



AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

666 FIFTH AVENUE  
NEW YORK, N. Y. 10019

March 31, 1972

DIVISION OF  
PROFESSIONAL ETHICS  
DONALD J. SCHNEEMAN  
DIRECTOR

RECORDED

APR 3 1972

A. Clarence Sampson, CPA  
Associate Chief Accountant  
Securities & Exchange Commission  
Washington, D.C. 20549

Dear Clarence:

Attached is a memorandum which I have prepared from my notes taken at a meeting of the committee on independence of the Ethics Division which was called to consider the updating of ASR 81. The memo has not been reviewed by the committee, nor does it have any official standing, although I think it accurately reflects the conclusions reached. I thought you might wish to look it over prior to our visit with you on April 6 so that you can have a prior idea of the committee's thinking.

Yours very truly,

Donald J. Schneeman

DJS:gc  
Attachment

MEMORANDUM OF MEETING  
Committee on Independence  
March 22, 1972

The first paragraph of page 1 of the Release states that it is not intended to supersede ASR 47 or 81, with a further indication that the views expressed in the proposed release should be regarded as indicative of the Commission's position whenever an inconsistency exists.

The committee suggests that to promote clarity of reference the SEC consider the merits of merging ASR 47 and 81 into a comprehensive statement on independence. The Release as proposed would put practitioners to a significant burden of deciding where inconsistencies exist, and its usefulness as a guide would be diminished to that extent. As a precedent to the suggested technique, the committee made reference to SAP 33 which incorporates in one place all prior statements of the committee on auditing procedure.

While the committee recognizes that the Commission has consistently used the term "accountant's certificate," its members suggested that the term "accountant's report" or "accountant's opinion" has a more common and generally accepted usage.

The second and third paragraphs on page 2 discuss possible conflicts of interest. There are a number of conflicts

of interest built into every audit -- the interest of the client as distinguished from the interests of the public, for example, and these conflicts will always exist. Because this concept has been traditionally used in a narrower context than the overall concept of independence, the committee thought that the reference to conflicts of interests should be replaced by the phrase "lack of independence."

The committee strongly endorses the contents of the last sentence on page 2 and the first paragraph of page 3 dealing with the concept of the independent audit committee. To emphasize the importance of this section, its members suggest its statement in a separate paragraph beginning with the last sentence on page 2.

The committee takes exception to some of the positions on pages 3 and 4 relating to accounting services. The members believe that there have been significant changes since the publication of ASR No. 81 in 1958 in the nature of the customary services rendered by accountants. In addition, Interpretive Opinion No. 22, and the proposed restatement of the Institute's Code of Ethics, which express the committee's views in these areas, seem to have been largely ignored in developing the draft ASR.

The members of the committee therefore thought that a mutually convenient meeting should be arranged to

discuss the basic premises of the accountant's independence as it relates to the area of EDP and bookkeeping services. The committee believes that the performance of mechanical functions in the EDP area does not involve any decision-making, and normally should not impair the accountant's objectivity. On the other hand, the committee reaffirmed its concern when the accountant actually becomes, or appears to become so identified with his' client's management as to be indistinguishable from it. In fact, Opinion No. 22 urges the necessity of employing accounting personnel by a client which is growing in size, and states that responsibility for maintenance of the accounting records should be assumed by the client when the latter's securities are subject to regulation by the SEC.

The following are other specific suggestions and comments by the committee:

Page 4. Penultimate paragraph, last line. The committee believes that the phrase attesting to the accuracy of places the wrong context on the nature and the purpose of the audit.

Page 5. With respect to items a, b and c, the committee feels that the distinction between basic accounting records and statistical records is presently so blurred that the discussion as presented is of slight value. In addition, as to item b, the committee does not understand the distinction made between the services described here

and accepted practices routinely performed as a part of the audit function, provided that the client understands and assumes responsibility for representations made in the financial statements. The committee believes that processing of source data, when performed within the guidelines of Opinion No. 22, does not adversely affect the accountant's independence. As to item c, there should at least be a test of materiality if the statement is to be retained.

Page 5, Item 1. The committee understands that "writing up the books" has traditionally been held by the Commission to result in a lack of independence. The committee questioned, however, the inclusion of "making adjusting entries" and "preparing financial statements." Such functions would not appear to be inconsistent with the accountant's traditional role provided final responsibility is assumed by the client.

Page 5, Item 2. The example seems unnecessarily broad. May any information be processed without the firm's independence being considered impaired?

Page 5, Item 3. The committee does not understand the rationale underlying this ruling. Item (2) does not seem to differ from item (4), yet the performance of (2) would lead to a loss of independence while (4) would not.

Page 6, Item 4. This ruling seems to be inconsistent with ruling No. 8 on page 7. The committee agrees with the latter.

Page 6, Item 6. The ruling appears to be inconsistent with the last sentence of the first paragraph on page 4.

Page 6, Item 7. This ruling seems to be inconsistent with the view taken under a. on page 5 that computer programming is an aspect of systems design, and is therefore a proper function for the qualified public accountant. The committee felt that if the Commission is stating that the auditor would be prohibited from acting as a registrar, a simple statement to that effect should suffice.

Page 7, Item 9. The concept of emergency situations as exceptions is mentioned here and in ruling No. 6 on page 6. In general the members felt that justification of departures on the basis of emergency should be kept to a minimum, and that rulings based on emergency situations should not be used as examples.

Page 7. Financial Interest: Rule 2-01(b) 2nd line: Add the underlined phrase he or any of his partners. 4th line: owned by the accountant's spouse is usually considered to be a direct interest. Delete or by his wife. Last sentence: And, in this context, the determination

is primarily made with reference to the net worth of the accountant, his firm, and the net worth of his client.

Although the SEC seems to use the term "accountant" to refer both to the individual partner and to his firm, the committee believes that the changes recommended above add to the clarity of the text.

Page 8, Item 12. Delete senior.

Page 8, Item 13. Change the wording of the ruling to: The firm would not be considered to be lacking in independence.

Page 8, Items 16 and 17. Actuaries: In addition to actuaries, there are several other classes of individuals who would have to be considered independent to permit reliance by the accountant in connection with the expression of his opinion. The committee therefore suggests that this caption be left out, because it did not consider it appropriate to make reference to one class of experts alone, and the emphasis of the release should be on the independence of accountants, consistent with its title. The SEC may decide, as an alternative, to discuss this area generally elsewhere in the Release.

Page 9. Accountant as Creditor of Client.

First sentence: The committee suggests the deletion of in relation to the current audit fee, because audit

fees vary, and may, in addition, be immaterial to the firm's total fees.

Page 9. Third sentence: The committee also recommends that the phrase is not a creditor of the client in the ordinary course of business and be deleted.

Page 9. Item 18. Add the phrase underlined to the last sentence: Held, if the accounting firm subordinates the amount due them, in the manner described above, its independence would be adversely affected.

Page 9, Item 19. Although the circumstances seem to be substantially identical with those under Ruling 14 on page 8, this ruling is significantly more restrictive. The committee suggested that the ruling be expanded as follows: Accountant should dispose of such long-term notes as promptly as possible and, if material, before undertaking any additional auditing work for this company. Delete: so received. Alternatively, you may decide to use Ruling No. 14, and delete No. 19.

Page 9, Item 20. Family Relationships: The committee believes that this inquiry needs further elaboration of facts in order to substantiate the blanket prohibition in the ruling.

The committee would agree with the ruling if



the accounting firm is a one-office firm, or if the brother of the controller is located in the same office that handles the client's work. The committee believes that such information is essential in reaching the conclusion stated.

Page 10, Item 21. 4th line: replace accountant with partner.

Page 10, Item 22. The sister-in-law relationship has not been generally considered by the committee to be a close one. If the partner in the accounting firm was in charge of the audit, the committee would agree with your conclusion.

Page 10, Item 24. The committee suggests that you delete the word prospective in the first sentence since the likelihood of the same facts occurring in practice is fairly remote.

Page 10, Item 25. This ruling seems to be inconsistent with No. 23.

Page 10. Business Relationships with Clients: The introduction seems to state that an auditor cannot have any business relationships with clients. The following substitute first sentence is suggested: "Material business relationships other than in the normal course of business with a client or with persons associated with the

client in a decision-making capacity, such as officers, directors or substantial stockholders, could adversely affect the accountant's independence with respect to that client."

Page 11. First paragraph, last line: The committee believed that the concept of materiality should be introduced, and took exception to the inclusion of investments in supplier or customer companies, and landlord-tenant relationships.

Page 11, Item 26. As you know, in Opinion No. 22, the committee does not consider the sale of block time alone to impair the CPA's independence.

Page 11, Item 27. The committee suggests that the last sentence be expanded to read: However, if the one percent interest is disposed of, no question will be raised in connection with the audits for prior years.

Page 11, Item 28. The committee believes that this ruling should be rephrased to focus on the materiality of the investment as the main reason for the impairment of independence.

Page 11, Item 29. As you know, Interpretive Opinion No. 16 deals with retired partners and firm independence. The committee questioned whether all connections must be severed by the retired partner, and

also if the fixed settlement mentioned in the ruling describes segregated funds. The last line should be expanded to read: ...or related in any significant way to the firm's earnings.

Page 12, Item 34. If the services referred to involve recognized management advisory services, the committee disagrees with this ruling. An individual employee of the firm should be allowed to perform services which may be provided by the firm without impairing its independence.

Page 13, Item 36. The committee suggests that this inquiry be left out because it understands that the SEC's ruling in this matter did not result in a denial of the firm's opinion. If your decision is to retain this inquiry, the committee would appreciate the deletion of the reference to Rule 1.01 of the AICPA since the committee's conclusion in this case was that technically the Rule was not violated but there was a definite conflict of interest involved.

Page 13, Item 37. The committee does not agree that this situation represents a joint real estate venture. In addition, its members suggest the deletion of the word "serious" on line 6, and deletion of all language in the sentence following "question of independence."

Page 13, Item 38. The committee disagrees with the conclusion that the relationship described impairs the firm's independence.

Page 13. Occupations with Conflicting Interests: The committee recommended that this entire section be made a part of and discussed under Business Relationships with Client.

Although the committee agrees that the concurrent occupation as a broker-dealer is not desirable, this section seems to be dealing with the image and behavioral standards expected of accountants generally instead of audit independence. Its members therefore suggested a closer focusing on specific activities, and their effect on the accountant's independence in individual cases.

Page 14. Accountant-Attorney: As a point of information, the committee is not sure whether rendering concurrent services is sufficiently prevalent to justify the inclusion of this caption.