1999

Comment Letters Re: Exposure Draft (ED 98-1) Independence Discussions with Audit Committees

Independence Standards Board

NEWS RELEASE
June 5, 1998

Independence Standards Board

William T. Allen
Chairman

Tel: (212) 596-6133
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Announcement of An Invitation to Comment

The Independence Standards Board (ISB) announced the issuance of an Invitation to Comment titled "Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants".

This Invitation to Comment (ITC) proposes that audit firms confirm their independence annually to each public company client's audit committee or board of directors. If adopted by the American Institute of Certified Public Accountants (AICPA) SEC Practice Section (SECPS) as a part of its membership requirements, compliance would be tested as part of its peer review program.

The ISB welcomes comments and suggestions on any aspect of the proposed Recommendation and in particular on the specific questions described in the document.

The ITC is available on the ISB website http://www.cpaindependence.org/pubs/98-1.htm or by calling the ISB at 212-596-6133.

Responses to the ITC should be received by July 23, 1998 and should be addressed to:

Independence Standards Board
1211 Avenue of the Americas
6th floor
New York, NY 10036-8775

Attn: ITC 98-1

In addition, responses can be faxed to 212-596-6137 or sent via e-mail to isb@cpaindependence.org (subject line should refer to ITC98-1).

ITC 98-1 Comment Letters

Corporate Affairs Division
Pfizer Inc
235 East 42nd Street
New York, NY 10017-5755
Tel 212 573 3273 Fax 212 573 1853

Terence J. Gallagher
Vice President—Corporate Governance

June 23, 1998

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

Re: ITC98-1

Gentlemen:

In my position as Vice President-Corporate Governance of Pfizer Inc. I am charged with recommending to the Board of Directors procedures which will improve the corporate governance structure of the company. The Proposed Recommendation would, in my opinion, be a positive addition to good corporate governance. The investing public should be able to rely on the opinion of the auditors with respect to the Company's financial statements in making an investment decision. It is vital to such reliance that the auditors expressing the opinion be independent.

The Proposed Recommendation would provide positive conformation of that independence both through the required statement and the review with the Audit Committee. It would be helpful if this process was conducted early in the audit process, however, I would leave flexibility to the companies. Since I believe this to be a positive development I would support it as a requirement for all auditors.

Very truly yours,

Terence J. Gallagher

Author: MIME:RBaker@umassd.edu at INTERNET
Date: 7/1/98 12:08 PM
Priority: Normal
TO: ISB at AICPA3
Subject: Response to ISB Invitaiton To Comment

This is a response to ISB Invitation to Comment (ITC 98-1).

My name is C. Richard Baker, and I am Associate Professor of Accounting at the University of Massachusetts-Dartmouth. I have been a professor of accounting for over twenty years and I have specialized in investigating the role of the public accouting profession in society. I have published over thirty papers dealing with various subjects in accounting and auditing.

My comments on ITC 98-1 are as follows:

1) Will the proposed Recommendation be helpful in fostering additional attention on independence issues by audit committees and their auditors?

If the auditor is required to communicate with an audit committee then the Recommendation will be helpful. If the auditor can communicate to the board of directors then the Recommendation will not foster additional attention on independence issues by audit committees. This is because, if there is no audit committee then there cannot be additional attention focused by a non-existent committee. The necessary precondition to answering the question is that there be an audit committee. Consequently, audit committees composed solely of non-executive directors should be required for all public companies.

2) Is there a more or equally effective mechanism for promoting audit committe evaluation of the independence of the entity's auditor?

Assuming that there is an audit committee, then the emphasis should be placed on meetings in which management is not present between the audit committee and the auditor. A written communication affirming independence is somewhat an matter of form. Substance would entail a mandatory meeting between the audit committee and the auditor during the course of which independence would be affirmed.

3) Do the benefits of the proposed requirement outweigh its costs?

Assuming that an audit committee exists, and assuming that the audit committee is properly carrying out its function, there should already be regular meetings between the audit committee and the auditor. Therefore, if a company is conforming with best practices in corporate governance, there should be no additional cost.

4) Would it be desirable to recommend that the independence confirmation be delivered at the time the auditor is appointed for the upcoming audit?

It would be desirable for the auditor to affirm that they are independent when they are appointed. However, the required affirmation from the auditor to the audit committee would be best made upon completion of the audit and prior to the release of the audit report. The audit committee and the auditor should meet regulary without management present in order to discuss any issues concerning the audit, including independence.

5) The proposed Recommendation should be adopted for all public companies, consequently, the proposal should be a dual recommendation to both the SECPS and the ASB.

Thank you for the opportunity to response to the request of the ISB.

Sincerely,

C. Richard Baker

==
C. Richard Baker, Ph.D., CPA
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HAROLD D. HEIN
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July 2, 1998

Independence Standards Board
6th Floor
1211 Avenue of the Americas
New York, NY 10036-8775
Attn: ITC 98-1

Gentlemen:

I am a retired partner of Ernst & Young and have been in public accounting practice for more than 40 years. I am also a former member of the Colorado State Board of Accountancy. I am presently completing 4 years as a member of the Board of Directors of NASBA.

I have a few comments concerning certain portions of the Proposed Recommendation to the Executive Committee of the SECPS of the AICPA. As I am not engaged in the auditing business, I do not have any comments concerning the first three questions asked. However, with respect to when the auditor should provide the written assurance to the client to be audited, from the public's perspective, I believe it would better serve the purpose if it is required to be delivered on or before the time the proposed auditor is to be appointed. The client is less likely to be surprised later on during the audit with an auditor independence problem. It just makes good logical sense to me to have the independence confirmed in advance of the start of the audit. I recognize there may be the need for a few exceptions, but I believe they should be few.

As to the need for a follow-up assurance at the end of the audit, I do not believe that is necessary in all instances. I believe the GAAS independence requirements should make it unnecessary in most audits. However, when there has been a change in the audit team personnel during the course of the audit, such as one of the principal's on the audit team going to work elsewhere, I think it would be useful to require the auditor to address the independence confirmation at the end of the audit in light of the audit team changes. This would help both sides focus on the change in personnel, particularly when one of the audit team goes to work for the client before the end of the audit.

Concerning the situations where the auditing firm is not a member of the SECPS and thus not subject to its rules, I believe it is prudent to have a dual submission of the Recommendation to both the SECPS and the Auditing Standards Board. While it may take longer for the ASB to fully implement the requirement, it still makes sense that <u>all</u> auditing firms be covered by the same compliance procedures.

Thank you for this opportunity to comment.

Very truly yours,

Harold D. Hein

copy to Dennis P. Spackman, CPA

Author: MIME:EdRockman@csi.com at INTERNET
Date: 7/7/98 12:26 PM
Priority: Normal
TO: ISB at AICPA3
Subject: ITC98-1

I am writing in response to the invitation to comment on confirmation of auditor independence. I think this is a case of attempting to "fix a problem with a rule." If there is a problem with independence in public companies, whether perceived or actual, I doubt that submission of a boilerplate letter will go very far to fix it. Unless the client's audit committee, or the board, actually takes an active role in monitoring independence, such a requirement will be meaningless. The firm has already taken the position that it is independent by performing the audit and issuing its opinion. An effective challenge to that position by the audit committee must come from the audit committee. I doubt it would be stimulated by the receipt of a boilerplate letter. About the only thing this rule would do would be to give peer reviewers another thing to look for (i.e., another nit to pick).

I would particularly not recommend taking this to the ASB. The definitional problems of determining what clients to apply this to would be challenging. I am afraid that the temptation would be to apply the recommendation to all audits. If there is one thing that private company auditors do NOT need, it's another requirement that puts form ahead of substance.

In my opinion, the ISB would perform a greater service with a public education campaign aimed at audit committees and boards. This campaign would explain the nature and importance of independence. The campaign should be aimed at getting the audit committee to think about sensitive areas of independence so that members can intelligently question the auditors.

As an aside, I note that the boilerplate report uses the term "examination." It is my understanding that the general term for opinion services on historical financial statements is "audit." The term "examination" is generally applied to services rendered under the attest services standards.

Edward F. Rockman
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AIR PRODUCTS ITC 98-1 Comment Letters Batch 2 Rec'd 7/13

Air Products and Chemicals, Inc.
7201 Hamilton Boulevard
Allentown, PA 18195-1501
Tel 610 481-7932
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Paul E. Huck
Vice President and
Corporate Controller

9 July 1998

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

Attn.: ITC 98-1

Dear Sirs:

Air Products and Chemicals, Inc. is pleased to comment on the "Proposed Recommendations to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants." Although we did not receive the Invitation to Comment directly, we believe a corporate response is appropriate.

We are a worldwide supplier of industrial gases and related equipment and selected chemicals. Air Products has more than 16,000 employees worldwide, operations in 30 countries and annual sales of approximately $5 Billion. We are listed on the New York and Pacific Stock Exchanges.

Our comments are formatted to address each of the five questions raised on page 4 of your document.

1. Not necessarily. Auditor independence is required by Generally Accepted Auditing Standards (GAAS) and therefore is presumed with no qualified opinion. If questions arise regarding auditor independence thereby causing the potential for a qualified opinion, it would most assuredly be discussed with the Audit Committee. This is best handled on an exception basis. The proposed letter will become one more annual boiler plate communication.

2. Ongoing questions and discussions at Audit Committee Meetings should be sufficient.

3. No. Although the costs should be minimal, they are still additional and the benefits, if any, to most companies do not warrant <u>any</u> additional costs. Incremental decisions are what lead to too many regulations and the resulting costs.

4. If there was such a requirement it would make most sense to have the discussion at the time of auditor appointment.

5. Since independence is already covered by GAAS, it would be appropriate for consideration to add or amend related requirements to be addressed by the Auditing Standards Board (ASB) and apply to all audits – not just those of SEC clients. However, this broadened requirement will add to the total cost which is a reason for not going forth with the proposal.

Sincerely,

Paul E. Huck

Paul E. Huck
Vice President and Corporate Controller

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c: J. H. Agger
A. J. Gubanich
J. M. Knepp

A Responsible Care® Company

Author: MIME:ammondson@worldnet.att.net at INTERNET
Date: 7/15/98 3:30 PM
Priority: Normal
TO: ISB at AICPA3
Subject: ITC98-1

Imput on questions regarding above.

Question:
1.Doubtful

2. Require all independent auditors to adhere to well defined standards and rules
of independence. If independence is defined properly there should be no need for additional opinions and the standard opinion should suffice. With monitoring through peer review and application of sanctions, there should be no need of audit committee concerns regarding independence.

3. Costs would be negligible as well as benefits.

4. See above.

5. See. above

Submitted by Curtis Ammondson, Montana Board

Utah State
UNIVERSITY

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July 13, 1998

American Institute of CPAs
Independence Standard Board, 6th Floor
1211 Avenue of the Americas
New York, NY 10036-8775

ATTN: ITC 98-1

Dear ISB Members:

As a member of the Technical Support Group for the NASBA Ethics Committee, I am taking the opportunity to comment on the ISB's Proposed Recommendation to the Executive Committee of the SEC Practice Section of the AICPA on Confirmation of Auditor Independence. My comments are made within the context that any standard or requirement of auditor independence must be focused on investors' confidence in the auditing profession. While I feel the current level of investor confidence in the profession is strong, the profession must continue to be proactive in establishing procedures and standards to maintain that confidence. It would be a mistake in judgement to wait until a lack of confidence arises to establish procedures to try to reestablish confidence.

The mission of the ISB is to establish independence standards applicable to the audits of public entities in order to serve the public interest and to protect and promote investors' confidence in the securities markets. The ISB Proposal to require discussion with an entity's management and written confirmation regards to auditor independence is congruent with the ISB mission and best interest of the public profession. Specifically:

1. The proposed Recommendation will be helpful in focusing additional attention on independence issues by audit committees and/or boards of directors and their auditors. While it is not reasonable for all boards of directors or even audit committees to be familiar with all the rules which constitute auditor independence, an open discussion on the subject with their auditors, accompanied by a confirmation letter, would enhance awareness of independence issues and further assure public confidence in the audit process.

2. The proposed Recommendation seems to be an effective mechanism for promoting audit committee evaluation of the independence of the entity's auditors. A formal meeting of the auditors and the entity's audit committee will not take a great deal of time but will cause more careful scrutiny and awareness of independence issues for both the entity and auditor.

3. The perceived benefits of increased entity awareness and direct accountability of the auditor, which should help preserve investors' confidence in the audit process, are well worth the incremental costs of implementing the Recommendation.

4. It seems most desirable to confirm independence at the time of auditor appointment. Once an audit is underway it becomes difficult and costly to make adjustments necessary to deal with a perceived independence issue. Moreover, if the report on independence is not required at the inception of an audit, perhaps with the engagement letter, some of the benefit will be lost. The entity's board of directors or audit committee should consider auditor independence as an important factor in auditor selection. Auditors should establish their independence with the entity as part of their proposal process.

5. The proposed Recommendation should be applied to all auditors of U.S. public companies. More stringent requirements for auditors belonging to the SECPS does not seem in the best interest of the profession. If a standard is appropriate, all who practice the profession should be held to it.

The proposal should be a dual recommendation to both the SECPS and the ASB. The SECPS Executive Committee can not only implement the Recommendation more expeditiously, but can have greater influence on the ASB implementation process through SECPS implementation. Furthermore, the SECPS has a responsibility to help foster standards that promote the interests of the auditing profession and the general public.

In summary , the proposed Recommendation of the ISB on Confirmation of Auditor Independence is an efficient and effective mechanism to help promote and assure auditor independence and help continue investors' confidence in the reporting process.

Respectively submitted,

Cliff Skousen

Clifford R. Skousen, Ph.D., CPA
Ernst & Young Professor and Head

cc D. Spackman, Chairman
NASBA Ethics Committee

Rec'd 7/20

IFAC

INTERNATIONAL FEDERATION OF ACCOUNTANTS

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Office of the Chair
IFAC Ethics Committee

Marilyn Pendergast
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Independence Standards Board
1211 Avenue of the Americas, 6th Floor
New York, New York 10036-8775

Attn: ITC 98-1

15th July 1998

Dear Sirs,

Confirmation of Auditor Independence

The Ethics Committee of the International Federation of Accountants (IFAC) is pleased to have this opportunity to respond to the Board's Invitation to Comment on the proposed recommendation to the SEC Practice Section of the American Institute of Certified Public Accountants (SECPS)

The IFAC Ethics Committee agrees that the proposed recommendation would be helpful in focusing the attention of audit committees and Boards of Directors of companies on the important issues related to auditor independence and foster greater understanding of these issues within SEC registered companies management without adding any significant additional costs to the company.

We concur with the proposed recommendation that the timing of the notification and discussion be flexible since the relationship of the client and the auditor is the best determinate of when and in what manner the required information should be communicated.

Because the requirement for independence is already clearly embodied in generally accepted auditing standards, changes in auditing standards, which would affect privately-held companies as well as those which are regulated would not appear to be appropriate.

The IFAC Ethics Committee notes that auditors of foreign companies registered with the SEC may not be members of the SECPS and therefore, this requirement, as proposed, would not extend to those auditors. The ISB might consider whether a recommendation to the SEC that similar guidelines for auditor notification regarding independence in accordance with the IFAC *Code of Ethics for Professional Accountants* be established for auditors of foreign registrants who are not members of the SECPS.

I should be pleased to discuss any questions you may have or to amplify any areas of this response.

Sincerely yours,

Marilyn Pendergast

Marilyn Pendergast,
Chair—IFAC Ethics Committee.

KPMG Peat Marwick LLP

55 East 52nd Street
New York, NY 10055

Telephone 212 909 5400

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Rec'd 7/20

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July 17, 1998

Independence Standards Board
6th Floor
Attention: ITC 98-1
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants (ITC 98-1)

Dear Board Members:

We support the ITC's proposal that the auditor should confirm the audit firm's independence to the audit committee and offer to discuss the subject further. The confirmation and offer would be constructive additions to the current communications between the auditor and the audit committee. An SECPS membership requirement requiring the confirmation and offer should be consistent with the spirit and requirements of SAS 61, building on the communication process already established.

In one respect the ITC's recommendation is not fully consistent with the approach in SAS 61. The SAS allows oral communications to the audit committee, whereas the recommendation in the ITC would call for a written confirmation in every instance. We suggest eliminating the proposed requirement that the confirmation be in writing. The SAS 61 process should not be fragmented. A written report would not add in any way to the auditor's obligation to be independent. The proposed written report's message is very brief. A letter is not necessary as documentation, because SAS 61 requires that if the option to communicate orally is taken, the communication be documented in the working papers.

The confirmation should assert independence under the rules that are relevant to audits of SEC registrants and should be no more lengthy than necessary. We therefore suggest this language: "we are independent accountants within the meaning of the applicable independence requirements recognized or adopted by the SEC." The rules "recognized" by the SEC at this time are those of the ISB. There is no need to single out the requirements of the AICPA. The AICPA recognizes the ISB's standards as the independence standards applicable to auditors of SEC registrants. There should be no allowable implication that the AICPA considers compliance with the rules of the ISB and SEC insufficient for audits of SEC registrants.

The ITC nowhere mentions the assurance of audit independence available to the audit committee from peer review. Audit independence is an element of quality control specified in professional standards, and a clean opinion in the triennial peer review means that the design and operation of the reviewed firm's quality control system, which includes its independence element, provide reasonable assurance of conforming with professional standards. The passage in the ITC that explains the desirability of the proposed confirmation in light of its costs (paragraph 6) should therefore acknowledge that the confirmation would stand in addition not only to the assurance given by the audit report's statement of compliance with GAAS, but also to the assurance provided by triennial peer review. Apart from making the text more complete and accurate, the inclusion would be a courtesy, since the ITC's recommendation is to be addressed to the SECPS and required quality controls with mandatory peer review is one of the most prominent elements in the SECPS's program to improve audit quality. Even in light of peer review the recommendation is desirable as a constructive contribution to the communications between the auditor and the audit committee.

With regard to the specific questions asked in the ITC:

1. The degree to which the proposal will focus additional auditor and audit committee attention on independence issues cannot be known. It will provide confirmations by auditors and occasions for independence to be discussed, which we think are sufficient reasons for the requirement. We do not believe there is a need to focus significant new attention on auditor independence, and the ITC brings to bear no evidence or argument justifying such attention. The context should be constructive communications between the auditor and the audit committee.

2. No mechanism, including the one recommended, can practicably promote effective audit committee "evaluations" of the auditor's independence. Each committee on such a quest would at least have to master the applicable rules, bring to bear evidence-gathering skills and evaluative techniques, and obtain and assess the evidence of compliance with

the rules. A fuller evaluation would include learning the quality controls and safeguards the firm employs, determining compliance with them, and assessing the effect of this system on the engagement team. Apart from the feasibility of achieving effective evaluations, the attempts to achieve them would radically change the cost-benefit ratio. The costs to the shareholders would be the dominant costs of the proposal, and they are not mentioned in paragraph 6 at the moment. Statements or implications that evaluations can be practicable either as a result of the proposal or by other means should not appear in follow-on documents.

It is not clear why this question was asked. It has no direct link to the recommendation, which does not involve an audit committee evaluation of audit independence. The confirmation would provide assurance, and the optional discussion could elaborate on that assurance as well as improve a director's understanding of audit independence. The audit committee could thereby obtain an additional measure of satisfaction as to audit independence, which would be one of the recommendation's benefits. But the receipt of such assurance is not an evaluation of audit independence. Moreover, paragraph 7, which mistakenly implies in sentence 2 that knowledge of the independence rules alone would be sufficient to make the determination, says the Board concluded that the audit committee could not determine the auditor's independence.

3. The benefits will exceed the costs, assuming the recommendation is set in the framework of routine SAS 61 communications between auditors and audit committees.

4. No. The confirmation should be a normal part of the communications between the auditor and the audit committee governed by the approach in SAS 61. Paragraph 9 of the discussion section suggests the Board favors following the SAS 61 approach on timing.

5. The recommendation should be submitted to the SECPS, not to the ASB and not to both, despite the fact that some small number of auditors are not members of the SECPS. The flexibility of SAS 61, the modest nature of the proposal, and the small number of auditors of SEC registrants who might escape the requirement argue against disregarding the regulatory symmetries now in place. The jurisdictions of the ISB and the SECPS are restricted to audits of SEC registrants, whereas the ASB has responsibilities for standards governing all audits, not just audits of SEC registrants. GAAS requires audit independence, but the ASB has generally looked elsewhere for independence rules, never getting into implementation requirements. Moreover, it is far more important for the nonmember auditors to join the SECPS and become subject to its full program of audit

quality than for them to adopt the recommended communication as nonmembers. The AICPA has done all it could to maximize the inclusion in the SECPS of all auditors of SEC registrants. The SEC should require that the remaining auditors be members.

***

Thank you for the opportunity to submit these comments. We would be happy to explain further any of them that are unclear or raise questions. Inquiries may be directed to John Guinan (jguinan@kpmg.com).

Sincerely,

KPMG Peat Marwick LLP

KPMG Peat Marwick LLP

Clifton Gunderson P.L.C.
Certified Public Accountants & Consultants

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June 30, 1998

Independent Standards Board
Sixth Floor
1211 Avenue of the Americas
New York, New York 10036-8875

Dear Members:

I submit the following thoughts and comments concerning ITC 98-1:

1) It is not clearly defined as to the time of confirmation of independence. I would encourage the Committee to require the confirmation of independence prior to the time the auditor is selected or as part of the selection process.

2) I endorse the independence confirmation process and encourage meetings with the audit committee as part of this process. I recommend the Board consider stronger language for encouraging meetings with the audit committee.

3) I disagree with the Board's approach in Item 9 to timing of the independence confirmation. It should be part of the process in the selection and approval process for auditors by the audit committee.

Thank you for your consideration.

Sincerely,

Ronald E. Nielsen

Ronald E. Nielsen, CPA, CFE, CVA, ABV

REN/my

July 10, 1998

Independence Standards Board
6th Floor
1211 Avenue of the Americas
New York, New York 10036-8775
Attn: ITC 98-1

Gentlemen:

The Audit Issues Task Force (AITF) of the AICPA Auditing Standards Board (ASB) has taken the opportunity to read and consider your Invitation to Comment, *Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants*.

The AITF members support your objective to increase the dialog between auditors and their clients on auditor independence. We look forward to considering the comments you receive about whether this matter should be put on the ASB's agenda.

The AITF consists of seven of the ASB's fifteen members. Among its various duties, the AITF serves as the ASB's planning committee and considers which matters are put on the ASB's agenda.

Very truly yours,

Deborah D. Lambert

Deborah D. Lambert, CPA
Chair
Auditing Standards Board

Thomas Ray

Thomas Ray, CPA
Director
Audit and Attest Standards

cc: Auditing Standards Board

FAX TRANSMISSION

TN STATE BOARD OF ACCOUNTANCY
500 JAMES ROBERTSON PARKWAY
NASHVILLE, TN 37243-1141
(615) 741-2550
FAX: (615) 532-8800

To:	Independence Standards Board	**Date:**	July 21, 1998
Fax #:	(212) 596-6137	**Pages:**	Two (2), including this cover sheet.
From:	Don Hummel, Administrative Director, TN Board of Accountancy		
Subject:	Confirmation of Independence		

COMMENTS:

See comments attached. Original follows by mail.

DEPARTMENT OF COMMERCE AND INSURANCE
TENNESSEE STATE BOARD OF ACCOUNTANCY
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July 21, 1998

Independence Standards Board
6th Floor
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Board:

As a member of the Technical Study Group for the Ethics Committee of the National Association of State Boards of Accountancy I have been asked to review and comment on your ITC 98-1 which proposes to require firms to confirm their independence annually to each public company client's audit committee or board of directors.

The comments herein are made as a member of the study group identified above and do nor reflect the opinions or beliefs of the Tennessee State Board of Accountancy.

One of the major qualities that a CPA brings to the audit environment is independence. In my mind anything that brings more focus to the issue of independence in the auditor's mindset and to the audit committee or board of directors as well, is good. I think especially that bringing a focus on independence to the audit committe or board of directors is needed. If that entity is fully aware of the importance of independence then the firm and auditor will necessarily be vitally concerned with independence. I know of no more effective mechanism than a bilateral focus of both the seller and buyer.

My impression is that it would be desirable to recommend that the independence confirmation be delivered at the time that the auditor is appointed. And, in my opinion there should be a dual recommendation to both the SECPS and the ASB. The more emphasis from regulators the better. As your paper states, the cost should be nominal and the benefits would outweigh that cost.

In short, I favor the proposed recommendation.

Sincerely,

Don N. Hummel

Don N. Hummel
Administrative Director

CROWE CHIZEK

July 13, 1998

Independence Standards Board
6th Floor
1211 Avenue of the Americas
New York, New York 10036-875

Attention: ITC 98-1

Gentlemen:

We are pleased to comment on the Independence Standards Board's proposed recommendation ITC98-1 and the five questions therein. This proposed recommendation encourages the AICPA's SEC Practice Section Executive Committee to require member firms to annually confirm independence to each public company, which we will refer to as "confirmation." In some, but not all, of our engagement letters this firm already provides this confirmation.

Question 1. The confirmation will slightly increase attention to independence issues by audit committees, since they will read an additional paragraph in the engagement letter, SAS 61 letter, or other communication, specifically stating the auditor is independent. Some audit committees may wonder why the obvious is being stated. We think auditors of public companies already devote considerable attention to independence issues and thus the incremental additional attention by auditors due to this confirmation will be minor.

Question 2. A more effective mechanism for promoting audit committee evaluation of auditor independence awaits more "principle-based" independence standards. As acknowledged in paragraph 7 of the Invitation, current independence rules contain many interpretations, circumstances, and other items to consider. Communicating the workings of today's rules and interpretations to an audit committee may require more effort than it provides in enlightenment. Accordingly, we encourage the ISB to move quickly to a more principles-based system.

Question 3. The benefits from this confirmation are probably minor, in that most audit committees already focus on independence in a general way. The costs are probably minor, since we anticipate the confirmation will become a ritual paragraph inserted in an engagement or other letter. Indeed, if the peer review process is to scrutinize whether this confirmation was delivered, as the proposed recommendation suggests, the confirmation will most likely become a ritualized process to ensure compliance.

Question 4. The timing of the confirmation is problematic, but it is probably better delivered at or near the end of the audit. At the commencement of the audit, the auditor is probably least likely to have an independence conflict, and thus the confirmation would have the smallest significance. The confirmation at this point also would be prospective ("we intend to stay

CROWE, CHIZEK AND COMPANY LLP
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independent accountants"), and thus weaker, because the auditor can not realistically confirm their independence during the audit until the audit has occurred. A confirmation after completion of the audit could follow the wording suggested in paragraph 4 of the Invitation ("Relating to our examination ...we are independent accountants..."). Such a confirmation would also cover the entire period of the audit, and not be prospective. If, as stated in paragraph 8 of the Invitation, the issuance of the auditor's report serves to reaffirm that the auditor was independent, there may be no need for an incremental confirmation—just refer the audit committee to the auditor's report.

Question 5. The SECPS requirement reaches all but a handful of audits of U.S. public companies, and thus appears sufficient. The incremental cost to develop an auditing standard via the Auditing Standards Board, versus the small number of additional audits to be covered, does not appear justified.

Additional comments follow.

The proposed language of the confirmation could be improved. In the optional lead-in, we suggest revising the words "is required to issue to the company's audit committee or board of directors a report confirming the auditor's independence under the applicable rules." To better express the point, we suggest instead: "to confirm to the company's audit committee or board of directors that it is independent under the applicable rules."

We suggest the proposed language of the confirmation refer to "audit" instead of "examination."

The last sentence of the document does not remind the reader that the independence representation is required by a principal auditor because generally accepted auditing standards require it, and not necessarily because the principal auditor has a separate desire for such a representation.

We note that only one of the 10 generally accepted auditing standards, independence, has been singled out for this recommended confirmation. Other standards, including technical training and proficiency, due professional care, adequate planning and supervision, sufficient internal control understanding to plan, and sufficient competent evidential matter obtained, are also considered important and may, if missing, perhaps lead to more audit failures than lack of independence. We are not suggesting that these other items be added to the confirmation, only that careful cost-benefit considerations be undertaken as to the one standard selected for confirmation.

If there are questions, please call Jim Brown.

Very truly yours,

Crowe, Chizek and Company LLP

THE INSTITUTE OF INTERNAL AUDITORS

William G. Bishop III, CIA
President

Professional Development

Research Foundation

Certified Internal Auditor®

July 21, 1998

Arthur Siegel
Executive Director
Independence Standards Board
1211 Avenue of Americas, 6th floor
New York, NY 10036-8775

Dear Art:

Thank you for your personal invitation for commentary on the Independence Standards Board's (ISB) proposed recommendation to the SEC Practice Section (SECPS) of the AICPA. The Institute of Internal Auditors (IIA) is pleased to comment on the proposed recommendation. The Board's objective of improving auditor independence requirements is of urgent importance to The IIA and all professional financial organizations.

Although you did not ask for an overall conclusion, we believe the proposed recommendation should not be presented, at least in its present form. Our reasoning follows:

a) A standard confirmation seems to be redundant. Auditors already affirm to the world the independence of their mental attitude as required by GAAS in their specific warranty contained in the standard audit report.

b) A standard confirmation asserting independence, particularly one provided at the beginning of the audit process, would not communicate how a firm did comply with the requirement to "be independent in fact and appearance when providing auditing and other attestation services" as stated in AICPA Code of Professional Conduct, Article IV.

c) A standard confirmation is likely to be a stereotyped routine communication that may not improve directors' understanding of independence issues.

d) It is unwise to place additional focus on the current highly technical and complex ethics rules. The time and resources spent to convince directors of the effectiveness of current standards may well detract from or delay achievement of ISB's goal of developing a new conceptual framework for auditor independence.

e) Without substantial amplification, the SECPS peer review program would be unable to effectively test compliance with existing independence rules, i.e. measure the success of a firm's systems designed to achieve stated behavioral objectives. Current quality control standards relating to independence are largely definitional and do not describe the "matters essential to the effective design, implementation, and maintenance of the system" as stated in AICPA Statement on Quality Control Standards No. 20.

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Although we do not favor the proposal as stated, we are very much in agreement with the Board's objective of increasing meaningful dialog between auditors and audit committees. To accomplish this objective, the Board should carefully consider several of the recommendations made by the Public Oversight Board in its monograph: *Strengthening the Professionalism of the Independent Auditor* and its pamphlet: *Directors, Management, and Auditors: Allies in Protecting Shareholder Interests.* In addition, we suggest consideration of an additional requirement that a firm at the end of the audit should communicate to the audit committee substantively what steps the firm took to achieve the requirement of maintaining an independent mental attitude and appearance of independence. This discussion could well be framed within the context of communicating qualitative judgements about accounting principles, disclosures, and estimates.

The following answers directly address the numbered questions in the invitation for comments:

1) No, while it is difficult to say that this activity may not be helpful, we believe the additional attention given to independence by directors will be marginal.

2) Yes, as stated above, a focus on communicating how the firm achieved the required behavior objectives would be more effective. Further, if the Board's primary objective is to promote audit committee evaluation of independence, this factor should be set forth more prominently.

3) No, since we believe that the benefits would be marginal, the recommendation may divert attention and resources away from the Board's long-term goals of developing a comprehensive framework for auditor independence.

4) No, this would stereotype the requirement into a predictive promise that would not be responsive to generally accepted auditing standards. We believe the alternative suggested in response to question #2 would be most effective.

5) Yes, the recommendation should be made jointly for the reasons stated.

Established in 1941, The Institute of Internal Auditors (IIA) is an international professional organization with world-headquarters in Altamonte Springs, FL. The IIA has nearly 70,000 members in internal auditing, governance, internal control, IT audit, education, and security. With representation from more than 100 countries, The Institute is the acknowledged leader in certification, education, research, and technological guidance for the internal auditing profession worldwide.

Best regards,

Bill

William G. Bishop III, CIA

CC: Executive Committee
Professional Issues Committee

MASON & COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS

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CORRESPONDENTS IN PRINCIPAL
U.S. CITIES AND ABROAD

July 21, 1998

Hon. William T. Allen, Chairman
Independence Standards Board
1211 Avenue of the Americas
New York, NY 10036

Dear Judge Allen:

I have been a licensed and practicing Certified Public Accountant for over 50 years. I have signed dozens (and possibly hundreds) of audit reports for inclusion in filings with the Securities and Exchange Commission, and I am impelled to describe the May 29, 1998 "proposed recommendation" as redundant and as a charade.

To have KPMG Peat Marwick advise General Electric, after many years, that they are independent, to have Deloitte & Touche (successor to Haskins & Sells) advise General Motors, after many years, that they are independent, to have Price Waterhouse advise Chase Manhattan, after many years, that they are independent - is just plain silly. If a CPA does not understand and adhere to Rule 101 "Independence" of the AICPA Code of Professional Conduct, they should be shunned and shamed.

The real heart of auditor independence is not ownership of shares in a client company, but rather the exercise of management activities by the "independent" auditor. The Fried Frank "White Paper" which was described as "educational materials bearing on the conceptual framework for protecting and enhancing auditor independence" was, in fact, an advocacy document for management and consulting services by "independent" auditors. Page 50 of the "White Paper" carries the caption, "There is No Evidence that the Performance of Non-Audit Services by Accounting Firms for Audit Clients Impairs Independence in Fact." Further, the "White Paper" does an injustice to former Securities and Exchange Commission Chairman Harold Williams under whose leadership Accounting Series Releases (ASR) 250 and 264 were promulgated. There was a time when the term used was "Management Advisory Services (MAS)," later converted to "Management Services (MS)," and now the dubious description is "Consulting." Chairman Williams knew that by any other name such services could intrude into the independent nature of the independent auditors' services. ASR 250 and ASR 264 both were a step in the right direction but were opposed by a segment of the accounting profession, and with a change of political administration in 1981, ASR 250 and ASR 264 were rescinded. I respectfully recommend that the members of the ISB reread ASR 250 and ASR 264 which were written by prophets at the SEC.

Right on point is the attached recent article written by Ms. Melody Petersen entitled, "Consulting by Auditors Stirs Concern," (The New York Times, July 13, 1998). The article starts, "Federal securities regulators have grown increasingly concerned that the accounting industry's lucrative expansion into computer consulting may be creating conflicts with the accountants' role of being watchdogs for investors." Also, right on point is the attached recent article written by Ms. Joann S. Lublin and Ms. Elizabeth MacDonald, entitled, "Scandals Signal Laxity of Audit Panels" (Wall Street Journal, July 16, 1998). Please note the following sentences in this article: "Too many audit committees are turning out to be toothless tigers." and "Investor activists have long attacked such panels for lacking enough independence or financial expertise to uncover most management misdeeds."

Also enclosed is Wall Street Journal full page ad inserted by Ernst & Young containing the verbiage "we helped a multinational manufacturer accelerate its product development cycle time by 30%." Also enclosed are lead sheets of SEC Administrative Complaint against KPMG Peat Marwick in the matter of KPMG Baymark. The SEC recently concluded two weeks of testimony against KPMG Peat Marwick before an Administrative Law Judge in which the SEC contended, among other things, that KPMG Peat Marwick made a six figure loan to the President of one of its audit clients.

Judge Allen, the real challenge to the four public members of the ISB is whether they will act with courage, objectivity and independence. After all, the Public Oversight Board (POB) during 20 years looked at "independence" time and again and never proposed a real solution thereby making it necessary for the new ISB to be created by pressure from the current Chairman of the Securities and Exchange Commission.

Respectfully yours,

Eli Mason

Copy: Hon. Arthur Levitt
Members of ISB

NEW YORK TIMES JULY 13, 1998

Consulting By Auditors Stirs Concern

Potential Conflicts Seen From Work on Software

By MELODY PETERSEN

Federal securities regulators have grown increasingly concerned that the accounting industry's lucrative expansion into computer consulting may be creating conflicts with the accountants' role of being watchdogs for investors.

Consultants from the Big Five accounting firms are now installing complex software packages at hundreds of companies. While the computer consulting is not new for the accounting firms, the business is so hot now that it is growing at annual rates of up to 50 percent. That growth, in turn, is drawing the attention of the Securities and Exchange Commission.

Federal regulations prohibit close ties between accountants and the companies they audit because auditors are expected to give an unbiased opinion on the accuracy of companies' financial statements. But because of the sudden consulting boom, never have the accounting firms been so involved in the day-to-day operations of some of their audit clients.

For example, Peoplesoft, a California software company whose products help automate a variety of vital corporate tasks, warned investors in its annual report this spring that sales could suffer if it could not find enough consultants skilled at installing its wares. The company's outside auditor, the accounting firm Ernst & Young, appears to be doing its best to help.

Ernst & Young not only gave Peoplesoft a clean bill of financial health, but is also a key partner of Peoplesoft's sales force. As many as 1,000 of the accounting firm's employees install Peoplesoft's products at other businesses around the world, many of them also Ernst & Young audit clients.

And, in a recent case that raised some investors' eyebrows, Ernst & Young's Dutch affiliate audited the books of the Baan Company for years even as the accounting firm had hundreds of consultants installing the software that Baan produces. The Ernst & Young consultants were so good at their software work, in fact, that Baan gave them its first "global gold award" as one of its most "successful implementation partners."

But it was only this spring, after forcing Baan to change some questionable accounting practices, that Ernst & Young decided to resign the auditing account to pursue what Baan described as a "business relationship" with the company.

Ernst & Young's computer consulting work is the biggest piece of an overall consulting practice that has grown to an expected \$3.6 billion this year from \$300 million in 1992.

But while Ernst & Young has one of the fastest growing computer consulting practices, all of the Big Five firms have a rising number of potential conflicts because of such work.

For example, Price Waterhouse Coopers, the new name of the accounting firm formed in the recent merger of Price Waterhouse and Coopers & Lybrand, audits the books of the Denver-based software publisher J. D. Edwards & Company even as its consulting side searches for potential recruits skilled in working with J. D. Edwards software.

As Isaac C. Hunt Jr., a commissioner at the S.E.C., warned in a speech to accountants, the growing number of relationships between auditors and their clients "calls into question the ability of auditors to be independent when carrying out their statutory responsibilities."

But the accounting firms argue that they have only loose alliances, and not contractual relationships, with the software and hardware companies that they audit. And the firms say that they are qualified to continue with audits of those companies even though they may be earning hundreds of millions of dollars by installing the companies' wares.

"We very much separate the work we do in consulting and the work we do in auditing," said Philip A. Laskawy, chairman of Ernst & Young. "We just do not believe that this is an issue."

In the case of Peoplesoft, Mr. Laskawy said that Ernst & Young was hiring consultants trained in that company's software because the product was in demand. "We aren't hiring people to help Peoplesoft," he explained. "We're hiring people because they have a product that our customers want."

He said that Ernst & Young was not marketing Peoplesoft's products, only helping other companies to install the software.

Mr. Laskawy said Ernst & Young's relationship with Baan while the firm performed the audit was similar to the firm's relationship with PeopleSoft and did not cause a conflict of interest.

Arthur Andersen, which audits SAP, a German software company that plans to sell stock in the United States this year, now has about 400 Andersen consultants installing SAP software. Recently, its consultants toured the nation with SAP sales representatives, making presentations to interested companies.

But the firm's partners say that its consultants are not allowed to actually promote SAP software.

"We feel we have a very workable system in place that allows us to stay independent from the hardware and software companies that we audit," said Michael Travis, a partner in charge of Arthur Andersen's SAP consulting practice in the Americas.

Yet the possible conflicts arising from such consulting work do not end with the software companies. The questions extend to the hundreds of public companies for which the accounting firms are both installing the computer systems and auditing the books. Ernst & Young consultants,

A Question of Accountability

All of the Big Five accounting firms have formed consulting relationships with some of the same companies they audit. For the accounting firms, this business has become increasingly important and some companies now pay the firms more for consulting than for auditing. All figures are for 1997.

Consulting firm	*No. of public companies audited*	*Total U.S. revenues (billions)*	*Consulting revenues as a share of total*	*Clients where consulting revenue exceeded audit revenue*	*Some companies audited by the firm whose technology the firm installs for other auditing clients*
Andersen Worldwide*	2,444	$5.45	66%	136	SAP, Oracle
Ernst & Young	2,510	4.42	41	77	Peoplesoft, Sun Microsystems
Deloitte & Touche	2,413	3.60	37	35	Microsoft
KPMG Peat Marwick	1,782	2.70	34	27	Siebel Systems
Coopers & Lybrand**	1,713	2.50	23	52	Baan
Price Waterhouse**	1,391	2.34	37	40	Compaq, J.D. Edwards

*Includes Arthur Andersen and Andersen Consulting

**Merged on July 1 to become Price Waterhouse Coopers.

Sources: American Institute of Certified Public Accountants; Public Accounting Report

for example, are now helping install a $300 million information system at Coca-Cola, a company whose books the firm has long audited.

Although no major problems have yet come to light in such cases, some accounting experts say the accounting firms' double duties raise many uncertainties. For instance, will an accounting firm that is being paid $100 million to install software be willing to disagree with company executives on a controversial accounting issue and demand they correct the financial statements if they fear they could anger management and lose the consulting job?

Or, will an auditor who works for the same firm that installed a company's information system raise questions about flaws in that system when it was the accounting firm's consultants who installed it? Such undisclosed flaws could be significant to the financial statements, since today's software packages are so far-reaching that a warehouse clerk can update accounting records from a computer on the loading dock.

Can auditors be comfortable doing double duty?

"As auditors, they will have to express an opinion on something that they did," said Itzhak Sharav, who teaches accounting at the Columbia Business School "That is a conflict, and that is a problem."

Scott Bayless, associate chief accountant at the S.E.C., said the commission was concerned about any instances in which auditors audit their own work.

But so far, the S.E.C., which raised concerns about these issues last year in a report to Congress, has taken few steps to limit the firms' consulting work. And, the Federal rules defining what auditors must avoid to remain "independent" from the companies they audit are little changed from 10 years ago when most of these potential consulting conflicts did not exist.

Last year, the S.E.C. did create an eight-member group, called the Independence Standards Board, to review whether the rules should be updated to protect investors. The board includes the chairmen of three of the Big Five firms, including Mr. Laskawy, as well as the president of the American Institute of Certified Accountants and four members appointed by the S.E.C. who are not accountants.

But Arthur Siegel, the board's director and a former partner with Price Waterhouse, said that the board had other issues to address before it could take up the software consulting. He said that the S.E.C. had long known that the firms were expanding their consulting practices but had let them continue.

"That doesn't make it right," he said, "but there is plenty going on, and the S.E.C. hasn't questioned it."

Indeed, many public companies are now scrambling to buy software packages created by such developers as SAP, Oracle, Peoplesoft and Baan, which sell for hundreds of thousands of dollars or more. The companies want to upgrade their computer systems before Jan. 1, 2000, when many existing systems are expected to malfunction when they do not recognize the new date.

Typically, tailoring software to the buyer's needs requires an army of consultants, and experts estimate that the companies must spend between two and five times the software's cost on consultants, who do everything from fine-tuning computer programs to training the company's workers to use the new system. Each consultant can bring his or her employer about $300,000 in revenue a year, according to estimates.

About 20 percent to 30 percent of companies needing to upgrade their computer systems choose their audit firm's consultants to help them put in the new software, said Vinnie Mirchandani, a vice president at the Gartner Group, which does research on the software consulting industry.

"The C.E.O. says go with this firm because I have known this firm for many years," Mr. Mirchandani said. And yet, the auditors themselves may not feel comfortable about the role of their consultant colleagues. "The audit partners don't always want the consulting side to do the job," he said, "because they're worried of problems and a black mark."

For their part, the software and hardware companies covet connections to the Big Five firms because of the firms' access to the executives and decision makers at the thousands of companies that they audit.

Last year, for example, Microsoft and Netscape struggled for KPMG Peat Marwick's allegiance, both wanting to supply the accounting firm's computer-networking software. Microsoft ultimately won by offering to pay KPMG millions of dollars if the firm would use its product. As part of the deal, KPMG agreed to set up a subsidiary that would market consulting services to corporations adopting Microsoft's Windows NT networking software.

The accounting firms, meanwhile, say that the new computer systems they help install can strengthen a company's controls over financial information and, therefore, should reassure investors rather than worry them. And the consulting work, they insist, actually helps them conduct better audits.

"The more you know about a company," Mr. Laskawy said, "the better the audit you can do."

But Mr. Sharav, at Columbia, notes that the S.E.C's rules say that auditors should avoid even the appearance of a conflict of interest. "Somehow," he said, "they have gotten around that."

Scandals Signal Laxity of Audit Panels

WALL STREET JOURNAL 7/16/98

By JOANN S. LUBLIN
And ELIZABETH MACDONALD
Staff Reporters of THE WALL STREET JOURNAL

Too many audit committees are turning out to be toothless tigers.

The corporate board committees supposedly review management's financial actions and controls, as well as keep tabs on internal and outside auditors. But a flurry of accounting scandals – topped by this week's surprise revelation that Cendant Corp. booked nearly $300 million in bogus revenue–indicates that the audit panels in many cases aren't doing their jobs.

Investor activists have long attacked such panels for lacking enough independence or financial expertise to uncover most management misdeeds. Until audit committees become tougher monitors, "we will have more bad [accounting] surprises and more shareholder lawsuits," warns Nell Minow, a principal of Lens Inc., an activist investment fund in Washington, D.C. Bolstering these panels "should be the next big push" in corporate-governance reform, Ms. Minow says.

The Securities and Exchange Commission and certain business leaders are challenging audit committees' effectiveness, too. In a March speech, SEC Chairman Arthur C. Levitt said the panels "should be asking hard questions" about financial-reporting issues. The commission recently launched investigations of possible financial-reporting shortcomings by Cendant, Sunbeam Corp., Waste Management Inc. and several other major companies.

Audit committees sometimes fall short because a chief executive picks members willing to go along with the flow–and not rock the boat too much," says Robert S. "Steve" Miller, chairman of Waste Management, a big trash hauler in Oak Brook, Ill. These panels need "several independent directors with a (sophisticated) financial background" because they know which rocks to look under and which hard questions to ask."

Mr. Miller should know. The turnaround expert overhauled Waste Management's audit committee as soon as he became interim chairman and chief executive last fall. He stepped into the top roles when Ronald T. LeMay quit after only three months amid growing questions about the company's accounting practices.

Mr. Miller immediately named two new outside directors, Roderick M. Hills and John C. Pope, and added them to the audit panel. Mr. Hills, an ex-SEC chairman and former chairman of Federal-Mogul Corp., became committee chairman, replacing James R. Peterson, who quit as president of Parker Pen Co. 13 years ago when earnings fell below expectations. Mr. Pope is a former UAL Corp. president. Steven Rothmeier, a former Northwest Airlines CEO, had joined the committee in March 1997.

In the time of Waste Management's old regime, Mr. Miller recalls, the audit panel's "strongest financial guy was Don Flynn," who was chief financial officer and is now retired. Did the committee's

lack of financial experience and independence hurt its ability to oversee management? "The record is not good," the company chairman asserts. "Something jumped the tracks here."

For instance, the prior audit panel neglected to obtain a "management letter" from outside auditors for three years, according to Mr. Hills. (Outside auditors typically use such letters to propose management improvements. Committee members, though honorable people, "probably didn't understand the significance of the fact they weren't getting an annual management letter," says Mr. Hills, who has headed audit panels at seven other public companies.

Mr. Miller dispelled any doubts about the revamped audit panel's clout by installing Mr. Hills in a headquarters finance office. Mr. Hills worked full time for months and "had completely free access" to any staffer, Mr. Miller recollects. Their internal review found that earnings had been hugely inflated by questionable accounting methods. Waste Management took a $3.54 billion pretax charge, much of that to make its accounting less aggressive; it also restated results back to 1991. Yesterday, it completed a merger with USA Waste Services Inc.

Cendant's Wednesday disclosure of wider-than-expected accounting fraud raises fresh questions about the vigilance of audit committees.

The Parsippany, N.J., franchising and marketing concern reported in April that it had found accounting irregularities in a unit of CUC International Inc. (CUC, a seller of discount-club memberships, merged late last year with HFS Inc. to form Cendant.) Without explanation, Cendant immediately dismissed a senior executive named Cosmo Corigliano, CUC's former chief financial officer.

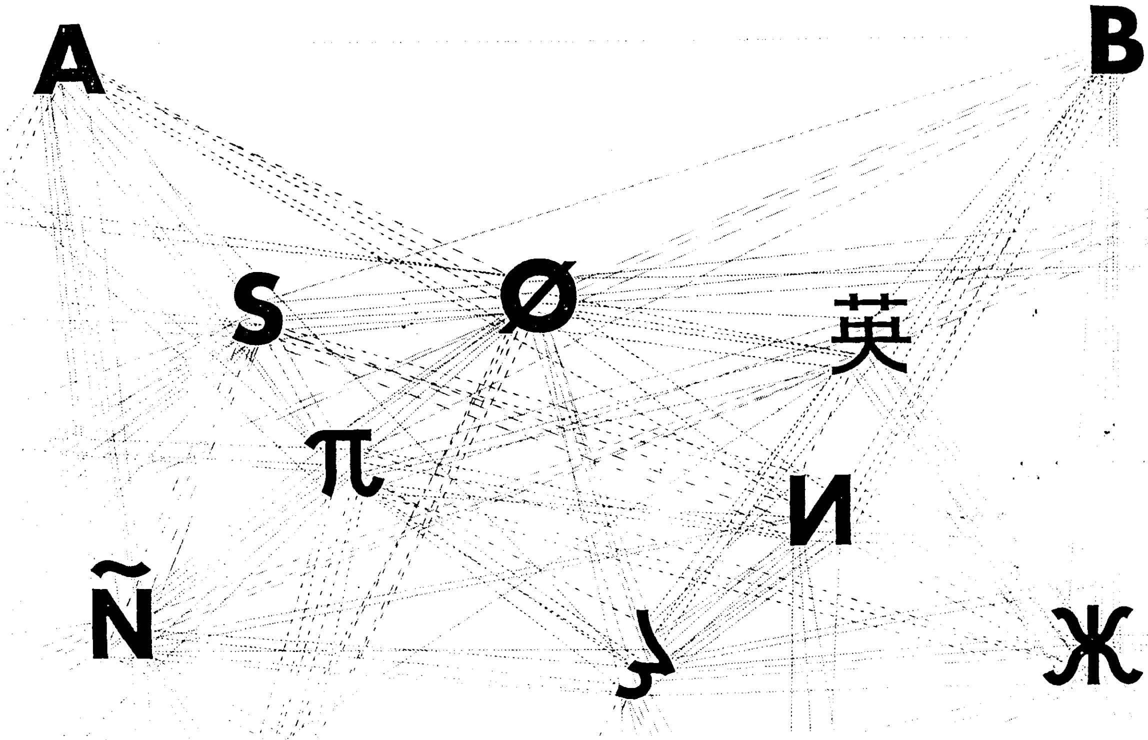
During the early 1980s, he audited CUC's books while employed by its outside accountants, Ernst & Whinney, now called Ernst & Young. The SEC's Office of the Chief Accountant may explore whether corporate audits suffer when auditors later become employees of their former clients. It isn't clear whether the CUC audit committee knew about Mr. Corigliano's past connection with the auditors. (A spokeswoman for Walter Forbes, Cendant's chairman and CUC's former CEO, declines to comment about Mr. Corigliano. The three former CUC audit-committee members didn't return repeated calls.)

The notion that Mr. Corigliano's experience as a young auditor somehow affected his independence or that of CUC's audit committee "is just ludicrous," says Gary Naftalis, a New York attorney for the former Cendant executive. "Any assertion that there was anything but a strictly professional relationship" between Ernst & Young and Mr. Corigliano while CUC's financial chief "is preposterous," concurs Don Howarth, an Ernst & Young spokesman.

An audit panel's alleged shortcomings can become legal ammunition when a company plunges into trouble. Creditors of Lomas Financial Corp., a defunct Dallas mortgage-servicing concern, have sued 20 former officers and directors as well as Lomas's auditors, Ernst & Young. Two suits, filed in state court in Dallas last October, seek a total of $600 million in damages. One names Lomas's audit-panel members.

"We are alleging that the insiders hid the true financial condition of the company from Lomas's audit committee and its board . . . to keep them in power," says Martin R. Pollner, a New York attorney and litigation trustee. An attorney representing former Lomas directors and officials and Ernst & Young have denied the charges.

Critics partly blame inadequate training for audit panels' failure to swiftly uncover financial malfeasance. Mr. Hills contends the board panels also could increase their effectiveness by wielding greater control over audit firms. "Outside auditors ought to understand they exist subject to the mercy of both management and the outside audit committee."



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SECURITIES EXCHANGE ACT OF 1934
Release No. 39400/ December 4, 1997
ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 994/ December 4, 1997
ADMINISTRATIVE PROCEEDING
File No. 3-9500

ADMINISTRATIVE PROCEEDINGS IN THE MATTER OF KPMG PEAT MARWICK LLP

The Commission announced today that it has instituted public administrative proceedings to determine if KPMG Peat Marwick engaged in improper professional conduct and violated and caused violations of the federal securities laws by issuing an unqualified report on the 1995 year-end financial statements of a client from which it lacked independence.

According to the allegations of the Commission's Division of Enforcement and Office of the Chief Accountant:

> In approximately January 1995, KPMG Peat Marwick organized and capitalized KPMG BayMark, a firm owned by Edward R. Olson and three others. KPMG Peat Marwick planned to use KPMG BayMark as a vehicle to engage in new lines of business, including the "corporate turnaround" business. Later in 1995, as part of a turnaround engagement, KPMG BayMark installed its principal Olson as the President and Chief Operating Officer of Porta Systems Corp., a financially troubled audit client of KPMG Peat Marwick's Long Island office.
>
> When KPMG Peat Marwick audited Porta's 1995 year-end financial statements and prepared its audit report, KPMG Peat Marwick's financial and business relationships with its audit client Porta and with KPMG BayMark impaired KPMG Peat Marwick's independence from its audit client, in both fact and appearance. In particular, KPMG Peat Marwick lacked independence because: (1) KPMG Peat Marwick had loaned $100,000 to the President/COO of its audit client Porta; (2) KPMG Peat Marwick had capitalized the separate business owned by the President/COO of its audit client Porta; (3) KPMG Peat Marwick had capitalized the "affiliate" of its audit client Porta; (4) KPMG Peat Marwick was entitled to a percentage of the earnings, disposed inventory and restructured debt of its audit client Porta; and (5) by reason of their contractual ties and interdependence, KPMG Peat Marwick and KPMG BayMark should be considered a single entity for independence purposes.

Despite warnings from the staff of the Commission's Office of the Chief Accountant concerning independence issues arising from KPMG Peat Marwick's relationship with KPMG BayMark, KPMG Peat Marwick completed its audit of Porta's financial statements and issued its "Independent Auditors' Report," which represented that it had "conducted [its] audits in accordance with generally accepted auditing standards" ("GAAS"). This statement was false and misleading in that GAAS requires auditors to be independent of their audit clients both in fact and in appearance.

The Division of Enforcement and the Office of the Chief Accountant further allege that, by conducting an audit of Porta's 1995 year-end financial statements and rendering an audit opinion thereon at a time it lacked independence from Porta, KPMG Peat Marwick, among other things: (1) rendered Porta's 1995 annual report on Form 10-K materially false and misleading in that the financial statements contained therein were not, as represented and as required by Section 13(a)(2) of the Securities Exchange Act of 1934, audited by independent accountants, thus causing Porta to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder; (2) directly violated Rule 2-02 of Commission Regulation S-X, which requires that auditors be independent of their audit clients; and (3) engaged in improper professional conduct under Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

A hearing will be scheduled to determine whether the allegations against KPMG Peat Marwick are true and, if so, what remedial actions, if any, are appropriate.

ILLINOIS CPA SOCIETY
222 S. Riverside Plaza
Chicago, IL 60606
Phone: 312/993-0407 or 800/993-0407
FAX: 312/993-9954

Date 7-22-98

Number Dialed 212-596-6137

Company Independence Standards Board

Attention ITC 98-1

Instructions Response

This cover letter plus 3 **pages.**

This FAX sent by Liger Needom x337

July 22,1998

Independence Standards Board
1211 Avenue of the Americas
6th Floor
New York, New York 10036-8775

Attn: ITC 98-1

The Auditing Services Committee of the Illinois CPA Society (Committee) is pleased to have the opportunity to comment to the May 29, 1998 ISB Invitation To Comment 98-1, *Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public* Accountants. The organization and operating procedures of the Committee are reflected in the Appendix A to this letter. The Committee offers the following comments to question 3 in the invitation to comment:

3) Do the benefits of the proposed requirement outweigh the costs?

Although the costs of this proposed requirement may be minimal, the Committee believes it provides little benefit. Further, the Committee questions the appropriateness of imposing a requirement for auditors to explicitly confirm their independence for the stated purpose of increasing auditors' and audit committees' focus on independence issues. The Committee also questions whether issuance of such a confirmation will encourage discussion of independence between auditors and audit committees and achieve the desired improvement in audit committees' understanding of independence issues.

The Committee recommends that the Board consider other approaches to meeting the objectives stated in the invitation to comment, such as continuing education and practice-monitoring programs for auditors and through educational information for members of audit committees.

We also noted that the recommended confirmation letter refers to the auditors' "examination," which we recommend be changed to "audit."

We appreciate the opportunity to comment on the invitation to comment. Should you have any questions regarding our comments, please don't hesitate to call me at 630/574-7878.

Sincerely,

James A. Dolinar

James A. Dolinar
Chairman, Auditing Services Committee

222 South Riverside Plaza
Suite 1600
Chicago, IL
60606-6098
FAX: 312 993-9432
TEL. 312-993-0393 or
800 993-0393 (Illinois only)

APPENDIX A

ILLINOIS CPA SOCIETY
AUDITING SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
1998 - 1999

The Auditing Services Committee of the Illinois CPA Society (Committee) is composed of 20 technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 15 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of auditing standards.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of auditing and attest standards. The Subcommittee ordinarily develops a proposed response which is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint..

Author: MIME:SpackmanDP@ldschurch.org at INTERNET
Date: 7/22/98 11:57 AM
Priority: Normal
TO: ISB at AICPA3
Subject: Response to ITC 98-1

Please see attached file. for e-mail response Original is also being mailed.

Best regards always.

Dennis

July 21, 1998

Independence Standards Board
6th Floor
1211 Avenue of the Americas
New York, New York 10036-8775

Re: ITC98-1, Request for Comment on Confirmation of Auditor Independence

Thank you for the opportunity to respond to the invitation to comment on the proposed, Recommendation to the Executive Committee of the SEC Practice Section of the AICPA on, *Confirmation of Auditor Independence.*

Matters of independence are a serious concern to state boards of accountancy. While considerable guidance exists in the accounting profession's Code of Conduct and its Practice Standards concerning independence, continuing vigilance is needed to make sure they are maintained current to assure their effectiveness in today's rapidly changing business world. I respect and appreciate the ISB's mission and diligence in seeking to establish independence standards for auditors of public entities which will serve to protect and promote investor's confidence in our securities markets.

My comments on the proposed Recommendation follow:

1. Will the proposed Recommendation be helpful in fostering additional attention on independence issues by audit committees and their auditors?

    The proposed recommendation may be helpful. In some situations it may in fact provide impetus for the opportunity for an open discussion on the subject of independence and thereby enhance the awareness of independence issues between auditors and members of audit committees or boards of directors. This will benefit public confidence in the audit process.

    However, its essence is such that it may simply become a perfunctory act. What this requirement lacks is a compelling need or benefit which would carry it beyond its current destined simple delivery of a written report which is not likely to be read, and invitation to meet which may not be taken up.

Those who engage CPAs to do audits expect them to be independent and feel no need to give the issue any more thought. Most engagement letters confirm the CPA's independence and, their report on the entity's financial statements also asserts their independence. The problem with the Recommendation is that it appears redundant to these events.

The objective of increasing or establishing meaningful dialogue between the audit committee and board of directors, and the auditors over independence has merit. Unfortunately, this recommendation lacks a persuasive need, apparent benefit, or stated behavioral objective that would give cause for these dialogues to occur with a meaningful expected outcome.

2. Is there a more or equally effective mechanism for promoting audit committee evaluation of the independence of the entity's auditors?

   The Recommendation could be strengthened by incorporating within it the outcomes of the auditor's initial considerations and assessment of independence made prior to acceptance of the audit engagement. Incorporating the outcomes of the initial assessment into pre engagement communications with the audit committee or board of directors would benefit all parties. Such pre engagement communications could create an environment which would give meaningful attention to independence as a condition necessary to a successful audit engagement. It would also facilitate the setting in place of behavioral expectations for the auditor and, management and staff of the entity being audited. Similarly, the engagement letter might have incorporated within it agreed to actions and behavioral outcomes relative to recognized independence matters which would help assure independence.

   At the conclusion of the engagement the auditor should provide a confirmation report to the audit committee or board of directors concerning independence. The independence confirmation could be incorporated into the SAS 61 letter and discussed with the audit committee or board of directors. The report and discussion could reference various issues encountered during the course of the engagement and the effectiveness of related actions taken to maintain independence. These matters could be made more meaningful to the audit committee or board of directors if the auditor discussed them in relation to the auditor's assertion of independence in the report on the entity's financial statements.

   The strength of this approach is that it keeps the auditor focused on current in-place requirements related to independence such as, the initial assessment of independence and, the need to remain independent during the course of the engagement in order to assert independence in the auditor's report on the financial statements.

3. Do the benefits of the proposal outweigh its costs?

Costs would be negligible.

4. Would it be desirable to recommend that the independence confirmation be delivered at the time that the auditor is appointed for the upcoming engagement?

   While it may be desirable to initiate discussions of independence early in the audit, it is essential that independence is maintained throughout the course of the audit as well. The engagement letter should be used to communicate the commitment to maintaining independence. A report at the end of the engagement which might be incorporated into the SAS 61 letter would be a better time to report that independence had been maintained throughout the engagement.

5. Should the Recommendation be submitted only to the Executive Committee of the SEC Practice Section of the AICPA or, should the proposal be a dual recommendation to both the SECTS and the ASB.?

   The recommendation should be made to both the SECPS and the ASB.

I hope you find these comments beneficial. Should you have any questions or want to discuss them with me, please feel free to call me.

Sincerely,

Dennis

Dennis Paul Spackman, CPA

ERNST & YOUNG LLP

1300 Huntington Building
925 Euclid Avenue
Cleveland, Ohio 44115-1405

Phone: 216 861 5000

July 21, 1998

Mr. William T. Allen, Chairman
Independence Standards Board
1211 Avenue of the Americas
New York, New York 10036-8775

Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants (File Reference No. ITC 98-1)

Dear Mr. Allen:

We support the issuance of the above-referenced proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants (SECPS) and believe it is an appropriate initial step by the Independence Standards Board (ISB).

In response to the five questions posed in the Invitation to Comment:

1.&2. We believe written communications regarding auditor independence will focus attention on independence issues by audit committees and will foster more dialogue about them with their auditors. We do not believe there is a more or equally effective mechanism for promoting audit committee "evaluation" of the independence of an entity's auditors at this time. As cited in paragraph 7 of the "Discussion" portion of the Invitation to Comment, we agree an audit committee cannot conclude on the auditors' independence without relying substantially on representations from the auditors. It is for this reason we believe the required written communication will promote meaningful dialogue between auditors and audit committees regarding independence matters.

Although we believe the confirmation letter recommended in the Invitation to Comment is appropriate at this time, we believe the letter should be reconsidered when the ISB develops its framework for establishing independence standards. We continue to support the principles-based approach set forth in the white paper entitled, *Serving the Public Interest: A New Conceptual Framework for Auditor Independence,* and believe incorporating those principles in the confirmation letter would better focus the auditor/audit committee communications, and in the process enable greater understanding among audit committee members of the procedures and safeguards employed by audit firms to maintain independence.

3. We believe the benefits of the proposed requirement outweigh its costs.

4. Regarding the timing of the written communications, we believe the discussions between audit committees and auditors are most beneficial early in the audit process, for example, when the auditor is appointed or reappointed. However, we agree with the recommendation to allow flexibility in the timing of the confirmation.

5. We believe a written confirmation of independence is best suited for public companies since the objective of the letter is to assist audit committees in performing their oversight responsibilities. We do not believe the requirement would be as useful or cost effective for non-public companies. Since an SECPS requirement would cover primarily all of the auditors of public companies, we suggest not referring the recommendation to the Auditing Standards Board.

We propose the following revisions to the model confirmation letter to make it clearer that this will be a requirement of member firms:

> Audit Committee of the Board of Directors [or The Board of Directors] ABC Company
>
> [Optional - Under the membership requirements of the SEC Practice Section of the American Institute of Certified Public Accountants ~~SEC Practice Section~~, ~~the~~ auditors of ~~a company~~ companies subject to the rules of the Securities and Exchange Commission ~~is~~ are required to issue to the ~~company's~~ companies' audit committees or boards of directors a ~~report~~ letter confirming the ~~auditor's~~ auditors' independence ~~under the applicable rules~~. Accordingly, and] R(r)elating to our examination of the financial statements of ~~the~~ ABC Company as of December 31, 19X1 and for the year then ended~~;~~, we are independent certified public accountants with respect to ~~the~~ ABC Company~~, under the published requirements~~ within the meaning of the applicable published rules and regulations of the Securities and Exchange Commission, ~~and~~ the pronouncements of the Independence Standards Board, and under Rule 101 of the American Institute of Certified Public Accountants' Code of Professional Conduct, ~~and~~ its interpretations and rulings. We would be pleased to meet with you, at your convenience, to further discuss our independence, including the related controls employed by our firm.

We would be pleased to discuss our comments with the Board or its staff.

Sincerely,

Ernst + Young LLP

MASON & COMPANY, LLP

CERTIFIED PUBLIC ACCOUNTANTS

ELI MASON, CPA
DAVID GOTTERER, CPA
PETER J. FAIRLEY, CPA, FCA (U.K.)

ROBERT PARKS, CPA
ROBERT GOTTERER, CPA

400 PARK AVENUE
NEW YORK, N.Y. 10022
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CORRESPONDENTS IN PRINCIPAL
U.S. CITIES AND ABROAD

July 22, 1998

Hon. William T. Allen, Chairman
Independent Standards Board
1211 Avenue of the Americas
New York, NY 10036

Re: May 29, 1998 ISB Proposed Recommendation

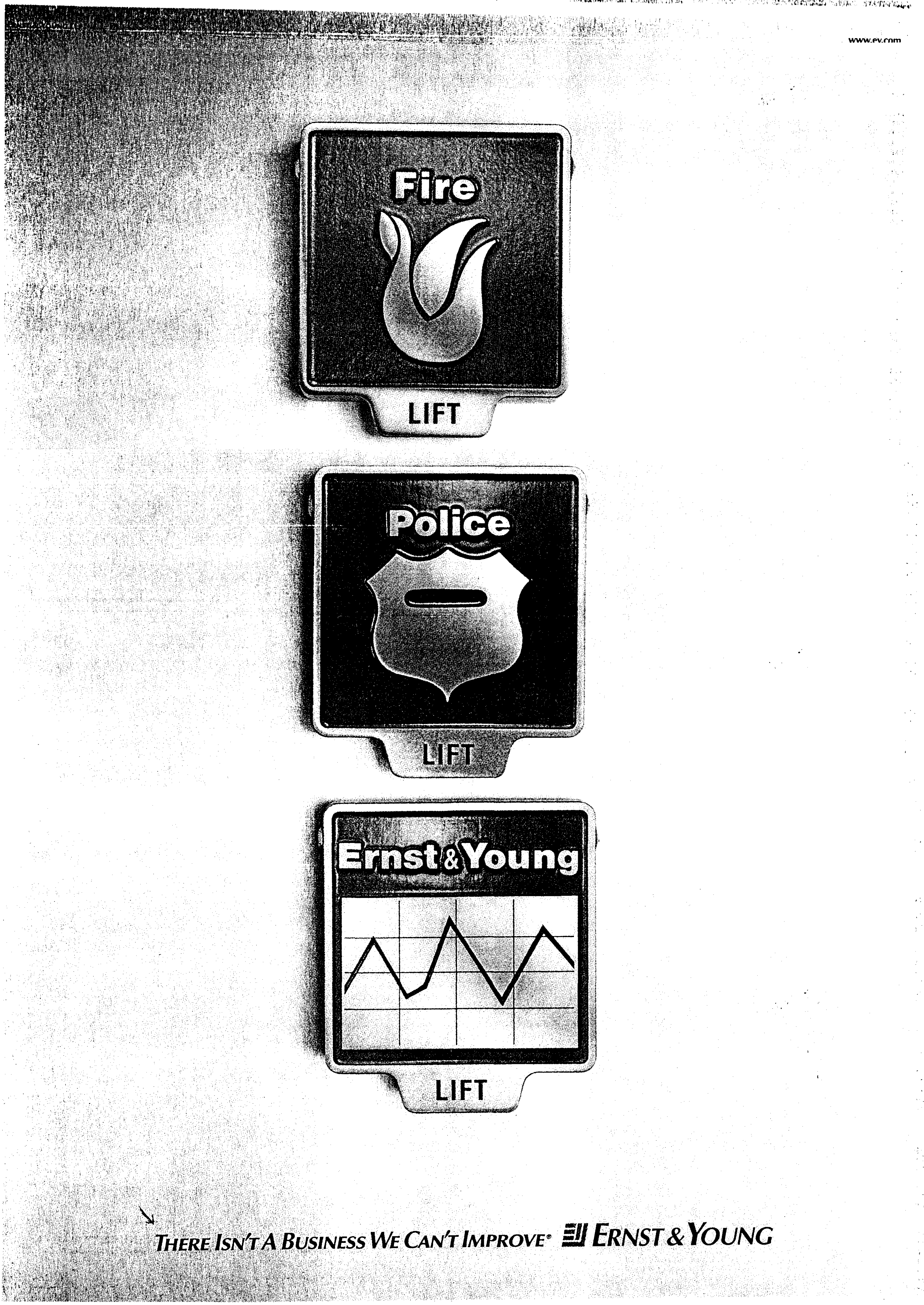
Dear Judge Allen:

Kindly include in my July 21, 1998 letter the enclosed Ernst and Young full page ad which appeared in the July 21, 1998 Wall Street Journal which contains the following: "There Isn't A Business We Can't Improve."

Respectfully yours,

Eli Mason

Copy: Hon. Arthur Levitt
Members of ISB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LIFT
THERE ISN'T A BUSINESS WE CAN'T IMPROVE®
ERNST & YOUNG

DePaul University

July 23, 1998

Curtis C. Verschoor
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Research Professor
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Independence Standards Board
1211 Avenue of Americas, 6th floor
New York, NY 10036-8775
Attn: ITC 98-1

By FAX 212 596-6137
2 pages

As an interested observer who closely follows the Board's actions and attends meetings at his own expense, I hope the following comments will help achieve your objective of improving auditor independence requirements. Your mission is of urgent importance to investors, professional accountants, and the public at large.

For the following reasons, I believe the proposal should not be adopted:

a. A confirmation of required independence would be unnecessary and redundant. As one of the specific warranties contained in the standard audit report, auditors already proclaim the independence of their mental attitude as required by GAAS, specifically the second general standard..
b. A standard confirmation is likely to be a stereotyped routine communication that may not improve directors' understanding of independence issues. Placing additional focus on the current highly technical ethics rules may well delay achievement of ISB's important goal of developing a new conceptual framework for auditor independence.
c. A routine confirmation, particularly one that merely asserts independence at the beginning of the audit process, would not communicate meaningful information. A more valuable report would describe at the end of the audit how a firm did in fact comply with the requirement to "be independent in fact and appearance when providing auditing and other attestation services" as stated in the AICPA Code of Professional Conduct, Article IV.
d. Without substantial amplification of present professional guidance, the SECPS peer review program would be unable to effectively test a firm's compliance with existing independence rules, ie. measure the success of a firm's systems that are designed to achieve stated behavioral objectives related to independence. Current quality control standards dealing with independence are largely definitional and do not describe the "matters essential to the effective design, implementation, and maintenance of the system" as stated in AICPA Statement on Quality Control Standards No. 20.

Although not in favor of the proposal as stated, I am very much in agreement with the Board's objective of increasing meaningful communication about independence from auditors to audit committees, particularly in view of the many recent examples of undetected lax controls and misleading financial reporting.

A valuable report could take the form of an end of audit statement of what substantive steps the firm took to achieve the requirement of maintaining the appearance of independence as well as an independent mental attitude in "all matters relating to the assignment" as required by SAS No. 1, Section 220. Independence matters could also be included within the context of communications to the audit committee already recommended by the Public Oversight Board. These include qualitative judgments about accounting principles, disclosures, and estimates. Several other recommendations made by the POB in its monograph: *Strengthening the Professionalism of the Independent Auditor* and its pamphlet: *Directors, Management, and Auditors: Allies in Protecting Shareholder Interests* concern the "applied independence" of CPA firms and may well harmonize with the Board's objectives.

One of the important paradigms contained in the AICPA's White Paper: *A New Conceptual Framework for Auditor Independence* is a recommendation for each firm to create a code of conduct for independence supported by effective compliance procedures. These should include senior-level oversight, extensive training, periodic monitoring, and a confidential hot-line to report violations. These are elements of the framework of best practices for achieving ethical behavior and were originally developed by the Defense Industry Initiative and later adapted for legal compliance by the Federal Sentencing Guidelines.

Although almost all large corporations have codes of conduct or ethics, only one large CPA firm presently has an ethics system designed to assure achieve ethical conduct. Unfortunately, the values upon which this firm's code of conduct is based are not appropriate for a CPA firm since they do not consider independence and the public interest. I urge the Board to encourage all large firms to follow this recommendation of the White Paper and both develop ethics codes covering independence and also implement effective compliance systems. Important to achieving the Board's objectives is a need focus on ethical behavior throughout a firm and not just avoidance of a list of hackneyed conditions that supposedly impair independence.

In terms of the matters upon which specific comment was requested:

1) No, there is doubt that the proposed Recommendation will accomplish this objective in a meaningful fashion.

2) Yes, as stated above, a focus on communicating how a firm achieved the required behavioral objectives would be more effective.

3) No, the proposal could set back achievement of the Board's longer-term important goal of developing a comprehensive framework for auditor independence.

4) No, this would stereotype the requirement into a prediction that would not be responsive to the requirements of generally accepted auditing standards.

5) Yes, if made, any recommendation should be made jointly for the reasons stated in the invitation .

Yours very truly,

Curtis C. Verschoor

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
101 Hudson Street
Jersey City NJ 07302
Telephone (201) 521 3000
Facsimile (201) 521 3333
Direct phone (201) 521 3048
Direct fax (201) 521 4444

Fax cover sheet

To:	Art Siegel
Company:	Independence Standards Board
Addressee fax No.:	(212) 596 6137
From:	Kenneth E. Dakdduk
Return fax number:	(201) 521 4444
Date:	July 23, 1998
No. of pages: (incl. this page)	3

If this fax is incomplete or illegible please telephone (201) 521 3044

Message:

Attached is our response to Invitation to Comment 98-1.

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
101 Hudson Street
Jersey City NJ 07302
Telephone (201) 521 3000
Facsimile (201) 521 3333

July 23, 1998

Mr. Arthur Siegel, Executive Director
Independence Standards Board
1211 Avenue of the Americas, 6th Floor
New York, New York 10036-8775
Attn: ITC 98-1

Dear Mr. Siegel:

PricewaterhouseCoopers is pleased to respond to the Independence Standards Board's Invitation to Comment (ITC) 98-1, *Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants*. We are pleased that the Board shares our belief that communications between auditors and audit committees is an important means of ensuring an effective audit, and we applaud you for your confidence in the profession's self-regulatory process.

In 1994, the Public Oversight Board's Advisory Panel on Auditor Independence (the "Kirk Panel") released its report titled, *Strengthening the Professionalism of the Independent Auditor*. That report contained a number of recommendations regarding auditor communications with audit committees and boards of directors. We embraced the Kirk Panel's recommendations, and we have found that the overwhelming majority of audit committees welcome the discussions regarding the company's accounting policies and significant estimates, encourage us to be forthright in our discussions with them, and would discourage any efforts by their management to inhibit us in our audit work. We believe audit committees also would embrace communications by auditors about independence.

As noted in ITC 98-1, confirmation of an auditor's independence is presently conveyed by the issuance of the auditor's report. An auditor's report confirms the auditor's independence not only as of the date the report is issued but at all times during the period of the professional engagement. Audit committees appear to understand the significant message conveyed each year by the auditor's report regarding independence, i.e., unless we notify them to the contrary, we are in compliance with all applicable independence requirements at all times. Therefore, it is not certain that the proposed requirement will heighten the awareness of audit committees regarding independence matters or increase (or result in) discussions between the auditor and the audit committee about auditor

PRICEWATERHOUSECOOPERS

independence when the auditor's independence is not impaired. Nevertheless, we support the proposed recommendation. If adopted, however, we recommend that the requirement be reviewed a year or two after its effective date to determine whether it has in fact improved auditor/audit committee communications on independence matters.

Our views regarding some of the other issues raised in ITC 98-1 follow.

- If the proposed requirement was to be adopted by the Auditing Standards Board (ASB) as a generally accepted auditing standard, it would apply not only to auditors who are not members of the SECPS, but also to auditors who audit nonpublic companies. We do not believe the benefits of the proposed requirement are sufficiently certain to justify its application to auditors of nonpublic companies. Accordingly, we believe that the proposed requirement should not be referred to the ASB

- Since the purpose of the confirmation is to stimulate discussion between the auditor and the audit committee about independence, the auditor should be permitted to deliver the confirmation at the time such discussion would be most likely to occur. Accordingly, the recommendation should continue to permit flexibility in the timing of the auditor's confirmation. Additionally, the recommendation should clearly state that the confirmation may be included in the same communication that includes other SECPS-required communications to the audit committee (i.e., description of and fees paid for non-audit services), and that this communication is not required to be written.

We would be pleased to discuss our comments with you. Please contact Robert H. Herz (201) 521-3038 or Kenneth E. Dakdduk (201) 521-3048 if you would like to do so.

Very truly yours,

PricewaterhouseCoopers LLP

Deloitte & Touche LLP

Fax Transmission

To:	Office:
Rick Towers	Independence Standards Board
Fax Number:	
212-596-6137	

Comments:

Attached please find Deloitte & Touche LLP's letter of comment on ITC 98-1.

The original of this letter will be sent via: Federal Express for delivery Wednesday, August 5th.

Thank you.

From:	Office:
Trevor J. Barton	N.O. Wilton
Fax Number:	Number of Pages (including this one):
203-761-3023	5
Date:	To confirm receipt, or if you do not receive all pages, please call:
08/04/98	203-761-3632 or Brenda @ 203-761-3172

Deloitte &
Touche LLP

Ten Westport Road
P.O. Box 820
Wilton, Connecticut 06897-0820

Telephone: (203) 761-3000

August 4, 1998

Arthur Siegel
Executive Director
Independence Standards Board
6th Floor
1211 Avenue of the Americas
New York, New York 10036-8775
Attn: ITC 98-1

Re: Invitation To Comment 98-1: Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants - Confirmation of Auditor Independence

Dear Mr. Siegal:

Enclosed is our letter of comment on the Independence Standards Board's Invitation to Comment 98-1, *Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants*, dated May 29, 1998.

If you have any questions concerning our comments, please contact Robert J. Kueppers at (203) 761-3579 or Richard M. Goligoski at (203) 761-3423.

Yours truly,

Deloitte & Touche LLP

Enclosure

Deloitte & Touche LLP

Ten Westport Road
P.O. Box 820
Wilton, Connecticut 06897-0820

Telephone: (203) 761-3000

August 4, 1998

Arthur Siegel
Executive Director
Independence Standards Board
6th Floor
1211 Avenue of the Americas
New York, New York 10036-8775
Attn: ITC 98-1

Re: **Invitation To Comment 98-1: Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants - Confirmation of Auditor Independence**

Dear Mr. Siegel:

We are pleased to comment on Invitation To Comment 98-1, Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants, (ITC 98-1). Such proposal would require member firms to confirm their independence annually to each public company client's audit committee or board of directors.

General Views

We support the Independence Standards Board's (the "Board") initiative to enhance communication between audit committees and auditors regarding issues of auditor independence. We further agree that such communication may assist directors in improving their understanding of independence issues and exercising their corporate governance responsibilities.

Paragraphs 8 and 9 of ITC 98-1 discuss the proposed timing of the issuance of the auditor's independence confirmation. Paragraph 8 specifies that the Board believes it would be beneficial to have the independence confirmation delivered by the auditor at the beginning of the audit. However, paragraph 9 acknowledges the need for flexibility in the timing of delivery of the independence confirmation and states that "... the confirmation could be delivered at any time during the audit process that fits the facts and circumstances."

While we agree that it would be beneficial for this communication to take place early in the audit process, we also concur with the need for flexibility in the timing and nature of the independence confirmation, thereby not placing any undue burden on either the registrant or the audit firm. Factors we believe support the need for flexibility include: (i) registrants may have different schedules for the timing of audit committee or board meetings; (ii) audit firms generally tailor the timing and procedures for each audit engagement to the specific client; and (iii) audit committees of smaller companies often do not observe as rigid a schedule as do larger companies in connection with the audit. We also believe that the audit committee or board of directors should be free to determine the point in the audit process that would be most appropriate to receive their auditor's independence confirmation. Further, flexibility would minimize incremental cost because the recommended language could be incorporated into an existing report or communication, obviating the need for a separate report.

If the Board determines to go forward with its recommendation, we believe the Board's recommendation to the SEC Practice Section should be worded broadly. The Executive Committee of the SEC Practice Section is in the best position to determine the specifics of any change to its membership requirements.

Responses to Questions

In addition to the comments discussed under General Views above, we would like to provide the following comments with respect to specific questions posed by the Board.

Question 1 *– Will the proposed Recommendation be helpful in fostering additional attention on independence issues by audit committees and their auditors?*

Response - We agree with the Board's belief that communication of an auditor's independence to the audit committee in the form of a confirmation or its equivalent would be helpful in fostering additional attention on independence issues.

Question 2 *– Is there a more or equally effective mechanism for promoting audit committee evaluation of the independence of the entity's auditors?*

Response – We believe that Question 2, as worded, is inconsistent with several points made elsewhere in ITC 98-1. First, the objective of the proposal as stated in paragraph 1 is to "… improve directors' understanding of independence issues…" – rather than requiring directors to evaluate auditor independence. Further, as recognized in paragraph 7, "… the audit committee's conclusion on the auditor's independence would necessarily be based, in large part, solely on the representations of the auditor..."

We firmly believe that the auditor's confirmation should not be construed as an evaluation tool to be used by the audit committee to determine the firm's independence. Even if the audit committee was knowledgeable with respect to all aspects of auditor independence, it could not have the specific information that would be necessary to evaluate the independence of the auditor. We believe the responsibility for monitoring and evaluating independence appropriately rests with the auditing firm and engagement personnel, as they are the only ones who are in a position to reach conclusions concerning the independence of the firm.

We believe that the Board's recommendation should emphasize that the primary responsibility for evaluating and determining independence rests with the auditing firm. However, once the firm has made that determination, it would be beneficial to encourage discussion about the firm's conclusion with the audit committee.

Notwithstanding the foregoing, the Board's intent in posing Question 2 appears to be the solicitation of input as to other means of achieving the objective set forth in paragraph 1. We believe that the proposal is the most expedient and effective means of achieving the stated objective and we have no specific alternatives to recommend.

Question 3 *– Do the benefits of the proposed requirement outweigh its costs?*

Response – We believe the benefits of a more heightened awareness of independence would outweigh any incremental costs associated with the issuance of the proposed auditor's confirmation. Further, any incremental costs associated with issuing such a communication would not be expected to be significant as firms presently "confirm" their independence in connection with the issuance of their auditors' report and letters to underwriters.

Question 4 – While the recommendation encourages independence discussion with the audit committee early in the audit process so that any concerns of the audit committee can be addressed before the audit is fully underway, the Recommendation is drafted to allow flexibility in the timing of confirmation delivery. Would it be desirable to recommend that the independence confirmation be delivered at the time that the auditor is appointed for the upcoming audit?

Response – We believe it would be desirable for the auditor's independence to be confirmed at the time the auditors are appointed. However, for the reasons discussed under General

Views above, we also believe it would be appropriate to allow for flexibility regarding the timing of the independence confirmation.

Question 5 *– A smaller number of auditors of U.S. public companies, as well as auditors of foreign companies registered with the SEC, are not members of the SECPS. Therefore, if the Recommendation became an SECPS membership requirement, rather than a requirement under U.S. generally accepted auditing standards, it would not apply to all audits of companies subject to SEC reporting requirements. Should the Recommendation be submitted to the Auditing Standards Board (ASB), as opposed to the SECPS, so that the requirement would apply to all audits of public companies? (It should be noted that there are existing SECPS requirements that apply only to member firms, such as those mentioned in paragraph 9 of the attached proposal.) Or should the proposal be a dual recommendation to both the SECPS and the ASB, because the SECPS Executive Committee can implement it immediately, while the ASB's process would require a significantly longer period of time?*

Response – We believe that this recommendation should be made to the SECPS for inclusion in its membership requirements. If adopted by the SECPS it would then become part of a broader set of requirements pertaining to SECPS members that are subject to testing in peer review. We also believe the Board's recommendation to the SECPS should be forwarded to the ASB with a recommendation that the ASB consider the establishment of a similar requirement in generally accepted auditing standards.

* * * * *

If you have any questions concerning our comments, please contact Robert J. Kueppers at (203) 761-3579 or Richard M. Goligoski at (203) 761-3423.

Yours truly,

Deloitte & Touche LLP

WERMER, ROGERS, DORAN & RUZON CERTIFIED PUBLIC ACCOUNTANTS
EMCO PLAZA BLDG., SUITE 202, 57 NORTH OTTAWA STREET, JOLIET, ILLINOIS 60432-1369 • 815/722-6693 • FAX 815/722-4263

July 8, 1998

Member State Illinois Board of Accountancy

Mr. Dennis Spackman
C/o Church of Jesus Christ
Of the Latter-Day Saints
15th Floor
50 East North Temple
Salt Lake City, Utah 84150-3643

Re ITC 98-1
Next Page

Dear Dennis:

Enclosed is my memorandum on the proposed recommendation of the Independence Standard Board (ISB) to the SEC practice section.

Furthermore, I have reviewed the Exposure Draft on the Omnibus Proposal of the Professional Ethics Division and I have no comment. I believe this proposal should be adopted, but that later revisions based on experience are likely.

Finally, I find myself in accordance with Commissioner Norman Johnson's comments. Clearly the new standard blurs the line as to the authority of the SEC to set the bond of 'improper processional conduct'. While I did not comment on the proposal of the SEC, I would agree that the SEC may be overreaching. Hopefully, the AICPA will undertake the problem of response.

Sincerely,

WERMER, ROGERS, DORAN & RUZON

Jack

John R. Rogers,
Partner

JRR:mas

WERMER, ROGERS, DORAN & RUZON CERTIFIED PUBLIC ACCOUNTANTS
EMCO PLAZA BLDG., SUITE 202, 57 NORTH OTTAWA STREET, JOLIET, ILLINOIS 60432-1369 • 815/722-6693 • FAX 815/722-4263

MEMORANDUM

Input on 'ISB Invitation To Comment' ITC-98-1.

A review of the specific questions indicates to me the following responses:

1. The recommendation, when implemented by the action of the auditors, (i.e. the letter required to be sent to the audit committee) should highlight and emphasize the importance of the independence issue, especially so if the letter delineates consulting engagements not considered harmful or germane to 'independence'.

2. The audit committee must rely on the integrity of the auditor's letters. No other method is as simple. If an auditor overstates the case for independence, the letter serves as record of much overstatement.

3. Since the principle of independence requires the audit firm to be aware of a question of the lack thereof, the letter should be a mere recording of data required to be kept.

4. The time for the independence confirmation must be at the inception of the engagement. Any later reporting could give rise to wasted audit fees, legal entanglement and/or controversy.

   The audit committee of the subject corporation must be fully aware at the commencement, not later.

5. Since the recommendation should be inclusive of all auditors of U.S. public companies and all companies registered with the S.E.C. the recommendation should be submitted to (and approved by) SECPS and the ASB.

<u>Further Discussion</u>:

The proposal suggests that audit committee should not be expected to understand the specific and complex rules pertaining to independence. This 'begs the question'. The independence of the auditor is of primary concern to the audit committee. The letters should provide more than flat statement (somewhat self-serving) by the auditor that the firm is independent.

Consideration should be given to including in the letter (and attachments) a statement as to how the non-stock ownership query to firm members is implemented as well as a brief synopsis of major consulting contracts in the last year as well as on-going contracts.

John R. Rogers

John R. Rogers

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Institute of
Management Accountants™

Certified Management Accountant Program
Certified in Financial Management Program

July 31, 1998

Arthur Siegel, CPA
Executive Director
The Independence Standards Board
1211 Avenue of Americas, 6th floor
New York, NY 10036-8775

Dear Mr. Siegel,

Your letter to IMA's President Keith Bryant has been referred to our committees, the Committee on Professional Issues and the Ethics Committee, for a response. We are pleased to comment to the Independence Standards Board (ISB) on its Invitation to Comment (ITC 98-1), "Proposed Recommendation to the Executive Committee of the SEC Practice Section of the American Institute of Certified Public Accountants" (the Recommendation).

Overall, we believe the proposal should not be adopted, at least in its present form. However, we are very much in agreement with the Board's objective to increase meaningful dialog between the auditors and the audit committees. Our reasoning follows:

- It is unwise to place additional focus on the current highly technical and complex ethics rules. This additional focus may delay the achievement of the ISB's goal of developing a new conceptual framework for auditor independence. In our view, that goal should be the foremost objective, and only after that is achieved, should there be reconsideration of how to implement its provisions.
- A standard confirmation would be redundant. More valuable would be a communication at the end of the audit of how a firm did comply with the independence requirement to "be independent in fact and appearance when providing auditing and other attestation services" as stated in the AICPA Code of Professional Conduct, Article IV.
- A standard confirmation is likely to be a stereotyped routine communication that may not improve directors' understanding of independence issues.
- Without substantial amplification, the SECPS peer review program would be unable to effectively test compliance with existing independence rules, such as measuring the success of a firms' systems designed to achieve the stated behavioral objectives. Current quality control standards relating to independence are inadequate for this purpose.

In terms of the matters upon which specific comment was requested:

1) *Will the proposed Recommendation be helpful in fostering additional attention on independence issues by audit committees and their auditors?*
   No, we believe there is considerable doubt that the proposed Recommendation will accomplish this objective in a meaningful fashion.

2) *Is there a more or equally effective mechanism for promoting audit committee evaluation of the independence of the entity's auditors?*
   Yes, as stated above, a focus on communicating how the firm achieved the required behavior objectives would be more effective. Further, if the Board's primary objective is to promote audit committee evaluation of independence, this factor should be set forth more prominently.

3) *Do the benefits of the proposed requirement outweigh its costs?*
   No, but we believe the proposal could set back achievement of the Board's longer-term goals of developing a comprehensive framework for auditor independence.

4) *While the Recommendation encourages independence discussions with the audit committee early in the audit process so that any concerns of the audit committee can be addressed before the audit is fully underway, the Recommendation is drafted to allow flexibility in the timing of confirmation delivery. Would it be desirable to recommend that the independence confirmation be delivered at the time that the auditor is appointed for the upcoming audit?*
   No, this would make the requirement a sterotype, a predictable promise that would not be responsive to generally accepted auditing standards.

5) *A small number of auditors of U.S. public companies, as well as auditors of foreign companies registered with the SEC, are not members of SECPS. Therefore, if the Recommendation became an SECPS membership requirement, rather than a requirement under U.S. generally accepted auditing standards, it would not apply to all audits of companies subject to SEC reporting requirements. Should the Recommendation be submitted to the Auditing Standards Board (ASB), as opposed to SECPS, so that the requirement would apply to all audits of public companies? (It should be noted that there are existing SECPS requirements that apply only to member firms, such as those mentioned in paragraph 9 of the attached proposal.) Or should the proposal be a dual recommendation to both the SECPS and the ASB, because the SECPS Executive Committee can implement it immediately, while the ASB's processes would require a significantly longer period of time?*
   Yes, the Recommendation should be made jointly for the reasons stated.

We would be pleased to discuss our comments with you at your convenience.

Sincerely,

L. Hal Rogero, Jr. /lc

L. Hal Rogero, Jr., CPA
Chair, Committee on Professional Issues

cc: Hayward Bell, CMA - Chair, Ethics Committee
John J. Perrell, III, CPA - Chair, Financial Reporting Committee

PUBLIC OVERSIGHT BOARD
One Station Place
Stamford, CT 06902
(203) 353-5300
Fax (203) 353-5311

August 13, 1998

Mr. Arthur Siegel
Executive Director
Independence Standards Board
American Institute of CPAs
1211 Avenue of the Americas
New York NY 10036-8775

Dear Art:

I believe it to be useful to respond more fully to your observation that the POB's suggestion to expand ITC 98-1 recommended communication to audit committees, to include the description and amount of all non-audit services provided by the audit and its affiliates, is the same as the SECPS membership requirement.

I think the POB recommendation would frame the existing SECPS communication in a way that would focus directors on why the disclosure is being made. That is, that directors should evaluate whether the non-audit services might affect the auditor's independence or appearance of independence. The purpose of the existing disclosure is not understood by many directors. Further, some board of directors do not permit their auditors to provide non-audit services because of a misguided concern that auditor independence might be affected by "management consulting services."

The disclosure the POB is recommending would not only disclose the nature and amount of non-audit services, but could also explain that they do not violate the independence requirements of the SEC and the profession because the services do not (a) result in the auditor assuming a managerial responsibility and (b) result in the auditor making decisions for the client, assuming custodianship of assets, maintaining books and records or providing a service that is otherwise proscribed.

I am confident that the expanded disclosure recommended by the POB could be made in a way that directors would better understand what they should be aware of from an independence perspective. That type of disclosure would likely not only be beneficial to directors, but would also benefit auditors, by helping to eliminate the concerns some directors have about the independence implications of non-audit services.

Sincerely,

Jerry

Jerry D. Sullivan
JDS/mb

PUBLIC OVERSIGHT BOARD
One Station Place
Stamford, CT 06902
(203) 353-5300
Fax (203) 353-5311

August 10, 1998

Independence Standards Board
1211 Avenue of the Americas
New York, NY 10036-8775

Attn: ITC 98-1

Gentlemen:

The Public Oversight Board (POB) is pleased to respond to the Independence Standards Board (ISB) invitation to comment on its proposed recommendation to the Executive Committee of the SECPS of the AICPA (ITC 98-1, May 29, 1998).

The ISB recommendation calls for member firms of the SECPS to confirm their independence annually to each public company client's audit committee or board of directors with the objective of initiating dialogue that would improve the directors' understanding of independence issues, thereby assisting them in exercising their corporate governance responsibilities.

The POB applauds efforts to improve the understanding of audit committees and board of directors about corporate governance issues related to the quality of financial reporting and strongly endorses efforts that focus directors on the fact that they are the independent auditor's client and they carry a fiduciary responsibility to protect shareholder's interests. (See Strengthening the Professionalism of the Independent Auditor, Report to the Public Oversight Board of the SEC Practice Section, AICPA from the Advisory Panel on Auditor Independence.)

However, the POB believes that the ISB's proposed recommendation needs to be expanded to attain its stated objective. Auditor independence is an elusive concept. Independence requirements of the AICPA and the SEC are a large body of published rules and interpretations that largely deal with situations directed at avoiding auditor-client relationships that create a financial relationship or other conflict of interests that would impair the reality of independence or create the appearance of a lack of independence. While client audit committees expect, and largely take for granted, their auditor's independence, they have little understanding in the abstract notions of independence and the disjointed myriad of published rules that auditors must either adhere or analogize to in assessing their independence in a specific client situation. They need more than a simple declaration to stimulate a meaningful discussion of auditor independence.

To meet its objective, the proposed recommendation should be expanded to require auditors to communicate to audit committees specific matters relating to the client-auditor relationship that the auditors and directors should be aware of, and evaluate, when reaching a conclusion that the auditor's objectivity with regard to the audit of the client's financial statements has not been impaired or that the relationship does not create the appearance of a conflict of interest. This communication therefore should include: (a) the description and the dollar amount of all non-audit services provided or agreed to be provided to the client by the auditor or its affiliates, (b) an explanation and the dollar value of all financial relationships between the auditor, its affiliates, and the client, such as joint ventures, marketing arrangements, and investments, and (c) any other significant matters relating to the client relationship that the auditor considered when reaching a conclusion about its independence.

The POB believes that a forthright explanation and discussion of the independence implications of the above matters in a required communication to directors will likely stimulate a meaningful discussion about the client-auditor relationship that will not only engage directors, but also will enhance auditor professionalism. Finally, the POB believes that the public interest would be served by a broader communication resulting in directors having a better understanding and assessment of all significant aspects of the client-auditor relationship that might affect the auditor's independence.

We will be pleased to further elaborate on our recommendations at your convenience.

Sincerely,

A. A. Sommer, Jr.
Chairman

AAS/mb

cc: Michael A. Conway, SECPS Chair
Lynn Turner, SEC Chief Accountant

August 26, 1998

To: Members of the Independence Standards Board

The AICPA's Professional Ethics Executive Committee (PEEC) submits this comment letter in response to the Board's Invitation to Comment on the proposal that the Board recommend to the Executive Committee of the AICPA's SEC Practice Section (SECPS) that it require member firms to annually confirm in writing their independence to each public company client's audit committee or board of directors and to offer to meet with the committee or board to further discuss independence.

Our comments will relate first to the five questions posed in the Invitation to Comment.

1. The proposed recommendation is a small step that may be helpful in focusing audit committees' and directors' attention on issues of auditor independence.

2. The recommendation will not promote "evaluation" of the independence of an entity's auditors for the reasons cited in paragraph 7 of the Discussion portion of the Invitation to Comment. To evaluate is to determine. We agree with the assessment in paragraph 7 that insufficient knowledge and impossibility of confirmation of auditor representations by the audit committee and directors would preclude their evaluation of auditor independence. We do agree, however, that the proposal will contribute to the overall awareness, understanding and discussion of independence issues by audit committees, directors and auditors.

3. The benefits of the recommendation outweigh the costs.

4. We support the recommendation as drafted; i.e. to allow flexibility in the timing of delivery of the independence confirmation. The auditor - client relationship is the best determinant of the appropriate delivery time. Should this recommendation be adopted audit clients will, together with their auditors, know best when confirmation is appropriate.

5. A majority of PEEC members oppose the referral of the recommendation to the Auditing Standards Board (ASB). Should the ASB adopt the recommendation and issue it as a Statement on Auditing Standards (SAS) it would not only subject the "small number" of auditors of public companies who are not SECPS members to the SAS but also the large number of auditors of non-public companies. To many of those auditors the SAS would

not be either cost effective or practical. Further, many non-public clients do not have audit committees or equivalent oversight. Should the ISB propose and the SECPS adopt this recommendation, the SEC through regulation or persuasion may seek to require it of auditors of public companies who are not SECPS members. Alternatively, to the extent public companies perceive value in this recommendation auditors who are not SECPS members might be persuaded by their clients to adopt the recommendation. In any event, issuance of a SAS causing the recommendation to be part of a GAAS audit would be counterproductive.

The PEEC offers this additional comment with respect to paragraphs 4 and 10 in the Discussion part of the Invitation to Comment and the wording of the Recommendation of Confirmation Language.

1. The word "report" in the fifth line should be deleted and replaced with the word "letter". SAS 72, is titled: "Letters for Underwriters" and throughout uses the word "letter". Paragraph 6 of the Invitation to Comment includes the word "letter". A "report" has a technical connotation which may not be appropriate in the context of the recommendation.

2. The sixth line contains the phrase "under the applicable rules". Because the applicable rules are stated a few lines below this phrase, the phrase is unnecessary. We suggest the first sentence of the confirmation language end with the word "independence".

3. The ninth line refers to "independent accountants". We suggest that be changed to "independent certified public accountants" as stated in SAS 72.

4. The tenth line includes the phrase "under the published requirements" of the SEC, etc. We recommend that phrase be deleted and replaced with the following: "within the meaning of: the applicable Securities Act, the published regulations and interpretations promulgated thereunder, the pronouncements of the Independence Standards Board and Rule 101 of the American Institute of Certified Public Accountants' Code of Professional Conduct, its interpretations and rulings".

   The phrase "within the meaning" is key: it is used in SAS 72; and it allows for discussion and explanation which is the objective of the ISB's recommendation.

Finally, with respect to the ISB proposal overall we note that neither Generally Accepted Auditing Standards nor SECPS rules require communications to audit committees or boards to be only in writing; accordingly, the PEEC recommends that the proposal be revised to not require only written communications regarding auditor independence.

The PEEC appreciates this opportunity to comment. I would be pleased to discuss the comments and other matters with respect to the ISB's Invitation to Comment.

Sincerely,

Frank K Pearlman

Frank J. Pearlman
Chair, Professional Ethics Executive Committee

FJP:bjb

cc: Members of the Professional Ethics Executive Committee
Susan Coffey
Herbert Finkston
Ethics Division Staff

ISBCom.DOC

August 26, 1998

To: Members of the Independence Standards Board

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3. The benefits of the recommendation outweigh the costs.

4. We support the recommendation as drafted; i.e. to allow flexibility in the timing of delivery of the independence confirmation. The auditor - client relationship is the best determinant of the appropriate delivery time. Should this recommendation be adopted audit clients will, together with their auditors, know best when confirmation is appropriate.

5. A majority of PEEC members oppose the referral of the recommendation to the Auditing Standards Board (ASB). Should the ASB adopt the recommendation and issue it as a Statement on Auditing Standards (SAS) it would not only subject the "small number" of auditors of public companies who are not SECPS members to the SAS but also the large number of auditors of non-public companies. To many of those auditors the SAS would

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Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881 (201) 938-3000 • (212) 318-0500 • fax (201) 938-3329

not be either cost effective or practical. Further, many non-public clients do not have audit committees or equivalent oversight. Should the ISB propose and the SECPS adopt this recommendation, the SEC through regulation or persuasion may seek to require it of auditors of public companies who are not SECPS members. Alternatively, to the extent public companies perceive value in this recommendation auditors who are not SECPS members might be persuaded by their clients to adopt the recommendation. In any event, issuance of a SAS causing the recommendation to be part of a GAAS audit would be counterproductive.

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   The phrase "within the meaning" is key: it is used in SAS 72; and it allows for discussion and explanation which is the objective of the ISB's recommendation.

Finally, with respect to the ISB proposal overall we note that neither Generally Accepted Auditing Standards nor SECPS rules require communications to audit committees or boards to be only in writing; accordingly, the PEEC recommends that the proposal be revised to not require only written communications regarding auditor independence.

The PEEC appreciates this opportunity to comment. I would be pleased to discuss the comments and other matters with respect to the ISB's Invitation to Comment.

Sincerely,

Frank J. Pearlman
Chair, Professional Ethics Executive Committee

FJP:bjb

cc: Members of the Professional Ethics Executive Committee
Susan Coffey
Herbert Finkston
Ethics Division Staff

ISBCom.DOC

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHIEF ACCOUNTANT

August 21, 1998

Mr. William T. Allen, Chairman
Independence Standards Board
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Chairman Allen:

The efforts of the Independence Standards Board ("ISB") to improve upon the protection provided to investors when an auditor engages in timely and thorough communications with the audit committee of an audit client are important to the Commission. As you may know, the Commission has endorsed the establishment by all publicly held companies of audit committees composed of outside directors. It also has urged the business and financial communities and all shareholders of publicly held companies to lend their full and continuing support to implement recommendations to enhance the abilities of audit committees. The Commission's support is intended to afford the greatest possible protection to investors who rely upon the financial statements of public companies.[1] Most recently, reflecting the Commission's long standing support, Chairman Levitt has stressed the importance of audit committees and their responsibility to question the auditing professionals.[2]

On a personal note, I have had extensive experience with audit committees as a partner with a big five firm and as a Chief Financial Officer ("CFO"). It is my personal experience that the company and shareholders gain tremendous value when the audit committee works closely with the auditors and the CFO. As an audit partner, I worked to keep the audit committee reasonably informed of the various services performed by the accounting firm through an in-depth discussion of the purposes and ramifications of the various services. It is only through these in-depth discussions that an audit committee can understand the auditor's assertions about its independence and make the committee's own reasonably informed decisions regarding the auditor's independence.

The staff of the SEC recognizes the importance of auditors confirming their independence annually to each public audit client's audit committee or board of directors. The staff has encountered numerous occasions where auditor independence problems have delayed the ability of a company to comply with the requirement to file with the Commission financial statements audited by an *independent* auditor. These problems usually arise in connection with the company's registration of securities for sale. In nearly every instance, the company's management, audit committee and board of directors were

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[1] Accounting Series Release ("ASR") No. 123 (March 23, 1972).
[2] Arthur Levitt, *The SEC Looks At Governance*, The Corporate Board, July/August 1998, at 4.

not aware of the particular auditor independence problems until those issues were raised by the staff. In many cases, these independence problems have prevented a public company filing from going effective on the date desired by its management thus preventing the company from the scheduled selling of its securities in the public markets. In some cases, registrants were even required to have a new audit performed by a different audit firm before a filing could go effective.

Based on these experiences, a mere confirmation of independence by an auditor is insufficient. In each of the aforementioned cases the auditors had presented their public company audit client with a report from an *independent auditor*. However, in these same cases, it was not until the SEC staff raised the question of independence that the management (and hopefully the audit committee and board of directors) became aware of the independence issue. Unfortunately, it is not the auditor, but the corporation and its shareholders that suffer when it is determined, at this late date, that an auditor lacked independence.

As noted by Chairman Levitt, directors are in an ideal position to monitor new developments and to address problems earlier, rather than after serious injury to the corporation has occurred.[3] As the Chairman stated, we must have a system that gives directors timely information, to help them represent shareholders.[4] The proposal that the auditors represent to the audit committee that they are independent at the time that the auditor is appointed is the first step to a system that gives directors information timely. However, an auditor's representation of independence is meaningless unless it is accompanied by a robust written discussion that provides the committee with the full range of facts and ability to become reasonably informed about the relationships with the auditor. With this approach, the audit committee is in the best position to make reasonable inquiries and protect the corporation and shareholders against the cost that can result when auditors are found to lack independence.

These observations are consistent with those of others overseeing the profession. The Public Oversight Board ("POB") has stated that, "in too many instances the audit committees do not perform their duties adequately and in many cases do not understand their responsibilities."[5] Consequently, as noted in the report prepared by the "Kirk panel," audit committee members must be provided with more background and training to enable them to be more effective.[6] The Kirk panel recommended that responsibility should be placed on the independent auditor to be more forthcoming in communicating with the audit committee.[7] The Kirk panel also noted that the Board should expect the auditor to

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[3] *Id.* at 5.
[4] *Id.*
[5] *A Special Report by the Public Oversight Board*, p. 50 (March 5, 1993).
[6] *Strengthening the Professionalism of the Independent Auditor, Report to the Public Oversight Board of the SEC Practice Section, AICPA from the Advisory Panel on Auditor Independence* (the "Kirk" panel), pp. 14-15 (September 13, 1994) (citing Improving Audit Committee Performance: What Works Best, p. 2 (1993)).
[7] *Id.* at 15.

assist it in discharging [its] responsibility to the shareholders, and the auditor should assume the obligation to do so.[8]

The POB, in its response to the ISB's invitation to comment, has recommended that the annual confirmation of an auditor's independence be enhanced to include information to enable the audit committee to make fully informed decisions about an auditor's independence. The staff of the SEC fully supports the POB's recommendations. In order to be effective, an annual representation of independence to an audit client should be accompanied by a discussion in writing of situations and/or services that might raise independence problems as well as the potential impact on the registrant should the situation and/or service cause an impairment of the audit firm's independence. This would prevent an auditor's annual confirmation of independence from becoming merely a form letter.

The staff also concurs with the POB that the ISB's guidance for auditors should surpass the guidance set forth by the SEC Practice Section ("SECPS") for its members. The SECPS guidance requires members to:

> Report annually to the audit committee or board of directors of each SEC audit client on the total fees received from the client for management advisory services during the year under audit and a description of the types of such services rendered. (SECPS Reference Manual § 1000.08).

The guidance provided in response to the ISB's recommendation (or any guidance provided directly by the ISB) should be much broader and should be required to be in writing. It should serve to educate the audit committee about issues involved in a determination of the auditor's independence. For instance, the guidance could require the auditor to advise the audit committee that:

- Professional standards require auditors to avoid situations that may lead outsiders to doubt their independence.[9]

- There are broad underlying guidelines to analyze whether an auditor can be lacking in independence such as when the audit firm is placed in the position of auditing its own work; the auditor is perceived as making decisions for the audit client; or the auditor is perceived as management or an employee of the audit client.

- There are other specific restrictions on auditors in areas such as financial interests, family relationships, employment of audit firm personnel, and acting in the capacity of an attorney, broker/dealer, or commercial competitor.

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[8] *Id.* at 16.
[9] Statements on Auditing Standards No. 1, AU § 220.03.

Finally, the guidance could require a discussion of the potential independence issues involved with each of the services referred to in the SECPS requirement.

The ISB is to be commended for its efforts to provide a process through which auditors and audit committees can focus on independence issues. This effort is consistent with the ISB's leadership role as the authoritative body[10] established to develop guidance with respect to independence for auditors of public companies. However, given that the ISB has been recognized as the authoritative body to provide guidance on issues of independence for auditors of public companies, a more affirmative demonstration of this authority would be to institute its own requirement for auditors of public companies rather than suggest to another group that it do so. This would permit the ISB to provide precise instruction to auditors that would emphasize the importance of independence to auditors and audit committees rather than relegate this responsibility to another standard setting body that lacks the mandate to promulgate independence guidance.

The staff's response to the specific numbered items posed by the Invitation to Comment follows.

Recommendation/Response:

1) The recommendation should be revised to incorporate the suggestions noted above.

2) The recommendation should be revised to incorporate the suggestions noted above.

3) The benefits of the recommendation (revised to incorporate the suggestions noted above) do outweigh the costs. From my experience as a CFO, I believe the incremental costs of implementing an appropriate standard would be very nominal and be greatly exceeded by the benefits of having an informed audit committee.

4) It would be desirable to recommend that the independence confirmation be delivered at the time that the auditor is appointed for the upcoming audit in order to permit timely discussion of any situations and/or services that might raise independence problems and the potential impact on the registrant so that an alternate auditor or method can be selected to resolve the independence issue. It should be noted that the auditor would in essence be re-confirming the earlier confirmation of independence at the conclusion of the audit through the issuance of the independent accountants opinion.

5) The dual approach appears to serve a valid purpose: that the requirement apply universally to all public companies. However, since the ISB has been recognized

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[10] The ISB was recognized as the authoritative body to set independence guidance for auditors of public companies in Financial Reporting Release ("FRR") No. 50 (February 18, 1998).

as the authoritative body in the area of independence, the ISB could, if it desires to do so, issue its own guidance and thus circumvent the necessity to encourage the promulgation of independence guidance by other bodies lacking that authority.

The staff does not object to the Objective (Item 1), the Applicability (Item 2) nor the Recommended Confirmation Language (Item 4). However, the staff would suggest that the Proposed Recommendation (Item 3) be revised to incorporate the suggestions above.

The staff appreciates the opportunity to comment on your proposal and encourages your serious deliberation of these issues. If you have any questions, please feel free to call me, Bob Burns, or Scott Bayless at (202) 942-4400.

Sincerely,

Lynn E. Turner

Lynn E. Turner
Chief Accountant

cc: A. A. Sommer, Jr.

18

Fidelity Investments

Fidelity Management & Research Company

82 Devonshire Street
Boston, MA 02109-3614
Phone: 617 563-7000

December 17, 1998

William T. Allen, Chairman
Independence Standards Board (ISB)
1211 Avenue of the Americas
New York, NY 10036-8775

Attn: Exposure Draft (ED-98-1)

Dear Chairman Allen:

We appreciate having the opportunity to express our views on the proposal for requiring discussions between a company's independent accountant and its audit committee. We are trustees of the Fidelity Group of Mutual Funds that comprises 242 individual funds, the audits of which are divided between two firms of independent accountants.

The independence of auditors is of importance to trustees and directors in fulfilling their governance responsibilities. If it is discovered subsequent to the completion of an audit that an auditor has not complied with the voluminous, seemingly arcane, rules and regulations and regulators' interpretations thereof, an audit may have to be reperformed by an independent firm. That is a costly and embarrassing event. In addition, trustees and directors may wish to establish their own ground rules, apart from the regulatory requirements, to be assured in their own minds of the auditors' independence in fact and appearance. The required discussion and communication that is being proposed by the ISB furnishes a starting point in addressing both of those points.

We at Fidelity have learned from our experiences over the last several years that compliance with the rules is, in certain circumstances, far from clear-cut. In addition, the expansion of both client and auditor activities makes policing of the relationships, particularly indirect ones, difficult. Based on our experiences we believe that the following should be included in the communications with the audit committee:

1. The relationships disclosed and discussed should include those between the auditor and its related entities and the company and its related entities. We recognize that defining the related entities may require careful thought. However, the independence rules do cover indirect relationships, and, therefore, it is important for trustees and directors to understand those relationships.

2. The discussion and disclosure should include a description by the auditors of its method of assuring compliance with the various independence rules. We recognize that assuring compliance is not a simple task, especially for world-wide firms, but the firms' clients need such assurances.

Robert Pozen, President Fidelity Management & Research Company	Gerald McDonough, Chairman of the Independent Trustees	Donald Kirk, Chairman of the Audit Committee

DEPARTMENT OF COMMERCE AND INSURANCE
TENNESSEE STATE BOARD OF ACCOUNTANCY
DAVY CROCKETT TOWER, 2nd FLOOR
500 JAMES ROBERTSON PARKWAY
NASHVILLE, TENNESSEE 37243-1141
615-741-2550 OR FAX 615-532-8800

November 17, 1998

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

ATTN: ED 98-1

Dear Board:

I have received your letter of November 12th with which you forwarded your Exposure Draft entitled, "Independence Discussions with Audit Committees."

I agree with your decision to issue this document as an Invitation to Comment to an Exposure Draft of a Board pronouncement. You are, after all, the Independence Standards Board. As such you enter the regulatory realm and certainly, as a Board, should have the authority to issue pronouncements on standards.

And I agree with your wording of the proposal. As a layman (think "potential client") I would rather have this meeting between the auditor and audit committee held before the audit is started but I also understand the reasons that you opted not to require that early a meeting.

Congratulations on a great first step.

Sincerely,

Don Hummel

Don Hummel
Administrator

9

Author: MIME:EdRockman@csi.com at INTERNET
Date: 11/23/98 5:33 PM
Priority: Normal
TO: ISB at AICPA3
Subject: Exposure Draft (ED 98-1)

I previously responded to the Invitation to Comment on this subject. In that response, I objected to the boilerplate nature of the proposed confirmation of independence. I also objected to any referral of the matter to the Auditing Standards Board. I believe that the new ED is an improvement from the Invitation.

The ED attempts to encourage a real substantive dialogue between the auditor and the audit committee about independence issues. However, I would suspect that the real effect will be even more salutary than the stated goal. Auditors, by nature, hate to report negatives. Therefore, auditors will do everything they can to avoid having any disclosable conditions, which may be an improvement in performance, rather than just in communication. In the end, I doubt that much new will be reported, but behaviors may change for the better.

I would like to comment also on the requirement for a "discussion." The ED talks about requiring a discussion. It takes two to have a discussion. I don't see how this can be made operational when it only governs the auditor. There is an old expression, "you can lead a horse to water, but you can't make him drink." The auditor may try to start a discussion, but can he or she force it? If the auditor reports and the audit committee just listens, with no comment, is that a discussion? If it isn't, does the auditor have to do something because there was no discussion, and if so what?

I also believe that the ED could do a better job of describing its goals. I have read it several times, and it does not specifically and explicitly encourage an in depth dialogue. I would like to see a better articulation of the goals of the proposed standard.

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November 23, 1998

Mr. Arthur Siegel
Executive Director
Independence Standards Board
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Siegel:

This has reference to your letter of 11/17/98 regarding Exposure Draft 98-1, Communication with Audit Committees. Thank you for inviting me to comment. In October the NACD, working in concert with the Center for Board Leadership, identified a group of experts in the field of corporate governance and financial reporting and control to comprehensively examine the role of the audit committee. This blue ribbon commission held its first meeting on November 11 and expects to complete its work and publish a report in the spring of 1999. Communications between the external auditors and various interested constituencies will be addressed in that report. My purpose in providing this background is to explain that my thoughts as expressed in this letter may not parallel the official position of NACD, as it will be reflected in the 1999 report.

I fully support the proposition that independent auditors should be routinely required to disclose "all relationships between the auditor and the company, including personal relationships that may reasonably be thought to bear on independence...". I also believe that all other financial dealings (e.g. consulting, related party engagements) should be included in these disclosure requirements. Finally, the exposure draft limits this disclosure to the audit committee, or in their absence, the full board. I believe this should be expanded to include the corporation's shareholders.

Thank you again for giving me an opportunity to comment on this very important subject.

Sincerely,

James J. Darazsdi
Interim President & Chairman

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Accountants and Management Consultants

The US Member Firm of Grant Thornton International

Grant Thornton

GRANT THORNTON LLP

November 24, 1998

Independence Standards Board
1211 Avenue of the Americas, 6th Floor
New York, New York 10036-8775

Attn: ED 98-1

Gentlemen:

Grant Thornton is pleased to provide comments to the Independence Standards Board about ED 98-1, *Independence Discussions with Audit Committees*.

In general, we support the Board's efforts to have the auditor confirm his or her independence to the Audit Committee (or the Board of Directors) of a client company annually. However, we have the following specific comments about the proposal:

1. The standard should specifically permit reporting to be made at the same time as other required communications, such as those required by SAS 61. The communications specified by SAS 61 are not required to occur before the issuance of the auditor's report on the entity's financial statements. However, the proposal requires the communication to be made "during the course of the annual audit." It is not clear whether a communication made after the issuance of the auditor's report (but sufficiently timely for purposes of SAS 61 communications) is deemed to be "during the course of the annual audit."

2. It is unclear from the ED whether the ISB would consider independence to be impaired if either a written report was not issued or the mandated discussion was not held. We believe that the failure to comply with the standard, although a violation of professional standards, should not, in and of itself, be considered to result in an independence impairment. However, if the ISB does, in fact, believe independence would be considered to be impaired as a result of noncompliance with this standard, we suggest that the Board also consider the effects of the audit committee failing to appropriately respond to the auditor's request for a discussion. Also, we urge the ISB to consider if the impairment would be "cured" through compliance at a later date.

3. We object to the requirement that the report be in writing. The proposal should be sufficiently flexible to allow oral communications, provided such communications are documented. Oral communications are permitted by SAS 61 and to have different requirements would be confusing to both auditors and audit committees. It would not,

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in our view, bring any less focus within audit firms on independence issues if the report is not delivered in written form.

4. The requirement to disclose all relationships, including personnel relationships that may reasonably be thought to bear on independence, is onerous and may be unworkable. There are many types of permitted relationships and the phrase "that may reasonably be thought to bear on independence" does not give guidance as to what types of permitted relationships bear on independence and what types do not. In addition, the standard should make it clear that it is the auditor who ultimately is responsible to make the decision as to whether a relationship "may reasonably be thought to bear on independence." Also, while we understand the ISB may want the types of management consulting services that are provided reported, it is unclear if all other services outside the annual audit need to be disclosed, including for example, tax services both for the client and its officials. In addition, the fees received for some of these services may be de minimis and in no way be thought to bear on independence by reasonable people. In addition, it may be onerous to even gather this information in the case of multinational or multioffice engagements. Our objection would be lessened if the Board decided that certain relationships where fees received were not material to the audit fee did not have to be specifically disclosed. Finally, it is unclear whether matters previously reported to the audit committee would need to be reported on an annual basis, and for how long. For example, if a manager joins the client as its controller and this is reported in the first year, would this need to be reported in the second year, and the third year, and the tenth year?

5. It is unclear whether this standard would be applicable to foreign auditors. We suggest the ISB carefully consider whether or not it should be applicable to them because of the logistical and cultural differences that pertain to a foreign auditor.

6. Whether or not the Board intends to require a report to be in writing, an illustrative report should be provided similar to the illustration in the previously exposed Proposed Recommendation to the SECPS Practice Section.

7. Finally, the basis for the ISB's statement that the "costs to implement this pronouncement would be small, particularly when compared with the benefits" is not clear to us. While the requirements of the standard may be of benefit when an auditor is also performing other types of services, the benefits of applying the standard is less clear for many thousands of SEC registrants for whom this is not the case, especially since, as it pertains to these registrants, there is no perceived need for this standard.

We would be pleased to discuss our views with the Board or its staff further. Please contact John Archambault, National Director of Professional Standards, at 312-856-0001, or Barry Barber, Director of Quality Assurance at 212-599-0100.

Very truly yours,

Grant Thornton LLP

Grant Thornton LLP

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WALTER ORENSTEIN *Certified Public Accountant*

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718-897-5884

November 24, 1998

Mr. William T. Allen, Chairman
Independence Standards Board
1211 Avenue of the Americas, 6th Floor
New York, New York 10036-8775

Re: ED 98-1

Dear Mr. Allen:

Since the highest degree of importance is placed on independence, a CPA should make a statement for each audit engagement as contained in the proposal, stating such independence in writing with respect to a specific company within the meaning of the Securities Acts. The term "confirm" is ambiguous because a confirm can be oral or in writing.

If the auditor is required to disclose in writing all relationships between the auditor and the company why not require a confirm in writing of the auditor's independence.

If no relationship exists between the auditor and the client relating to independence, is a written confirm required? This is not clear in the "Proposal".

Very truly yours,

Walter Orenstein

Walter Orenstein

8

WSL

WEINICK SANDERS LEVENTHAL & CO., LLP

CERTIFIED PUBLIC ACCOUNTANTS

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November 24, 1998

Mr. William T. Allen, Chairman
Independence Standards Board
1211 Avenue of the Americas, 6th Floor
New York, New York 10036-8775

Re: ED 98-1

Dear Mr. Allen:

The highest degree of importance is placed on the independence of the CPA. The current proposal requiring the CPA to "confirm" his independence must be in the form of a written confirmation of independence. This written confirmation should disclose any relationship(s) between the auditor and the company e.g., tax or consulting services, and also state why the relationship(s) do not impede the CPA's independence.

Very truly yours,

WEINICK SANDERS LEVENTHAL & CO., LLP

Gregory J. Lavin, CPA
Executive Partner

GJL:so

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FINANCIAL EXECUTIVES
INSTITUTE

Susan M. Koski-Grafer
Vice-President - Professional Development
and Technical Activities

December 4, 1998

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

Attn: ED 98-1

The Committee on Corporate Reporting (CCR) of the Financial Executives Institute appreciates the opportunity to comment on the ISB Exposure Draft 98-1 on Independence Discussions with Audit Committees. We support meaningful discussions between the audit committee and the independent accountant on issues that might impact independence in addition to the issuance of an annual independence confirmation. We believe that open communication will enhance the understanding of the issues and will benefit all parties. In this regard, we believe that it is desirable to clarify the reference to personnel relationships (e.g. what are the intended parameters).

Sincerely,

Susan Koski-Grafer

Susan Koski-Grafer
Vice President-Professional Development and Technical Activities

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UNIVERSITY of ARKANSAS

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Sam M. Walton Leadership Chair
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December 3, 1998

Independence Standards Board
ATTN: ED 98-1
1211 Avenue of the Americas, 6th Floor
New York, NY 10036-8775

As a member of the audit committee of a publicly held company, I'm writing to object to the issuance of ED 98-1. The proposal does not address the standards for independence. Independence is a concept of relationships; this proposal does not define standards for relationships that would impair independence or objectivity. Failure to follow this proposal would have no bearing on whether the auditor is independent or on the auditor's relationship with the client.

If it is deemed that the proposal has merit, it should be issued by the AICPA SEC Practice Section, since the proposal addresses a practice (performance) standard.

Further, the proposal is vague in several respects. For example, "during the course of the audit," is unclear. I can see a need for the issues to be discussed at the beginning of the audit. I can also see a need for such discussions to take place at the time of issuance of the report. The proposal should directly address this issue.

The term "personnel relationships" is unclear. Does "personnel relationships" include "personal relationships?" If so, how far are these relationships extended for purposes of this proposal? For example, to what extent do such relationships include business, professional or social relationships?

The responsibilities of the audit committee are unclear in this proposal. Are such discussions to be documented in the minutes of the audit committee? Are other responsibilities envisioned?

With respect to the final sentence in the proposal, the auditor is currently required to disclose any lack of independence in its audit report, suggesting that this provision is redundant.

I hope these comments are helpful.

Sincerely,

Doyle Z. Williams
Dean

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ARTHUR ANDERSEN

Arthur Andersen LLP

225 North Michigan Avenue
Chicago IL 60601-7600
312 782 0225

December 17, 1998

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

Re: ED 98-1

Dear Board Members:

We applaud the recommendation of the Independence Standards Board to require the independent auditor to more fully communicate with a company's audit committee concerning the auditor's independence. Increased information to and communications with audit committees (or the board of directors if there is no audit committee) is, without question, highly desirable. We are fully supportive of a requirement to provide the kind of written communication that is proposed and believe that an annual discussion with the audit committee is also desirable and would be very beneficial in enhancing the effectiveness of many audit committees. We do, however, have several comments on the exposure draft for your consideration.

The exposure draft provides that the auditor should discuss the auditor's independence with the company's audit committee during the course of the annual audit. We suggest deleting the reference to "during the course of the annual audit" and replacing it with an annual requirement. Some audit committees may prefer that the required discussions take place before the annual audit begins, others after the date of the auditors' report. An annual requirement would adequately serve the objectives of ensuring (1) improved corporate governance, and (2) increased focus by the auditor on independence issues. Accordingly, we recommend that "during the course of the annual audit" be deleted from that sentence and the word "annually" be added at the end thereof.

ARTHUR
ANDERSEN

The exposure draft indicates that the auditor is required to disclose "all relationships, including personnel relationships, that may reasonably be thought to bear on independence." We have two editorial suggestions with respect to this phrase. First, the reference to "including personnel relationships" should be deleted. The inclusion of the word "all" makes this reference unnecessary, and it raises questions as to whether "personnel" or "personal" relationships was intended. Since both may bear on independence, nothing is added by singling out this one type of relationship. Second, we recommend that the phrase be clarified so that it is clear that it is the auditor who is required to determine what bears on independence and to disclose and discuss what he or she believes may reasonably bear on independence, recognizing that an audit committee may require additional information it deems appropriate. This clarification can easily be accomplished with the following insertion: Specifically, "the auditor shall disclose, in writing, all relationships between the auditor and the company that he or she concludes may reasonably be thought to bear on independence, including any specific relationships that the audit committee wants considered, so that the audit committee and the auditor can discuss them." Providing more clarity on that phrase is particularly important since we believe it was the intent of the ISB, as implicitly stated in the exposure draft's background section, to require the auditor to identify those "judgmental matters that might impact on independence."

Finally, because the Board's proposal requires discussions with the audit committee, we believe the proposed standard is a desirable behavioral standard rather than a practical or principle-based independence standard. We urge the Board to consider not requiring the completion of a discussion as a condition of maintaining auditor independence unless it also clearly addresses the consequences when the required discussion does not take place. If that cannot be addressed in a clear and practical manner without raising undue compliance and enforcement-related questions for SEC registrants and auditors, then we believe the Board should consider deleting a mandatory discussion requirement, adopting a requirement that the auditor offer to have a discussion, or going back to its original and more practical proposal of pushing for an SECPS membership requirement. The last option, in our judgment, would be the most effective means of achieving the Board's objectives without creating many unintended and unnecessary complications.

We appreciate the opportunity to provide comments on this exposure draft and would be happy to discuss our suggestions and comments with you or your staff at any time. Please feel free to contact Chuck Horstmann (312/507-3071) or Jean L. Rothbarth (312/507-2827).

Very truly yours,

Arthur Andersen LLP

DEPAUL UNIVERSITY

December 18, 1998

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By fax 212-596-6137 (2 pages)

COMMENTS ON INDEPENDENCE STANDARDS BOARD EXPOSURE DRAFT ED 98-1

General comments

In my letter on the invitation to comment (ITC) on this subject I stated that an auditor's confirmation of independence to its client was redundant since it basically duplicated the auditor's representation in the standard audit report that an independence in mental attitude was maintained throughout the audit. Merely imposing an unstructured "discussion" about "relationships that may . . . bear on independence" without stating any objective, purpose or desired conclusion from the discussion is unlikely to lead to the hoped-for result. Requiring the auditor to state that its statement that it is independent is based on its professional opinion does not change this conclusion.

Issue Confirmation by the audit firm that it is independent is redundant, as the auditor already confirms this as part of the standard audit report. The audit committee (AC) should conclude the firm has not impaired its independence.
Suggestion This portion of the ED should be deleted.
Commentary Reminding audit committees of their responsibility to evaluate the independence of their external auditor is a worthwhile objective, but a strategy based primarily on an auditor confirmation is unlikely to achieve it. As the SEC ITC comment letter states: "a mere confirmation by the auditor is insufficient." The Illinois CPA Society comment letter says: "[The proposal] provides little benefit." The AICPA comment calls it "a small step." The Crowe Chizek ITC letter states: "[a confirmation] will slightly increase attention to independence issues."

Comments About an Independence Discussion

Issue Requiring the auditor provide the AC information on **relationships** bearing on independence fails to provide sufficient information needed by the AC so it has insight on all matters that might impact on the independent mental attitude auditors must maintain as required by generally accepted auditing standards.
Suggestion The ED should require the auditor to identify and communicate to the audit committee the details of all circumstances posing a threat or risk to independence and objectivity. *The European Profession Common Core Principles for Statutory Audit Independence and Objectivity* suggests this approach and categorizes these threats or risks into five categories: Self-Interest, Self-Review, Advocacy, Familiarity or Trust, and Intimidation. This document was published as of July 1998 by the Federation des Experts Comptables Europeens (FEE) in Brussels. It also suggests independence must encompass both independence of mind and independence of appearance.
Commentary As recognized by the FEE, the independence required by auditors so that they act objectively is a behavioral condition, not entirely a matter of relation -

ships. Globalization of capital markets demands that the best practices useful to assuring auditor independence be harmonized on a world-wide basis. The ISB should take advantage of the deliberations of their European counterparts on common issues like auditor independence.

Issue As stated in the board's Basis for Conclusions, many respondents to the earlier invitation to comment suggested that auditors communicate the "important matters considered . . . in reaching a conclusion that independence was maintained." The ED is not responsive to this concern because it does not suggest that the auditor provide to the audit committee information as to the supporting rationale for the auditor's conclusion how it has maintained an independent mental attitude.
Suggestion The ED should require the auditor to describe the safeguards which have been put into place to offset all of the threats and risks communicated in each of the five risk categories. The FEE document previously referred to states that "auditors should always consider the use of safeguards which may negate or reduce" any such threats or risks. It suggests firms take both external and internal steps. Internal steps include maintaining an overall control environment of quality and ethics taking into account the assurance provided by "a regularly monitored and evidenced control system." Other steps include the elements of a well-designed ethics program..
Commentary Again, the ISB should take advantage of the best and most recent world-wide thinking on the subject of auditor independence.

Issue The ED is unreasonably focused on process rather than results or objectives. Although providing an opportunity for ACs to discuss independence issues, the ED outlines no purpose or objective for such discussion. Thus, the discussion is likely to be unproductive, possibly stereotyped and weak.
Suggestion It would seem to be a reasonable expectation that a structure be established for the AC discussion and an objective stated. The auditor should assert that the described safeguards in place do provide reasonable assurance that the independence of the firm and its representatives has not been impaired. After questioning the auditor and deliberating, the AC should be able to conclude that the auditor has addressed in reasonable fashion each of the threats and risks to maintaining independence in appearance and mental attitude. This process should provide assurance to the AC that the company has met the statutory requirement to engage an independent accountant.
Commentary The proposal as stated will not necessarily improve corporate governance as the ED states by merely requiring a discussion designed to "deepen AC understanding of auditor independence issues." Improved corporate governance will only result if ACs engage in a robust evaluative discussion with the auditor which would allow a conclusion to be reached as to the auditor's independence.

Conclusion

I do not favor issuance of the exposure draft.

Respectfully submitted,

Curtis C. Verschoor, EdD, CPA, CMA, CIA, CFE
Ledger & Quill Research Professor, DePaul University

23

THE INSTITUTE OF INTERNAL AUDITORS

William G. Bishop III, CIA
President

Professional Development

Research Foundation

Certified Internal Auditor®

December 21, 1998

Arthur Siegel, Executive Director
Independence Standards Board
1211 Avenue of the Americas, 6th Floor
New York, NY 10036-8775

Dear Art:

Thank you for the opportunity to comment on the Independence Standards Board's (ISB) Exposure Draft (ED) on *Independence Discussions with Audit Committees (ED 98-1)*. As in our earlier response to the ISB's Invitation to Comment 98-1 on the proposed recommendation to the SEC Practice Section, we still do not favor issuance of this standard in its present form. Our comments are as follows:

General comment

In our previous comment letter on this subject we stated that an auditor's confirmation of independence to its client basically duplicated the representation made in the standard audit report that an independence in mental attitude was maintained throughout the audit. Requiring the auditor to provide relationship information and state that this conclusion is based on the auditor's professional opinion does not change our opinion. Merely providing the opportunity for an unstructured discussion without a stated purpose is unlikely to lead to any beneficial conclusion.

Specific comments

1. Issue Requiring the auditor to provide the audit committee (AC), all **relationships** bearing on independence fails to provide insight to the AC on all matters that might impact on the independent mental attitude auditors must maintain as required by generally accepted auditing standards.

Suggestion The auditor should identify and communicate to the audit committee all situations posing a threat or risk to independence and objectivity. The European Profession Common Core Principles for Statutory Audit Independence and Objectivity suggests this approach and categorizes these threats or risks into five categories: Self-Interest, Self-Review, Advocacy, Familiarity or Trust, and Intimidation. This document was published as of July 1998 by the Federation des Experts Comptables Europeens (FEE) in Brussels. This document also suggests independence must encompass both independence of mind and independence of appearance.

Commentary Globalization of capital markets suggests that the best practices useful to assure auditor independence be harmonized on a world-wide basis. The ISB should take

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advantage of the deliberations of their European counterparts on common issues like auditor independence.

2. Issue As stated in the board's Basis for Conclusions, many respondents to the earlier invitation to comment suggested that auditors communicate the "important matters considered . . . in reaching a conclusion that independence was maintained." The ED is not responsive to this concern because it does not give the audit committee information as to the supporting rationale for the auditor's conclusion how it has maintained an independent mental attitude.

Suggestion The auditor should describe the safeguards which have been put into place to offset each of the threats and risks communicated in each of the five risk categories. The FEE document previously referred to states that "auditors should always consider the use of safeguards which may negate or reduce" any such threats or risks. It suggests firms take both external and internal steps. Internal steps include maintaining an overall control environment of quality and ethics taking into account the assurance provided by "a regularly monitored and evidenced control system." Other steps include the elements of a well-designed ethics program.

Commentary Again, the ISB should take advantage of the best world-wide thinking on the subject of auditor independence.

3. Issue The ED is overly focused on process rather than results or objectives. Although providing an opportunity for ACs to discuss independence issues, the ED outlines no purpose or objective for such discussion. Thus, the discussion is likely to be weak and unproductive.

Suggestion It would seem to be a reasonable expectation that a structure be established for the AC discussion and an objective stated. The auditor should assert that the described safeguards in place do provide reasonable assurance that the firm's independence has not been impaired. After questioning the auditor and deliberating, the AC should be able to conclude that the auditor has addressed in reasonable fashion each of the threats and risks to maintaining an independent mental attitude. This process should provide assurance to the AC that the company has met the statutory requirement to engage an "independent" accountant. The ISB should consider issuing guidance concerning a stated objective along with a structured discussion agenda.

Commentary The proposal as stated will not necessarily improve corporate governance as the ED states by merely requiring a discussion designed to "deepen AC understanding of auditor independence issues." Improved corporate governance will only result if ACs engage in a robust evaluative discussion with the auditor which would allow conclusions to be reached.

4. Issue Confirmation by the audit firm that it is independent is redundant, as the auditor already confirms this as part of the standard audit report.

Suggestion This portion of the ED should be deleted.

Conclusion

We do not favor issuance of this standard in its present form.

The IIA is an international organization comprised of nearly 70,000 internal auditing professionals in 120 countries. It is the only organization dedicated solely to the advancement of the individual internal auditor and the internal auditing profession. The IIA is the world leader in research and education for internal auditors and is the standards-setting body for the internal auditing profession.

Best Regards,

William G. Bishop III, CIA

cc: Executive Committee
Professional Issues Committee

AICPA

22

Division for CPA Firms

December 22, 1998

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

Attn: ED 98-1

Gentlemen:

The AICPA's SEC Practice Section Executive Committee (SECPS) is pleased to submit this comment letter to the Independence Standards Board with regard to ED 98-1, *Independence Discussions with Audit Committees.*

The SECPS supports the Board's proposal to have the auditor confirm its independence with the audit committee (or Board of Directors) of the client company on an annual basis. The SECPS believes this will increase communication with audit committees and improve their understanding of auditor independence.

The SECPS may decide to provide future best practices guidance if that is considered necessary to deal with implementation matters.

We have other comments on the proposal.

1. Not all audit committees, or Boards where there is no audit committee, may be willing or able to meet with the auditor to discuss independence. There is no requirement on the part of audit committees to meet with the auditors to have such a discussion and the auditor cannot compel such a meeting. Accordingly, the proposal should indicate that if the audit committee does not meet with the auditor, the auditor nevertheless can still be deemed to have complied with this requirement if the auditor prepares the letter and requests the discussion with the audit committee, even though the audit committee may cause no discussion to occur. (This also will cover, for example, a situation where an auditor is terminated before the discussion with the audit committee occurs so that an independent audit may still be deemed to have occurred.)

2. It may be the wish of the audit committee to have a designated representative, such as the chairman of the audit committee, meet with the auditor and then convey the substance of this meeting to the full audit committee. The ISB proposal should allow for this possibility by indicating that, if it is the desire of the audit committee, the auditor can satisfy the requirement by communicating with the designated representative rather than having a discussion with the full audit committee.

American Institute of Certified Public Accountants
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3. The proposal is unclear as to what entities will be covered. The proposal is broad as it applies to any auditor intending to be considered an independent accountant with respect to a specific company within the meaning of the Securities Acts administered by the SEC. For example, as written the proposal may apply to municipalities, companies with private placement offerings, private companies being acquired by a SEC registrant, foreign registrants, banks filing with other Federal regulatory agencies, employee benefit plans, or broker – dealers, each of whom may be argued to have some possible applicability "within the meaning of the Securities Acts". The SECPS definition of a SEC client does not cover all such entities. The ISB may wish to slightly limit the scope of the proposal. We suggest that the ISB consider whether its purpose will adequately be served if this requirement initially is defined to cover the vast majority of companies for which independence is intended within the meaning of the Securities Act, such as perhaps those companies listed on an exchange, and to allow further study as to the proper applicability to employee benefit plan registrants, non-public companies being acquired, foreign entities, etc. It would greatly aid practitioners if the definition were the same as the SECPS definition.

4. The proposal requires disclosure of all relationships between the auditor and the company and highlights "personnel relationships." Given that *all* relationships that may reasonably be thought to bear on independence are required to be disclosed, we fail to see the need to highlight personnel relationships. Singling out "personnel" relationships seems to serve no purpose, and therefore, we recommend that this clause be deleted.

5. The phrase, "that may reasonably be thought to bear on independence", is unclear as to who makes this determination. We recommend that the language be clarified to state "*in the auditor's judgment* may reasonably be thought to bear on independence", to avoid controversy as to who makes, or can second-guess, this determination.

6. It is unclear what period is meant by "during the course of the annual audit." We understand that the Board intended for this requirement to be flexible in order to meet the needs of the audit committee, and therefore, the standard should clarify the intent of the Board. We recommend that "during the course of the annual audit" be deleted and the word "annually" be added at the end of the sentence. Otherwise, we fear that the auditor may not be deemed independent if this communication occurs before the commencement of, or after the completion of, the audit fieldwork. Such a change also might eliminate the need to describe how a failure to communicate "during the course of the annual audit" could be cured (see 7 below).

7. The proposal doe not address the consequences of what happens if the auditor does not make the required communication. Is independence impaired? If so, how can this impairment be cured?

The SECPS appreciates this opportunity to comment. I would be pleased to discuss these comments and any other matters with respect to the Board's proposal if you so desire.

Sincerely,

Michael A. Conway, CPA
Chairman
SECPS Executive Committee

23

Alice Groomes
91 Burgin Street
Brookhaven, NY 11719

December 13, 1998

Independence Standards Board
Response to ED 98-1, Independence Discussions with Audit Committees
1211 Avenue of the Americas, 6th Floor
New York, New York 10036-8775

Dear Board Members:

I know about your work from your website, and reading the documents you posted led me to write this letter. There are several questions I thought you should have answered.

I cannot reconcile the Board's Operating Policies with the exposure draft. So far as I can tell, the ISB was not set up to improve corporate governance, and that is the proposal's stated purpose. The project appears inconsistent with the Board's constitution.

The exposure draft says: "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." Nothing in the Operating Policies says the ISB should improve the qualifications and performance of audit committee members.

The proposed standard imposes an obligation on audit committees ("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"). How would ISB standards bind audit committees?

You should explain why you are changing the structure of independence regulation. The exposure draft's reporting and discussions would create opportunities for audit committees to evaluate independence. Some audit committees would evaluate audit independence, and others would not. The result would be to substitute a system with incidental committee evaluations for a uniform system of compliance with rules. Compliance with requirements would be less important than audit committee attitudes. You should explain how you concluded this unevenness is justified and why downgrading the importance of SEC rules this way makes sense.

You said in the Invitation to Comment that audit committee members are not equipped to evaluate audit independence. Since the exposure draft would probably lead to audit committee evaluations, you should explain how you resolved the inconsistency.

Thank you.

Alice Groomes

Sincerely,

Pfizer Inc
235 East 42nd Street
New York, NY 10017-5755
Tel 212 573 3273 Fax 212 573 1853

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December 15, 1998

Terence J. Gallagher
Vice President—Corporate Governance

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

Attention: ED98-1

Gentlemen:

We would agree with the proposal except in so far as it relates to personal relationships. We believe that it is a fairly widespread practice at this time for the Audit Committee to review the various business relationships with the auditors before recommending them for appointment. This system is working well and should not be disturbed except for good reason.

The addition of a requirement for disclosure of personal relationships would put the Audit Committee in the difficult position of assessing the relative importance of a variety of relationships between individuals. Whether or not such relationships would have a bearing on the independence of an auditing firm with multiple partners and employees is a relevant question. At best such an inquiry would most likely lead to a change of engagement partner although the present checks and balances in place in audit firms might make even that step unnecessary in many cases.

In sum we believe that the adoption of the proposal would not change present practice and would in fact add a disruptive element that would not be to the advantage of investors.

Very truly yours,

Terence J. Gallagher

Terence J. Gallagher