new york state society of
NYSSCPA
certified public accountants

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January 27, 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: Proposed Interpretations on *Indemnification/ Limitation of Liability Provisions; and Forensic Accounting Services*, dated September 15, 2005

Dear Ms. Snyder:

The New York State Society of Certified Public Accountants, the oldest state accounting association, representing approximately 30,000 CPAs, is pleased to submit the attached comments on the above-referenced Exposure Draft of the AICPA Professional Ethics Executive Committee.

This letter only addresses proposed Interpretation 101-17 dealing with client advocacy services, fact witness testimony and forensic accounting services. Under separate cover, the Society has submitted its comments on proposed Interpretation 101-16 dealing with indemnification, limitation of liability and ADR clauses in engagement letters, and the proposed deletion of Ethics Rulings Nos. 94 and 95

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,

Stephen F. Langowski

Stephen F. Langowski,
President

Attachment

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NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON AICPA EXPOSURE DRAFT

PROPOSED INTERPRETATIONS ON INDEMNIFICATION/LIMITATION OF LIABILITY PROVISIONS AND FORENSIC ACCOUNTING SERVICES (September 15, 2005)

Omnibus Proposal:

Proposed Interpretation 101-17, *Performance of Client Advocacy Services, Fact Witness Testimony, and Forensic Accounting Services,* Under Rule 101, Independence

January 27, 2006

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

Comments on AICPA Exposure Draft - Proposed Interpretation 101-17, *Performance of Client Advocacy Services, Fact Witness Testimony, and Forensic Accounting Services*, Under Rule 101, dated September 15, 2005

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 Interpretation 101-17, *Performance of Client Advocacy Services, Fact Witness Testimony, and Forensic Accounting Services*, Under Rule 101, Independence

The Committee has the following suggested changes and comments on this proposed interpretation:

(1) The words "For An Attest Client" should be added to the title of the proposed interpretation (page 12) so that it would read: "Proposed Interpretation 101-17, *Performance of Client Advocacy Services, Fact Witness Testimony, and Forensic Accounting Services For An Attest Client*, Under Rule 101, Independence." This addition will help clarify that this proposed interpretation is applicable only to such services being provided to attest clients.

(2) In the second paragraph of the Explanation section of the proposed interpretation (page 12), PEEC explains that the overriding principle behind this proposed interpretation is that independence is deemed to be impaired when there is an expectation of confidentiality between the member and the client/attorney and the communication of any information uncovered by the member during the course of a forensic engagement is restricted and cannot be shared with members of the attest engagement team. For various reasons, we disagree with this principle.

First, there is an expectation of confidentiality in any and every service a member provides to a client. That is at the very foundation of our profession. Except in a few instances required by law, accountants cannot share information about clients with others. Second, the professional standards already support attest teams in their ability to obtain whatever information they need to satisfy themselves. It is the long-standing position of the profession that the failure to obtain sufficient competent evidential matter constitutes a scope limitation that will either result in a qualification in the auditor's report or an inability to issue a report. There is nothing stopping an attest team from inquiring about the matter. In fact, auditors routinely seek information about clients' privileged matters when they perform audit procedures over litigation and claims. Accountants have historically provided litigation and

forensic services to attest clients for years without there being any notable problems in this regard. Third, there is no evidence that having a different accounting firm perform the forensic services for the client will improve the audit firm's ability to obtain confidential information, get better or more information, or result in better, more effective audits.

In summary, we do not agree that confidentiality should be the triggering point in determining whether independence is impaired. In fact, there is no universal view that providing forensic and litigation services to attest clients impairs independence at all. To be sure, there are those who believe that providing those services does impair independence. On the other side, there are those who 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. To be sure, 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.

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 these services for private attest clients then we believe the conceptual basis for doing so should not be confidentiality. We have given this issue considerable thought and have concluded that a possible basis could be appearances. As you know, a member must be independent in fact (independence of mind) and independent in appearance. Given the nature of forensic and litigation services, we do not believe providing such services violates the requirement to be independent in fact. However, since some people believe that providing such services does impair independence, an argument could be made that there may be an *independence in appearance* issue. Although even proscribing such services on the basis that they fail the test for being independent in appearance is not a certainty in that the definition of *independence in appearance* in the Proposed Conceptual Framework 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." On the one hand, knowledgeable, reasonable and informed individuals would know that expert witnesses express their own opinions and not management's. On the other hand, the general public may not understand that. We empathize with PEEC because this is not an easy issue to deal with.

One other possible basis for limiting these services is materiality. 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.

(3) The word "litigation" should be added as a modifier to the term consulting services in the second sentence of the first paragraph of the *Litigation Services* section of the Explanation (page 13) since the term consulting services is so broad and can describe many different services that members provide. We also believe court-appointed expert should be moved to the end of the sentence so that it is clear that "court-appointed" is not intended to be a modifier of the other roles in the sentence. As such, we believe the sentence should be rewritten to read: "They consist of expert witness services, litigation consulting services, and other services, such as serving as a special master, trier of fact, referee, arbitrator, mediator, or court-appointed expert."

(4) The words "report on or" should be added to the first sentence of the second paragraph of the *Litigation Services* section of the Explanation (page 13), so that the sentence would read: "Expert witness services are not subject to the general requirements of Interpretation 101-3 because experts must report on, or testify to, their own representations…." This change is necessary because expert witnesses frequently issue expert reports and then, for various reasons, do not testify.

(5) In the second paragraph of the *Litigation Services* section of the Explanation (pp.13-14), the proposed interpretation again indicates that independence would be considered to be impaired if there is an expectation of confidentiality between the client/client attorney and the member and the communication of any information uncovered by the member during the course of the engagement is restricted. As noted earlier, we disagree with this principle.

First, as noted above, confidentiality is required in all services that a member provides. Second, an expert witness is 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. That is, an expert is subject to rigorous cross examination and all information he or she learns of is discoverable. Failure to testify truthfully or to produce all information subjects the member to being discredited in front of the trier of fact, potential perjury charges, and legal exposure to his or her client. Furthermore, a member serving as an expert must always comply with the profession's rules governing integrity and objectivity.

(6) In the third paragraph of the *Litigation Services* section of the Explanation (page 14), the proposed interpretation indicates that litigation consulting services are subject to the general requirements of Interpretation 101-3. We disagree with this conclusion and do not believe that such services should in all instances be subject to all of the general requirements of Interpretation 101-3. If the accountant is engaged by the client, then we agree that he or she should be subject to the general requirements of Interpretation 101-3. However, if the accountant is engaged by the client's attorney to render technical advice or apply his or her expertise directly to the attorney (i.e., serving as a consulting expert), then many of the general requirements should not be required. In substance, such a litigation consulting assignment is not much different

from an expert witness assignment and, as such, the rationale for not subjecting expert witness services to the general requirements of Interpretation 101-3 should equally apply to consulting expert assignments.

With respect to the last sentence of this paragraph pertaining to restricted communications, we reiterate our previous concerns and objections about this topic.

(7) In the fourth paragraph of the *Litigation Services* section of the Explanation (page 14), the proposed interpretation indicates that serving as a trier of fact, special master, court-appointed expert, referee, arbitrator, or mediator may create the appearance that the member is performing either management functions or making management decisions on behalf of the client. We believe this explanation reflects a misunderstanding about such services. We do not believe that performing any of those roles would lead any reasonably knowledgeable person from concluding that the member is acting as or for management. The role does not entail acting for management but 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.

However, if adopted, the written explanation for adoption should be changed. At a minimum, the reference to acting as management should be deleted. 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).

Lastly, if this rule is adopted, the words "or on behalf of an attest" and "or in a matter in which an attest client is a party to the dispute " should be added in the last sentence of the fourth paragraph of the *Litigation Services* section of the Explanation (page 14), so that the sentence would read: "Accordingly, independence would be considered to be impaired if such services were performed for or on behalf of an attest client or in a matter in which an attest client is a party to the dispute."

(8) We agree that it would be helpful to have written rules regarding client advocacy services in the context of independence; however, we do not believe they should be lumped in with fact witness testimony and forensic accounting services (i.e., they should be codified in a separate section) since a member could be advocating on behalf of his or her client by providing many types of services or engaging in a variety of different activities. Also, it would be preferable to provide a clear definition of client advocacy services in the *Client Advocacy Services* section (page 15). In addition, we believe that the final interpretation should make it clear that

forensic accounting services are not client advocacy services.

Also, the word "attest" should be added as a modifier before client in the second and third sentences of the *Client Advocacy Services* section (page 15). As such, the second sentence would read: "Independence would be considered to be impaired if … a member serves in an advocacy role for, or on behalf of, an attest client." The third sentence would then read: "Regardless … making management decisions on behalf of an attest client would impair independence."

In addition, it would be helpful to include examples of activities or engagements that constitute client advocacy services. Two that come to mind are: acting as a promoter of a client's stock and representing a client in tax court.

(9) The description of *Litigation services* in the Forensic Accounting Services section of the proposed interpretation (page 16) is confusing and does not reflect the role of an expert or consultant in litigation. 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 the investigative services rendered by the member. As such, we suggest the first sentence be rewritten to read: "Litigation services are those services provided as part of actual, pending, or threatened legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties."

(10) The words "apply his or her technical expertise or specialized knowledge" should be added to the definition of expert witness services (page 16) and the word designated be replaced with the word engaged, 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." This change reflects the definition of an expert witness as contemplated in the Federal Rules of Evidence.

(11) With respect to the paragraphs covering expert witness services (page 16), please see all our earlier comments and objections. Additionally, this section should make it clear that these rules apply only to attest clients.

(12) The definition of consulting services (page 16) is confusing and does not reflect the true role of a consultant in litigation. As such, we suggest the first sentence be rewritten to read: "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."

(13) With respect to the paragraphs covering consulting services (page 16), please see all our earlier comments and objections.

(14) The first and second sentences of the other services paragraph (page 17) reflect a

misunderstanding about such services, are confusing and do not reflect the true role of someone serving in such capacity. As discussed earlier, such services do not constitute management functions or management decisions. Accordingly, the first sentence should be rewritten to read: "Other services are those litigation services where a member serves as a trier of fact, special master, referee, arbitrator, mediator, or court-appointed expert."

With respect to the second sentence in the other services paragraph (page 17), please also see all our earlier comments and objections. That said, if PEEC is intent on adopting this rule, we believe the second sentence of the other services paragraph should be shortened to read: "These other services may have a direct impact on the subject matter of an attestation engagement."

Additionally, the words "for or on behalf of an attest client or in a matter in which an attest client is a party to the dispute " should be added at the end of the third sentence in the paragraph, so that the sentence would read: "Accordingly, independence would be considered to be impaired if during the period covered by the financial statements or during the period of the professional engagement, a member were to serve in such a role for or on behalf of an attest client or in a matter in which an attest client is a party to the dispute."

(15) In the Compliance with Independence Requirements of Other Regulatory Bodies section (page 17), the proposed interpretation indicates that a failure on the part of a member to comply with the independence rules of another applicable body would constitute a violation of the AICPA's independence rules. We generally agree with this provision. However, we believe that the names of the specific organizations that this rule pertains to (i.e., SEC, GAO, DOL, PCAOB, etc.) should be spelled out specifically either in the final interpretation or in another approved document and not referred to generally as is currently drafted in the proposed interpretation. Furthermore, as is the case with the protections provided to members in instances involving other potential violations of the Code of Professional Conduct, we believe that there should be an automatic violation of the AICPA independence rules only where the member violated the independence rules of those organizations that afford due process and other safeguards.

We also would like to note for the record that AICPA and the profession should strive to minimize differences in the rules among applicable organizations in order to simplify the rules that members are subject to and to reduce the likelihood of inadvertent violations. To the extent those other organizations' independence rules have merit, the AICPA should strongly consider adopting them.

Lastly, given the significant restictions on providing litgation and expert witness services to public audit clients, the final interpretaion should discuss those restrictions, the Sarbanes-Oxley Act and the related independence rules of the SEC and PCAOB.