new york state society of
NYSSCPA
certified public accountants

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November 14, 2006

Ms. Lisa A. Snyder
Director, Professional Ethics Division
AICPA
Harborside Financial Center
201 Plaza Three
Jersey City, NJ 07311-3881

By email: lsnyder@aicpa.org

In re: Exposure Draft - Omnibus Proposal of Professional Ethics Division Interpretations and Rulings dated September 8, 2006:
Proposed Deletion of Rulings Under Rule 101, and
Proposed Revision to Interpretation 101-3 under Rule 101: *Performance of Nonattest Services: Forensic Accounting Services and Tax Compliance Services*

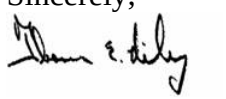
Dear Ms. Snyder:

The New York State Society of Certified Public Accountants, representing 30,000 CPAs in public practice, industry, government and education, is pleased to submit the attached comments on the above-referenced Exposure Draft issued by the AICPA Professional Ethics Executive Committee.

This letter only addresses proposed deletion of Ethics Rulings Nos. 94 and 95 and the proposed revisions to Interpretation 101-3 under Rule 101: *Performance of Nonattest Services.* The Society is formulating comments on the Proposed Interpretation 101-16: *Indemnification/Limitation of Liability Provisions* for submission at a later date under separate cover.

The NYSSCPA Professional Ethics Committee deliberated the exposure draft and prepared the attached comments. If you would like additional discussion with us, please contact Francis T. Nusspickel, chair of the Professional Ethics Committee, at (201) 891-2754, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,



Thomas E. Riley
President

Attachment

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NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON AICPA EXPOSURE DRAFT

OMNIBUS PROPOSAL OF PROFESSIONAL ETHICS DIVISION INTERPRETATIONS AND RULINGS (September 8, 2006)

Omnibus Proposal:

Proposed Deletion of Ethics Rulings No. 94 and No. 95 Under Rule 101, Independence; and

Proposed Revisions to Interpretation 101-3, *Performance of Nonattest Services*, Under Rule 101, Independence

November 14, 2006

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The New York State Society of Certified Public Accountants
Professional Ethics Committee

Comments on AICPA Exposure Draft - Proposed Deletion of Ethics Rulings No. 94 and No. 95 Under Rule 101; and Proposed Revisions to Interpretation 101-3, *Performance of Nonattest Services,* Under Rule 101, dated September 8, 2006

Comments

The Professional Ethics Committee (the "Committee") of the New York State Society of Certified Public Accountants has reviewed the above-referenced AICPA Exposure Draft (ED) and offers the following comments for consideration by the Professional Ethics Executive Committee (PEEC) of the American Institute of Certified Public Accountants (AICPA).

Proposed Deletion of Ethics Ruling No. 94 Under Rule 101, Independence: *Indemnification Clause in Engagement Letters*

In the event Proposed Interpretation 101-16 is adopted it should include guidance that an indemnification or limitation of liability provision that seeks to limit or eliminate a member's liability with respect to actual damages arising from the attest client's knowing misrepresentation, willful misconduct or fraudulent behavior would not impair independence. That is, the guidance in Ethics Ruling No. 94 should be carried over and included in proposed Interpretation 101-16. The Committee has no other comments on the proposed deletion.

Proposed Deletion of Ethics Ruling No. 95 Under Rule 101, Independence: *Agreement With Attest Client to Use ADR Techniques*

The Committee has no comments on the proposed deletion.

Proposed Revisions to Interpretation 101-3, *Performance of Nonattest Services*, Under Rule 101, Independence

The Committee has the following suggested changes and comments on the proposed revisions to Interpretation 101-3:

(1) The words "for an Attest Client" should be added to the title of Interpretation 101-3, so that it would read: Interpretation 101-3, *Performance of Nonattest Services for an Attest Client*." This addition will help clarify that this interpretation is applicable only to such services being provided to attest clients.

(2) The proposed revision to Interpretation 101-3 takes the position that independence is

deemed to be impaired if the member provides expert witness services for an attest client. There is, however, no universal view that providing expert witness services to attest clients impairs independence at all. While some believe that providing those services does impair independence, others believe that members can continue to provide such services, as they have historically, without impairing independence. By definition, experts express their own opinions concerning matters in dispute. They are not advocating management's views. This is well known and was previously addressed by the AICPA in Ethics Ruling No. 101, which said that a "member serving as an expert witness does not serve as an advocate but as someone with specialized knowledge…who should arrive at and present positions objectively." Of course, a member's views as an expert witness might benefit management or the client, just as the member's other services might benefit management or the client. Unlike other services, however, a member's work as an expert is subject to rigorous cross examination by the other party in the dispute and being personally challenged on every aspect of his or her work. After all, the expert witness is the member personally and not the member's firm. Therefore, it is the member's personal reputation and credibility that is at risk and must be maintained. We believe these factors provide a sufficient deterrent to a member who may think about straying into the realm of professional misconduct (i.e., the are significant safeguards in the U.S. litigation process to prevent any member from engaging in the unprofessional conduct of advocacy on behalf of an audit or non-audit client).

That said, we recognize that some people believe that these deterrents are not enough and that the AICPA should adopt the Sarbanes-Oxley rules for all attest clients, both public and private. As you know, the Sarbanes-Oxley Act and related SEC independence rules prohibit accountants from providing expert witness and litigation consulting services to their public audit clients. If PEEC is intent on limiting or prohibiting expert witness services for private attest clients then we believe the conceptual basis for doing so should be carefully considered so that members who provide these services to nonattest clients are not tainted in any way. As you know, a member must be independent in fact (independence of mind) and independent in appearance. There seems to be a consensus view that providing expert witness services does not violate the requirement to be independent in fact. However, some believe that providing expert witness services presents an *independence in appearance* issue. The proposal prohibits expert witness services for attest clients on that basis. However, the prohibiting of expert witness services for attest clients on the basis that there is an appearance of advocacy is not supported by the Conceptual Framework for AICPA Independence Standards. Proscribing such services on the basis that they fail the test for being independent in appearance does not meet the definition of *independence in appearance* in the Conceptual Framework, which is the "avoidance of circumstances that would cause a reasonable and informed third party … to reasonably conclude that the integrity, objectivity, or professional skepticism … had been compromised." Knowledgeable, reasonable and informed individuals would know that expert witnesses express their own opinions and not management's.

All of the safeguards to independence seem to be more than sufficient to overcome any of the real or perceived threats to independence when a member serves as an expert witness on behalf of an attest client. There is no consensus that serving as an

expert witness violates the requirement to be independent, with the possible exception of those instances where the member's work in the litigation assignment has a direct and material effect on the financial statements. Given this lack of consensus, we believe PEEC should reconsider the conceptual basis for concluding that serving as an expert witness creates an independence issue or alternatively defer adopting the proposed revisions to Interpretation 101-3 at this time.

(3) The definition of forensic accounting services (page 21) could be better. We would suggest that a clear and succinct description of forensic accounting services be used. If PEEC decides to use the existing definition, then the words "generally" and "knowledge" should be inserted in the definition, the words "and/or" should be used in place of the word *and*, and the other skills and knowledge that are commonly applied should be included. As such, we suggest the definition be rewritten to read: "…forensic accounting services are nonattest services that generally involve the application of special skills and knowledge in accounting, auditing, financial reporting, internal control, recordkeeping, computer systems, finance, quantitative methods, business structure and operations, and/or certain areas of the law…."

(4) The description of *Litigation services* in the Forensic Accounting Services section of the proposal (page 22) is confusing. In addition, we believe the word *potential* should be removed from the definition since litigation could potentially arise from, or in connection with, any service a member provides. In particular, litigation could potentially arise as a result of investigative services rendered by the member. As such, we suggest the definition be rewritten to read: "Litigation services are those services provided as part of actual or threatened legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties."

(5) The definition of *Expert witness services* in the Forensic Accounting Services section of the proposal (subparagraph a, page 22) is confusing. The words "apply his or her technical expertise or specialized knowledge" should be added to the definition of expert witness services so that the sentence would read: "Expert witness services are those litigation services where a member is engaged to apply his or her technical expertise or specialized knowledge to render an opinion before a trier of fact as to the matter(s) in dispute." We believe this change reflects the definition of an expert witness as contemplated in the Federal Rules of Evidence.

(6) The second paragraph in the description of *Expert witness services* in the Forensic Accounting Services section of the proposal (subparagraph a, page 22) as currently written does a disservice to accountants who practice in this field. It states definitively that providing such services creates the appearance that the accountant is advocating for his or her client. This is not the case. As discussed in Ethics Ruling No. 101, expert witness services are not advocate services. Furthermore, stating that expert witness services create the appearance of advocacy does not comport with the true role of an expert witness in the litigation process (see, for example, the Federal Rules of Evidence as well as AICPA Consulting Services Special Report 93-2, *Conflicts of Interest in Litigation Services Engagements* (72/105.21), which states that the "CPA does not serve as an advocate but rather is presented to the trier of fact as someone with specialized knowledge, training, and experience in a particular area and

presents positions with objectivity"). The insertion of footnote 12 is an attempt to clarify this but it is not effective. We believe there is no consensus that expert witness services present a threat to independence that cannot be overcome by the safeguards in place with these assignments. If PEEC is intent, however, on proscribing expert witness services for all audit clients, we suggest the paragraph and footnote 12 be deleted and replaced with the following: "The judicial system has long recognized the role that expert witnesses perform in judicial proceedings and the adjudication of disputes. If technical or other specialized knowledge will assist the trier of fact in understanding the evidence or facts at issue, then a witness who is qualified as an expert may be permitted to testify. The expert witness is usually retained by one party in the dispute and is subject to rigorous cross examination by the opposing party and being personally challenged on every aspect of his or her work. In addition, an expert witness is usually required to turn over any documents in his or her possession to the other side in the dispute and must testify truthfully about information obtained in the course of his or her engagement. Failure to testify truthfully or to produce all information subjects the expert witness to being discredited in front of the trier of fact, potential perjury charges, and legal exposure to his or her client. As such, it is the expert's personal reputation and credibility that is at risk and must be maintained. The totality of these factors ordinarily should provide a sufficient deterrent to an expert witness behaving in an inappropriate manner, including acting as an advocate for his or her client. A member who serves as an expert witness is further subject to all applicable professional standards including Rule 102, *Integrity and Objectivity* [ET section 102], which requires that the member maintain objectivity and integrity, not knowingly misrepresent facts and not subordinate his or her judgment to others. Accordingly, although expert witnesses technically do not advocate on behalf of their clients but testify as to their own opinions based on their technical or other specialized knowledge (see Ethics Ruling No. 101), some portion of the general public may not understand that and thus may view accountants that serve as expert witness services for their attest clients as having the appearance of not being independent. In addition, in certain instances the member's work in an expert witness engagement may have a direct and material effect on the financial statements and, as such, there possibly could be a question as to whether the member or member's firm is independent in appearance in those instances. Accordingly, if a member agrees to provide expert witness testimony for an attest client, independence would be considered to be impaired because… [Include the basis for this conclusion]."

(7) The definition of *Litigation consulting services* in the Forensic Accounting Services section of the proposal (subparagraph b, page 22) is confusing and does not encompass all the roles of a consultant in litigation. The words "apply his or her technical expertise or specialized knowledge" and the additional roles that a consultant serves should be added to the definition of litigation consulting services. As such, we suggest the first sentence be rewritten to read: "Litigation consulting services are those litigation services where a member uses his or her technical expertise or specialized knowledge to provide advice to a client or the client's attorney about the facts or issues in dispute or case strategy, or to provide other assistance to a client or the client's attorney in the dispute resolution process."

(8) The words "for an attest client" and "for the attest client" should be added, respectively, to the first and second sentences of the second paragraph of litigation consulting services in the Forensic Accounting Services section of the proposal (subparagraph b, page 22). As such, the paragraph would read: "The performance of litigation consulting services for an attest client would not impair independence provided the member complies with the general requirements set forth under this interpretation. [Retain footnote.] However, if the member subsequently agrees to serve as an expert witness for the attest client, independence would be considered to be impaired."

(9) The definition and discussion of other services in the Forensic Accounting Services section of the proposal (subparagraph c, page 22) should be structured like the two other subparagraphs in this section. That is, other services should be defined in one paragraph and then the standard should be set forth in a second paragraph. Therefore, there would be no need to refer to the client in the generic definition of other litigation services. In addition, the definition should be expanded to include the other types of litigation services that are typically performed by members (i.e., referee, mediator, claims administrator and settlement administrator). As such, the first sentence of subparagraph c should be rewritten to read: "Other services are those litigation services where a member serves as a trier of fact, special master, referee, mediator, claims administrator, settlement administrator, court-appointed expert, or arbitrator (including serving on an arbitration panel)." Then, a second paragraph should set forth the independence standard, including an explanation that serving as a referee or mediator would not impair independence.

(10) The second and third sentences of the other services paragraph in the Forensic Accounting Services section of the proposal (subparagraph c, page 22) indicate that performing other litigation services for an attest client would impair independence. However, there is no basis stated for that position. We would suggest that the basis for that conclusion be clearly stated in the final interpretation. That said, we do not believe that serving as a trier of fact, special master, claims administrator, settlement administrator, court-appointed expert or arbitrator creates the appearance that the member is not independent. In fact, this situation is not an Independence issue; it is a conflicts of interest issue. We do not believe that performing any of those roles would lead any reasonably knowledgeable person from concluding that the member is not independent (although one of the parties to a dispute may view the member's relationship to the attest client as being a conflict of interest of such a level that would prevent it from retaining the member to serve in the proposed role). The role of trier of fact, special master, claims administrator, settlement administrator, court-appointed expert or arbitrator entails serving as an objective party between two sides in a dispute. The appointment of someone to those roles is indicative of the person's perceived neutrality. The marketplace, and the nature of the American adversary system, has historically determined whether someone is sufficiently objective enough to serve in such a role. We do not believe that there have been many instances where audit firm personnel have been able to serve in such capacity without the other side raising objections to their appointment. As such, we do not believe the proposed rule is necessary in our profession to address this. Moreover, we believe the profession's existing rules governing conflicts of interest and the existing practice aides and

guidance for litigation services adequately address this topic. Accordingly, we believe it should be left to the market to decide whether the member is objective enough to serve in such capacity. Existing practice has appropriately dealt with this issue for years. The existing standards and guidance are working well and there is no need to replace or supplement them.

However, if adopted, the written explanation for adoption should be articulated. At a minimum, the conceptual basis for concluding that the member in not independent should be clearly stated. We will note for the record that from the market's perspective there isn't any substantive distinction between serving in such capacity for an attest client versus a nonattest client (i.e., serving in a matter in which an attest client is a party to the dispute versus serving in a matter in which an nonattest client is a party to the dispute).

One possible basis for limiting these services is materiality in relation to the subject matter of an attest engagement. That is, if the member's work in the litigation assignment has a direct and material effect on the financial statements then there possibly could be a question as to whether the member or member's firm is independent in appearance. We suggest that this basis be further explored.

(11) A footnote should be added to the end of the second sentence of the paragraph describing *Investigative services* in the Forensic Accounting Services section of the proposal (page 22) that says, similar to footnote 13, "For purposes of complying with general requirement no. 2, the client may designate its attorney to oversee the investigative services."

(12) The words "question the member" should be used in place of the words *request that the member testify* in the fifth sentence of the Fact Witness Testimony section of the proposal (pp. 22-23), so that the sentence would read: "While testifying as a fact witness, the trier of fact or counsel may question the member as to his or her opinions…."

(13) The word "include" should be used in place of the word *involve*, and the first use of the word *and* should be deleted, in the first paragraph of the Tax Compliance Services section of the proposed revision to the interpretation (page 23), so that the paragraph would read: "Tax compliance services include preparation of a tax return, transmittal of a tax return, transmittal of the related tax payment…."

(14) The words "for an attest client" should be added to the first sentence of the second paragraph of the Tax Compliance Services section (page 23), so that it would read: "Preparing a tax return … for an attest client would not impair a member's independence…."

(15) The words "an attest client" should be used in place of the words *client management* in the second sentence of the second paragraph of the Tax Compliance Services section (page 23), so that it would read: "However, signing and filing a tax return on behalf of an attest client would impair independence…."

(16) The word "attest" should be added as a modifier to the first use of the word *client*, and the word "the" should be used in place of the word *a* before the second use of the word *client*, in the first sentence of the third paragraph of the Tax Compliance Services section (page 23), so that the sentence would read: "Authorized representation of an attest client in administrative proceedings…does not commit the client…."

(17) The proposed revision to Interpretation 101-3, in the second sentence of the third paragraph of the Tax Compliance Services section (pp. 23-24), takes the position that independence is deemed to be impaired if the member represents the client in a court to resolve a tax dispute. We believe certain representations should be permitted. That is, we believe a member should be permitted to represent a client in tax court and that doing so does not involve an impairment of independence. We believe the hearing of a tax dispute in tax court is an extension of the IRS examination process and that tax court is akin to an administrative court of limited jurisdiction. We believe tax court is different from regular court or the court of claims and, as such, should be treated differently for independence purposes. If PEEC is intent on adopting the proposal as currently written, then the word "attest" should be added as a modifier to the word *client*, so that the sentence would read: "Filing a petition or otherwise representing an attest client in a court…."