

SEC Staff Remarks regarding Independence: 2006 AICPA National SEC / PCAOB Conference

At the December 2006 AICPA *National Conference on Current SEC and PCAOB Developments*, staff from the SEC Office of the Chief Accountant (OCA) made several remarks regarding auditor independence. **Michael Husich** (Associate Chief Accountant in OCA), who has primary responsibility for independence, addressed the following issues:

Smaller Audit Clients Needing Assistance with Accounting Issues.

The staff occasionally receives inquiries from smaller accounting firms about what constitutes prohibited bookkeeping and management functions versus acceptable accounting advice. Mr. Husich referred to guidance in the *Codification of Financial Reporting Policies*. That guidance states that the basic consideration is whether to a third party the client would appear to be substantially dependent on the auditor's skill and judgment. He suggested several questions to help think through the issue, including:

- Is management sufficiently knowledgeable to maintain books and records that are materially correct?
- Is management's knowledge commensurate with the complexity of the business and accounting standards it must apply?
- Is the auditor's advice limited to comments or editorial suggestions on the company's financial statements (including the footnotes) or is the auditor significantly adjusting the financial statements and re-drafting the footnotes?

However, Mr. Husich also reminded the audience that the auditor and the

company should not resort to another extreme and abandon two-way communication on accounting matters for fear of violating the independence standards. The SEC addressed this issue in its May 2005 statement on the implementation of Section 404 of the Sarbanes-Oxley Act. As long as the company does not come to rely on its auditor to perform prohibited management or bookkeeping functions (e.g., determine specific accounting or design or implement controls), the auditor is permitted and encouraged to maintain an open and healthy dialogue with the company about accounting matters.

SEC Staff May Issue Additional Guidance. Mr. Husich also indicated that the staff may issue additional guidance to address certain types of financial interests, application of the "not subject to audit" exemption provided for certain nonaudit services, and application of the independence rules to FIN 46R variable interest entities.

Effective Dialogue with the Audit Committee. Mr. Husich reminded the audience of the importance of their obligations under the PCAOB interim independence rule (i.e., ISB No. 1) to disclose to the audit committee all matters that may raise independence issues. He stated that auditors should consider *all types* of relationships with the client and its affiliates and not focus solely on nonaudit services or actual violations of the rules. Without this frank exchange of information, he noted, "the value of auditor and audit committee communications is greatly diminished".

Zoe-Vonna Palmrose, OCA Deputy Chief Accountant, addressed two

important independence-related issues in her remarks:

Moving Towards a Principles-based Approach. Following-up with comments made by Ed Bailey of OCA at last year's *AICPA National Conference on Current SEC and PCAOB Developments*, Ms. Palmrose noted that she and OCA Chief Accountant, Conrad Hewitt, support the development of a more principle-based approach to independence and were considering ways in which to advance this type of an approach.

Converging SEC Independence Rules with non-US standards. Ms. Palmrose also stated that the SEC has begun assessing the landscape for converging SEC independence rules with international standards and other regulations throughout the world. The staff is working with other regulators to understand how the rules compare and contrast, which will be used as a starting point for future discussions.

Speeches made by SEC commissioners, staff, and the SEC chairman (including those made during the previously mentioned AICPA conferences) are available on the SEC web site at www.sec.gov/news/speech.shtml#chair.

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