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## Presentation to 1998 Twenty-sixth Annual AICPA National Conference on Current SEC Developments

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Independence Standards Board

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## A. Siegel, 1998 AICPA Conference on Current SEC Developments

# 1998 Twenty-sixth Annual AICPA National Conference on Current SEC Developments

**1998 Twenty-sixth Annual  
AICPA National Conference  
on Current SEC Developments**

**December 9, 1998**

**Arthur Siegel  
Executive Director  
Independence Standards Board**

Good afternoon. It's a pleasure to have the opportunity to speak to you again about the Independence Standards Board. I want to remind you, however, that my comments reflect my personal views and not necessarily those of the Board or of any Board member.

The Independence Standards Board recently wound up its first year of operations, and I'd like to update you on our progress in achieving our goals, reflect on the challenges ahead, and spend a few minutes on some personal observations.

As you know, the Board's most fundamental project is to develop a conceptual framework for independence applicable to audits of public companies. That framework will then serve as the foundation for the development of principles-based independence standards. Our goal is to develop a framework that works, that makes sense in today's world, that is easy to understand, and which articulates coherent principles that can be applied to new or unique situations.

Hank Jaenicke, a professor at Drexel University, has been engaged to direct, draft, and provide thought-leadership on the conceptual framework project. Alan Glazer, a professor at Franklin & Marshall, will assist Hank.

We have assembled a broad-based, project task force, representing a wide variety of groups, including auditors, academics, analysts and other users of financial statements, and corporate directors and officials, to assist in framework development. The idea is to have a broad group representing all constituencies closely involved in the process, to ensure that all issues and viewpoints are adequately considered in each stage of framework development.

This group held its first meeting at the end of October and Professors Jaenicke and Glazer led a lively and fruitful discussion. The group is scheduled to meet again on February 5 to review the first part of a discussion memo, that eventually will be exposed for public comment, on the objectives of auditor independence.

Concurrent with its work on the conceptual framework, the Board is studying two

specific issues - family relationships at the audit client, and audit firm people going to work for audit clients - for possible standard-setting. Broad-based task forces, similar in composition to the conceptual framework task force, have been formed to assist the Board in ensuring that documents exposed for public comment are comprehensive and balanced, and in determining what, if any, research is required. At its January 8 meeting, the Board is expected to deliberate about possible new standards on family relationships and, if agreement is reached, exposing that new standard for public comment. In addition, the Board will consider authorizing the exposure, for public comment, of a "neutral" discussion memo on the employment with audit clients issue.

A fuller discussion of each of these projects is included in our 1998 Annual Report, copies of which are available outside. The Annual Report is also available on our website, [www.cpaindependence.org](http://www.cpaindependence.org).

In May, the ISB issued an Invitation to Comment 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 member firms to confirm annually to the audit committee (or board of directors) of each public company audit client, that the firm was independent of the client. In the confirmation the auditor would have also offered to meet with the audit committee to discuss independence matters.

After deliberation and review of comments received, 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 mandated, rather than encouraged .

The comment period on the Exposure Draft ends on December 16<sup>th</sup>, and the Staff will summarize comments received for Board consideration at the January 8<sup>th</sup> meeting. If adopted, the communication requirement would be effective for audits of companies with fiscal years ending after June 30, 1999, with earlier application encouraged. A copy of the Exposure Draft (ED 98-1) is available on the ISB's website and I urge you to furnish us with your comments.

As you know, the Independence Issues Committee of the ISB is organized to provide guidance on emerging auditor independence issues not specifically addressed in the literature, within the framework of the existing independence rules - much like EITF for accounting matters.

The IIC is currently studying the independence issues related to "alternative practice structures," and the nature and level of assistance that firms can provide their audit clients in implementing FAS 133, Accounting for Derivative Instruments and Hedging Activities. The IIC hopes to present consensus on these issues to the Board for ratification in January.

Before I conclude, I'd like to share some personal reflections after a year at this job.

The NYS Society of CPAs is sponsoring a Symposium next week entitled "The

CPA and Independence - Illusion or Reality." Some of you may have seen the promotional flyer for the symposium. It asks questions such as:

- Do lawsuits against accountants reveal a lack of auditor backbone - i.e., independence?
- Do investment advisors feel auditor independence needs strengthening?
- Is a lack of independence a threat to the capital markets?
- Do Chairman Levitt's concerns on earnings management raise independence issues?
- Do accounting firms see independence concerns as a threat to the way they presently operate? And
- What responsibility does the preparer community have in preserving auditor independence?

I don't know about you, but I am troubled by the use of the word illusion regarding independence. I am also troubled by the tone of those questions and that the symposium is attracting a blue ribbon panel and a large audience -and I am one of the panelists! Yes, I welcome the attention to my new favorite subject of auditor independence - I just wonder why it is suddenly a favorite of so many other people. I don't criticize the NY Society - they have simply described the mood they are sensing.

In considering, however, what the ISB could do about that mood, it is becoming increasingly clear to me that no approach to auditor independence - whether it is our current detailed-rule approach, or the goal of the ISB of a conceptual framework for independence and principles-based standards - will work if the environment isn't right. So let me describe what I believe would be ideal - some would say idyllic - conditions.

In an ideal world the leadership of the profession and of each of the firms would regularly remind their partners and staff, in all departments, and their clients, that integrity, objectivity and independence are the hallmarks of the profession, that they consider those the core values of their firms, and that violations of those core values will not be tolerated.

In an ideal world, partners would reinforce that message to their staff through both words and actions - and demonstrate that they value the audit by making sure their audits are done right; sure, auditing is a business, but it's a profession and public responsibility first and foremost.

In an ideal world, firms would promote audits as adding value in their own right - by providing the credibility that reduces the client's cost of capital, and by providing additional assurances to senior management and the board of directors that they are managing with reliable information. Talk of the audit as a commodity would be prohibited, and violators would have their mouths washed with soap!

In an ideal world, firm communications - whether in proposals, or in brochures or on websites - would describe the firm's core values of integrity, objectivity and independence, would describe the audit as a continually improving, value-added service - and only then would describe the other value-added services that the firms offer and that clients could expect.

In an ideal world, senior management of companies would communicate - at least

once a year - that they are committed to reliable financial reporting as a company core value, and they too will not tolerate violations of that core value.

In an ideal world, audit committees would work with the outside auditor to help strengthen the auditor's independence and - if necessary - his backbone, by emphasizing to management their commitment to fair financial reporting and their intolerance for violations. And audit committee members who see their primary charge as negotiating a lower audit fee would be reassigned to the management compensation committee!

I don't believe those ideal conditions would be hard to attain.

I believe the leadership of the firms hold these values - they just need to be reminded that maintaining the right tone at the top requires rearticulation on a regular basis, because of the understandable day-to-day business pressures everyone is feeling, and because of the number of new employees hired each year.

I believe audit partners and staff would welcome a reaffirmation of the value of their core service, and would be happy to reinforce it.

I believe most corporate managements are of high integrity, and it is already a best practice to remind everyone regularly of the company's commitment to integrity and fair financial reporting.

And similarly, I believe that the best audit committees are a positive force for auditor independence and proper financial reporting, and hopefully the blue ribbon panel on audit committees will reinforce that practice.

We seem to have been inundated recently with stories of financial reporting gone bad; we need the good people out there - the vast majority - to not only stay good, but to drown out the bad with positive messages of their own. Otherwise, we will be left with the notion that "everybody does it" - and in that "lowest common denominator" environment, no set of independence standards will be effective.

Thank you for your attention.

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