

**MEMO# 8184**

August 28, 1996

## **PROPOSED RULE IMPLEMENTING REPORTING OF ILLEGAL ACTS**

1 See SEC Rules Members No. 82-95 (December 22, 1995). August 28, 1996 TO:  
ACCOUNTING/TREASURERS COMMITTEE No. 35-96 SEC RULES COMMITTEE No. 92-96 RE:  
PROPOSED RULE IMPLEMENTING REPORTING OF ILLEGAL ACTS

The SEC recently issued the attached proposed Rule 10A-1 under the Securities Exchange Act of 1934. The proposed rule implements the reporting requirements contained in Section 10A of the Exchange Act that were adopted as part of the Private Securities Litigation Reform Act of 1995.<sup>1</sup> Under Section 10A, if the auditor detects or otherwise becomes aware of information indicating that an illegal act has occurred, the auditor must promptly inform the appropriate level of management and assure that the audit committee or the board of directors is adequately informed with respect to the illegal act. If the auditor concludes that 1) the illegal act has a material effect on the financial statements of the issuer, 2) senior management has not taken, and the board of directors has not caused senior management to take timely and appropriate remedial action, and 3) the failure to take remedial action is expected to warrant departure from the standard audit opinion, or resignation from the engagement, then the auditor shall directly report its conclusions to the board of directors. An issuer whose board receives such a report must notify the SEC within one business day after receiving the report and must send a copy of the notice to the auditor. If the auditor does not receive a copy of the notice from the issuer within the one day period, it must furnish a copy of its report to the SEC directly. Proposed Rule 10A-1 The proposed rule implements procedures for filing the notices and reports contemplated under Section 10A. The proposed rule designates the Commissions Office of the Chief Accountant as the appropriate office to receive the notice provided by any registrant and any report provided by an auditor. The proposed rule sets forth the required contents for a registrants notice to the Commission. The notice would be in writing and identify the registrant and the auditor, state the date the auditor made its report to the board, and provide a summary of the report. The required summary would describe the illegal act and the potential impact of that act on the registrants financial statements. The proposed rule specifically would permit a registrant to provide additional information regarding its view of, and response to, the Section 10A report it has received from the auditor. The proposed rule provides that any notice provided by a registrant and any report provided by an auditor shall be non-public and exempt from disclosure under the Freedom of Information Act to the same extent as the Commissions investigative records. In the proposing release the Commission notes that Section 10A and proposed Rule 10A-1 apply to all audits required pursuant to the Exchange Act, including audits of investment companies. In addition, the Commission requests comment on whether the proposed reporting requirements under Rule 10A-1 need to be modified to reflect the operations of investment companies. Comments on the proposed

rule are to be filed with the Commission within 60 days after publication in the Federal Register. If there are any comments that you would like the Institute to include in a comment letter, please contact the undersigned at 202/326-5851 or Tom Selman at 202/326-5819 by October 4, 1996. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment

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