence of attitude and judgement. SAS 1 provides that independence might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence. The Code of Professional Ethics also states the auditor must be free of any financial or other interest, which would create the perception that he may not be independent. SAS 1 further states the auditor must be free from any obligation to or interest in the client, its management or its owners. The Securities and Exchange Commission continues to endorse and require scrupulous adherence to these principles.

Section 606.02.f deals with retired partners. If any circumstances exist indicating that the retired partner in fact retains some influence in the firm or gives that appearance, independence would be impaired. Any payments to a retired partner that are related to current revenues would indicate continuing influence. As described earlier, P was a partner in name only and had no financial interest in the firm. Further, there are no future payments to be made to her and, therefore, she is unable to exert any continuing influence in the firm.

A closer problem might exist under this section since P was closely connected to the professional services rendered to C before retirement and very shortly after retirement became associated with C. The conclusion reached however, even if P has become part of C management (which I do not believe as explained further on) all active connections with the firm were severed and, therefore, independence is not impaired.

Section 606.02.i.ii deals with litigation. When an accountant commences litigation against a client in connection with audit work, it is presumed that the accountant and management are placed in an adversarial situation. The existence or expressed threat of litigation would adversely affect the independence. Even under circumstances that there is a strong possibility that a suit will be brought will effect independence.

The potential firm bonus claim against P was not client-audit related, and the claim for client engagement is not audit related. If P were part of management, these issues might impair independence.

During 1997, P was engaged as an independent accountant/consultant for the specific purpose of amending prior filed financial statements. She was not an officer, was not part of management and made no managerial decisions. The claims my firm has against her do not affect C in any way and independence should not be impaired.

The fact that she is now being considered for the CFO position should not affect independence for the 1997 audit. Others are also being considered during this period and C has made no decisions. Also, although this consideration may have the flavor of intended management, P is currently not part of management, has not assumed any of the CFO responsibilities and this additional fact does not impair independence.

Finally, we have examined the extent P was able to "mold" the financial statements due to her contract work on certain audit schedules and financial entries to the general ledger. We have concluded that her work was analytical in nature and did not require any decision making ability on her behalf. In other words, these workpapers were calculations that we could have prepared for the

client since their purpose was for us to test correctness of certain accounts. Her preparation of these plus the adjustment to the general ledger to correct the accounts for the calculation did not change her status from outside contractor to management nor give her the ability to "mold" financial statements of C.

To paraphrase from the Financial Reporting Release, independence is determined in light of all the pertinent circumstances in the particular case. The various rules, while not all encompassing, are intended to act as a general notification, which educates practitioners and places the responsibility for recognizing these general areas of potential loss of independence. We strongly believe that we have examined all the relevant facts and circumstances in this situation and it is our firm belief that independence for the 1997 year has not been impaired.

In conclusion, I appreciate your review of this situation and respectfully request a timely response from you.

Very truly yours,

AJ. ROBBINS, P.C.

AJ. ROBBINS, PC
Certified Public Accountants
and Consultants

March 18, 1998

Mr. Rick Towers
Independence Standards Board
1211 Avenue of the Americas
New York, NY 10036-8775 **VIA FAX 212-596-6137**

Dear Rick:

Thank you for your timely response. The following additional facts will hopefully allow you to come to a final conclusion.

Our client 'C' has current revenues of approximately $13 million. During 1997, the existing Chief Financial Officer was promoted to Chief Executive Officer; thereby leaving the Chief Financial Officer position available. Since the old CFO is still employed by the client, the open position of CFO does not cause a hardship since the CEO is able to fulfill both positions. In addition to the CEO/CFO individual, the Company employs one accountant who prepares financial statements on a monthly basis. The Company also employs four other accounting clerks and maintains an internal audit department of approximately 4 individuals. It is apparent that there are adequate accounting department employees without "P" or an equivalent individual capable to maintain the Company financial

reporting.

"P" was employed as an audit manager in January 1994 and was promoted to the "partner"designation approximately June 1995. As discussed in my first letter, as a partner she was not entitled to any different equity benefits from other employees except for the bonus. In effect, she was more an employee than a partner.

"P" was the audit manager on the "C" engagement. The planning memo for 1997 was written by a staff accountant and reviewed by "P". After "P" was terminated from my firm, I hired an audit manager to replace her on this and other engagements. This new individual reviewed the entire planning memo and made changes as deemed necessary considering the knowledge that "P" had of the client.

We have interviewed "P" to gain a full understanding of the work she performs as an independent contractor for "C". During 1997, her engagement was limited to only preparation of schedules and she had nothing to do with management. According to the Chief Executive Officer, "the services provided to the Company by "P" were limited solely to the preparation of analytical schedules under the direction and close supervision of Company officials for the purpose of the Company amending certain Forms 1OQSB and 1OKSB and the Company filing Form 10QSB for the period ended September 30, 1997. Ironically, no such Forms were amended. "P" did not prepare, effect or otherwise influence the books and financial records of the Company nor did she have any authority to effect policy or influence the operations of the Company in any manner whatsoever during 1997. "P" has not been nor has "P" functioned as an employee, officer or director of the Company at any time in the Company's history." During the three months in 1997, she billed the client only a total of $5,950.

In 1998 "P" was engaged for three months (January through March) at a rate of $8,000 per month. According to the Chief Executive Officer, "pursuant to a written letter agreement dated December 18, 1997, the Company engaged the consulting services of "P" intermittently from January 1, 1998 until it expires under its own terms on March 31, 1998. "C" compensated "P" at a rate we believe is commensurate with the local market for similarly qualified consultants offering similar services. The services performed for the Company by "P" during 1998 have been limited to a) researching, evaluating and recommending an upgrade to the Company's general accounting software systems; b) the analysis of the workflows within the Company's accounting department and recommendations for the improvements thereof; c) researching and evaluating the Company's current implementation of SFAS 123 and SFAS 128 and recommending possible improvements in internal record keeping for the proper implementing of SFAS 131;d) reconciling the deferred income tax accounts to Schedule M-1 on the Company's Federal Income Tax Returns; e) preparation of certain analytical schedules under the direction and close supervision of Company officials for the purpose of the Company's officials applying the provisions of SFAS 109, SFAS 123 and SFAS 128 for December 31, 1997 and the twelve months then ended; f) other miscellaneous analytical work as designed and directed by Company officials, and g) under the direction and close supervision of Company officials, researching and evaluating the completeness of the drafts of the Company's Form KSB for the period ended December 31, 1997 and the Company's Definitive Proxy Statement to be filed in April 1998. "P" did not prepare, effect or otherwise influence the books and financial records of the Company nor did she have any authority to affect policy or influence the operations of the Company in

any manner whatsoever during 1998. "P" has not been nor has "P" functioned as an employee, officer or director of "C" at any time in the Company's history. No other agreement, written or otherwise, exist or are, as of the current date contemplated between the "C" and "P". "

Finally, I would like to give you additional details regarding the firm's money purchase pension plan and discretionary contribution plan. Neither of these plans have any specific benefits for partners; they are nondiscriminating for all employees. Since "P" was a full time employee, she was entitled to the same percentage contribution of salary as all employees each year. Those contributions were made usually in October of the year following the plan year. An equal percentage contribution was made for "P" in October 1997 for calendar year 1996. Her balances in the trust which are administered by an outside investment firm are approximately $30,000 which is vested 40% as of December 1997. As a result of termination, 60% of the balances will be forfeited. At any time she requests these funds she can be paid them or they may be left in the plans similarly to any employee of the firm. Although she is a participant in the plans during 1997, the fact that she has balances should not be construed that she is a remaining member of the firm.

The hope this second letter gives final clarification of facts and circumstances.

I look forward to your response.

Very truly yours,

AJ. ROBBINS, P.C

AJ. ROBBINS, PC
Certified Public Accountants
and Consultants

March 23, 1998

Mr. Rick Towers
Independence Standards Board
1211 Avenue of the Americas
New York, NY 10036-8775

VIA FAX 212-596-6137

Dear Rick:

Thank you again for your timely comments to my letter of March 18, 1998.

I understand your and the SEC staff concerns regarding the appearance that a member of the firm may have been part of the client accounting staff. I am able to appreciate that the size of the consulting fees and the consideration of the offer of CFO position may give the appearance that a line may have been crossed. However, my review of the facts and review of Exchange Act Release 798 yields

different conclusions.

As stated to you previously, P was discharged from my firm on July 21, 1997. After that date she ceased all work for my firm, received no further compensation, share of profits, nor did she participate in any firm benefits except for medical benefits for three months until covered under COBRA law and participation in the firm employee benefit plans as required by ERISA.

P became a Consultant for C in October 1997. The engagement, as confirmed by C and her, was assisting in the preparation of analytical schedules for the purposes of amending prior Forms 10-Q and assisting in the preparation of the September 30, 1997 10-Q. It is important to note that the prior Forms 10-Q did not require amending since they were filed correctly by C. That decision was made by C after consultation with my firm and not with P.

Indeed, we noted that certain journal entries were made by P after the year end to adjust certain accounts for the client. Specifically these were normal accruals of expenses, recording issuance of stock warrants, recording some non-cash transactions and reclassifications for corrections. These journal entries were recorded ant the requests of The Chief Operating Officer, who is an accountant and was the prior Chief Financial Officer. He had in the past supervised these types of adjustments with accounting staff and supervised these adjustments with P.

This situation is entirely different from the one described in Release 798. In that case, the member participated as the firm's auditor after he accepted employment with the client. This distinction is extremely important. The member prepared audit schedules after accepting employment. In addition while still employed by the firm, he prepared schedules noted as "prepared by client", which the audit firm later audited which placed the firm in the improper position of auditing its own work. These issues purport to show that the member played a dual role as auditor and client management.

P did not play a dual role as auditor and client management. There is a clearly defined line when her firm employment terminated and when she becomes a client consultant more than two months later. As I have also stated in previous letters, P never becomes part of C management. As confirmed by P, she was not part of C management and therefore did not function as a decision maker for C. Furthermore, C confirms to us P did not prepare, effect or otherwise influence the books and financial records of the Company nor have any authority to effect policy in any manner.

Minutes of the board of directors of C discussed the possibility of offering P the CFO position. However, the board decided that that it was premature to offer any individual such a position and recommended that the CEO continue on in the CFO position for the time being.

I understand your concern with the overall environment considering the size of the consulting fees and the status of the CFO position. However, in my firm's opinion, even considering the closeness of substance of the issues, we continue to firmly believe that our independence was not impaired due to the above facts.

The second issue of sensitivity noted by the SEC staff concerns the proposal to amend former Forms 10-Q. C believed that Forms 10-Q needed to be amended

since prior filed financial statements included a Pooling of Interest which was later rescinded. At the time the Forms 10-Q were filed, the Pooling was a correct accounting treatment. There was no error. During the third quarter of 1997, certain condition occurred whereby C felt in it's best interest to undo the transaction. Amending the Forms 10-Q is not necessary although C is restating financial statements for those periods without the transaction in future periods.

At no time was amending or restating an issue of dispute between C, P or my firm. The disputes leading to P's termination from my firm resulted from disagreements of treatment of employees and clients. There were never issues relating to client audit matters.

To repeat certain facts, P did not have an engagement letter with C for the final three months of 1997. It appears that C was under the impression that prior filings had to be amended. They were not. However, the analytical work performed by P is not being disputed since it is being used for subsequent filings.

Again, I appreciate your timely response and comments to the above. Time is of the essence.

Very truly yours,

AJ. Robbins, P.C.

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