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1998

## Exposure draft: independence discussions with audit committees, November 12, 1998; ED 98-1

Independence Standards Board

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# **Exposure Draft**

## **Independence Discussions with Audit Committees**

November 12, 1998



**Independence  
Standards  
Board**



**Independence  
Standards  
Board**

**Exposure Draft  
(ED 98-1)**

**Independence Discussions with  
Audit Committees**

**November 12, 1998**

Comments are due by December 16, 1998 and should be mailed to:

Independence Standards Board  
1211 Avenue of the Americas, 6<sup>th</sup> Floor  
New York, NY 10036-8775

Attn: ED 98-1

Alternatively, they may be faxed to 212-596-6137 or sent via e-mail to [isb@cpaindependence.org](mailto:isb@cpaindependence.org) (the subject line should refer to ED 98-1).

**(ED 98-1)**



**Independence  
Standards  
Board**

Date: November 12, 1998

To: Interested Parties

From: William T. Allen, Chairman

The Independence Standards Board is seeking comments on the following proposal for required discussions between the independent accountant of a publicly-owned company and that company's audit committee.

**BOARD**

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*Center for Law and Business*  
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*Technical Director*

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All responses will be available for public inspection and copying for one year at the offices of the Independence Standards Board and at the library of the AICPA at Harborside Financial Center, 201 Plaza Three, Jersey City, New Jersey.

**Proposal**

This standard applies to any auditor intending to be considered an independent accountant with respect to a specific company within the meaning of the Securities Acts ("the Acts") administered by the Securities and Exchange Commission. Such an auditor and the audit committee of the company (or the board of directors if there is no audit committee) shall, during the course of the annual audit, discuss the auditor's independence. Specifically, the auditor shall disclose, in writing, all relationships between the auditor and the company, including personnel relationships, that may reasonably be thought to bear on independence, so that the audit committee and the auditor can discuss them. The auditor should then confirm that, in its professional judgment, it is independent of the company within the meaning of the Acts.

The above communication is required with respect to audits of companies with fiscal years ending after June 30, 1999, with earlier application encouraged.

**Background and basis for conclusions**

In May 1998 the ISB issued an Invitation to Comment (ITC 98-1) regarding a proposed recommendation to the Executive Committee of the SEC Practice Section (SECPS) of the American Institute of Certified Public Accountants. The proposed recommendation would have required audit firms that are members of SECPS to confirm annually to the audit committee (or board of directors) of each public company audit client, each year,

that the firm was independent of the client. In the confirmation the auditor would also offer to meet with the audit committee to discuss independence matters.

The Board received twenty-six letters in response to the ITC. Most of the letters were supportive, but some urged the Board to go further and require communication to the audit committee of the important matters considered in each particular situation in reaching a conclusion that independence was maintained.

After deliberation, the Board concluded that it agreed with those who suggested that the proposal be expanded, and it also decided that it would itself address the matter as a proposed standard, rather than ask the Executive Committee of SECPS to do so. Consequently, the proposal has been converted from an Invitation to Comment to an Exposure Draft of a Board pronouncement. In addition, the Board decided that the discussion about independence between the auditor and the audit committee should be required, rather than encouraged by the auditor's written communication.

The Board believes that the proposed pronouncement would improve corporate governance by affording to audit committees a mandated opportunity to deepen their understanding of auditor independence issues. Companies are required by the Acts to engage "independent" accountants, and this proposal will assist directors in satisfying themselves that the company has met that requirement. The Board also believes that a mandate that audit firms describe and discuss the judgmental matters that might impact on independence will bring more focus within firms on this important issue.

The Board considered whether to require that the discussion between the audit committee and the auditor take place before any substantive audit procedures had begun. There are clear benefits to the audit committee to obtaining satisfaction about independence before the audit is started. The Board recognizes, however, that many audit committees have established meeting schedules which would not accommodate such a discussion before the audit begins, and it concluded that imposing such a requirement was not essential to achieving the objectives of this pronouncement.

The Board recognizes that every additional requirement imposes costs, but the Board believes that the costs to implement this pronouncement would be small, particularly when compared with the benefits.



**Independence  
Standards  
Board**