



U.S. Securities and Exchange Commission

Speech by SEC Staff: Remarks Before the 2007 AICPA National Conference on Current SEC and PCAOB Developments

by

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Continued Focus on Auditor Independence

The last time the Commission discussed and amended the auditor independence standards was in 2003 in adopting the requirements of the Sarbanes - Oxley Act¹ and before that in 2000 with its "Revision of the Commission's Auditor Independence Requirements"² release. From these releases I would like to remind you that the independence rules were designed to be prophylactic and to accomplish two distinct, public policy goals.

The first goal is to foster high quality audits by minimizing the possibility that any external factors will influence an auditor's judgments. The second and related goal is to promote investor confidence in the financial statements of public companies.

In order to accomplish these goals the statutory framework requires that financial information filed with the Commission be certified or audited by "independent" public accountants and this makes you, the auditors, the "gatekeepers" to the public securities markets, giving you both a valuable economic franchise and an important public trust.

SEC sources addressing auditor independence

The primary SEC sources that address auditor independence for issuers are:

- Regulation S-X, Rule 2-01, Qualifications of Accountants;³
- Exchange Act Section 10A(g);
- Release No. 33-8183, Strengthening the Commission's Requirements Regarding Auditor Independence;
- Release No. 33-7919, Revision of the Commission's Auditor Independence Requirements; and
- FAQ - Application of the Commission's Rules on Auditor Independence (August 6-2007)⁴

Additional guidance can be found at Section 602 of the SEC codification of Financial Reporting Releases that codifies staff interpretations and releases. Further be mindful that the PCAOB has issued Rules regarding auditor independence and has interim ethics standards. This list is not exclusive and more materials related to independence, like no action letters, can be found under the Office of the Chief Accountant section at <http://www.sec.gov/index.htm>

Frequently Asked Questions

The staff continues to monitor the application of the auditor independence standard in its mission of protecting the reliability and integrity of the financial statements of public companies. The staff also tries to ensure that the auditor independence requirements remain relevant and as a result issued an additional nine (9) Frequently Asked Questions (FAQ's) in 2007 to address some of the questions posed by you.

These FAQ's were merged and incorporated into the existing FAQ's. The additional FAQ's addressed topics related to the following areas:

- Financial Relationships
- Prohibited and Non-audit services
- FIN 46R under Other Matters
- Audit Committee Pre-approval
- Fee disclosures and
- "Cooling-Off" period

In addition during the year the staff put on the SEC website a brochure addressing audit committees and auditor independence related issues. This brochure highlights certain Commission rules and other authoritative pronouncements relevant to audit committee oversight responsibilities regarding the auditor's independence. It does not represent new staff guidance.

You can access both, the FAQs and the audit committee brochure on the SEC's website at <http://www.sec.gov/info/accountants/independref.shtml>

Initial Public Offerings

The staff wants to remind you that the Commission's rules on auditor independence require that the auditor is independent in each period for which an audit report will be required in a filing. Prospective registrants and their accounting firms need to consider their relationship with a client both prior to and after a client becomes an issuer.

The timing of an IPO may depend on market conditions and exit strategies previously contemplated by persons or entities that control the company. The company should take into consideration that the auditor must be independent for all years that might be included in an IPO registration statement.

The staff continues to address independence violations associated with IPO situations. Auditors and their audit clients should be mindful of the SEC's independence rules as they affect private companies that may some day aspire to be public companies. There are differences between the SEC rules and the AICPA rules, among others, in the area of providing prohibited bookkeeping services and preparing financial statements and related footnotes for your audit clients.

Accounting Application Assistance

Given the complexity associated with current accounting standards the staff is constantly asked how much advice an auditor may provide to an audit client in regards to an accounting issue or standard without impairing its independence. The independence threat is that an auditor in the course of providing such advice might find itself either in the position of auditing its own work or in the position of acting as management. The Commission addressed this issue from an internal control perspective in its May 2005 statement on implementation of Section 404 of the Act, see [Staff Statement on Management's Report on Internal Control Over Financial Reporting \(May 16, 2005\)](http://www.sec.gov/divisions/corpfin/cfguidance.shtml#soxsec404), <http://www.sec.gov/divisions/corpfin/cfguidance.shtml#soxsec404>. The May 2005 guidance encourages frequent and frank dialogue between management, auditors and audit committees. The staff also looks to ISB Interpretation No. 99-01, "Impact on Auditor Independence of Assisting Clients in the Implementation of FAS 133 (Derivatives)"⁵ for general guidance on what constitutes "assistance" as opposed to "performing" certain functions or services.

Management is responsible for the financial statements, and responsibility for the choices and judgments inherent in the presentation of those financial statements cannot be delegated to the auditor or to anyone else. Depending on the facts, some of the services that will not impair an auditor's independence when providing accounting application assistance to an audit client are:

- Discussing the requirements and the related concepts, terminology and implementation issues related to an accounting application

- Providing sample journal entries that help management understand the accounting application
- Discussing factors to be considered in making judgments that may become critical in the accounting process
- Discussing the nature of relevant model inputs and related market sources of information

In general the staff believes that the auditor may provide advice to the audit client on the proper application of accounting and assist him or her in gaining an understanding of the methods, models, assumptions and inputs used by such accounting application or standard.

Network Firm

The independence rules define "accounting firm" and within that definition include "associated entities" of an accounting firm. The staff receives questions in regards to what is an "associated entity" of an accounting firm. As noted in the 2000 release and in the FAQ's, the staff continues to address independence questions regarding associated entities of an accounting firm, and network firms and their affiliates, by interpreting the existing rules and by analyzing each situation in light of all relevant facts and circumstances. Some of the facts that the staff considers are:

1. Does an auditor refer to another firm in its audit opinion or does he take responsibility for the work performed by the other firm?
2. Do the firms have common ownership, profit sharing or cost sharing agreements?
3. Do the firms share management, have a common brand-name or use shared professional resources?
4. Do the firms have common quality control policies and procedures?

Much of the related guidance was cited in footnotes 489 and 491 of the November 2000 adopting release "Revision of the Commission's Auditor Independence Requirements".

Consents

The staff is frequently asked whether a predecessor auditor has to be independent in order to issue a consent for a previously issued opinion. An auditor has to be independent during the audit and professional engagement period. Once the audit and professional engagement period has ended, he or she does not have to be independent. Issuing a consent for a previously issued opinion does not constitute a new "audit and professional engagement period" for which the auditor needs to be independent. However, if there is going to be a restatement of previously issued financial statements (whether it be for error correction, retrospective adoption of an accounting principle, for a discontinued operation, etc) and the auditor is required to dual date their opinion on restated financial statements, the auditor has to be independent.

The staff has also been asked whether a predecessor auditor that is not currently registered with the PCAOB can issue a consent for a previously issued opinion. The staff has taken the position that an auditor does not have to be registered with the PCAOB in order to issue consent to a previously issued opinion. The auditor can merely consent to the use of the report previously issued when it was registered. He or she can not update the previously issued opinion or audit any restatements because that involves more audit work.

This completes my prepared remarks. Thank you.

Endnotes

¹RELEASE NO. 33-8183; *Strengthening the Commission's Requirements Regarding Auditor Independence*; <http://www.sec.gov/rules/final/33-8183.htm>

²Release Nos. 33-7919; Revision of the Commission's Auditor Independence Requirements; <http://www.sec.gov/rules/final/33-7919.htm>

³See Regulation S-X at: <http://www.sec.gov/divisions/corpfin/ecfrlinks.shtml>

⁴See Frequently Asked Questions related to independence at: <http://www.sec.gov/info/accountants/independref.shtml>

⁵ISB Interpretation 99-01, Impact on Auditor Independence of Assisting Clients in the Implementation of FAS 133 (Derivatives). See interpretation at : http://www.pcaobus.org/Standards/Interim_Standards/Independence_Standards/index.aspx

<http://www.sec.gov/news/speech/2007/spch121007vk.htm>