

MEMO# 12643

September 15, 2000

INSTITUTE DRAFT COMMENT LETTER ON SEC AUDITOR INDEPENDENCE RULE PROPOSALS

[12643] September 15, 2000 TO: ACCOUNTING/TREASURERS COMMITTEE No. 35-00
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 24-00 SEC RULES COMMITTEE No.
113-00 RE: INSTITUTE DRAFT COMMENT LETTER ON SEC AUDITOR INDEPENDENCE RULE
PROPOSALS As we previously informed you,¹ the SEC has proposed substantive rule
amendments intended to modernize and strengthen auditor independence requirements.
Attached is a draft of the Institute's comment letter. Comments on the SEC's proposals are
due Monday, September 25, 2000. Please provide any comments you may have on the
draft letter to Greg Smith by telephone at (202) 326-5851 or email at smith@ici.org or to
Barry Simmons by telephone at (202) 326-5923 or email at bsimmons@ici.org by the close
of business, Wednesday, September 20, 2000.

Statement of General Principles The
Commission's proposals include a statement of general principles under which an
accountant will be deemed to lack independence from his client. Also included is a non-
exclusive list of specific investments in an audit client, along with services provided to an
audit client, that would violate these principles. The Institute's draft letter agrees with the
proposed principles but recommends against incorporating them into the rule because the
combined effect of the general principles and the statement that the rule is non-exclusive is
an open-ended rule that leaves accountants (and issuers) uncertain as to the type of
financial relationships and non-audit services that constitute an independence violation.

Non-Audit Services The proposing release identifies certain non-audit services provided by
audit firms that, if provided to an audit client, would impair an auditor's independence. The
draft letter agrees that most (but not all) of the services listed in the proposing release can
potentially create conflicts, but recommends that any such rulemaking in this area should
be curtailed until a determination has been made as to the effectiveness of the recently
adopted rules relating to 1 Memorandum to Accounting/Treasurers Committee No. 27-00
and SEC Rules Committee No. 96-00, July 14, 2000. 2 corporate audit committees. The letter
recommends, however, that if the Commission determines nonetheless to go forward, then
the non-audit services related to the design and implementation of (i) financial systems,
and (ii) systems intended to ensure regulatory compliance should be excluded from the list
of incompatible services. The letter explains that these services do not compromise an
auditor's independence but rather provide important benefits to the audit client and its
shareholders as they focus on enhancing certain aspects of the firm's business, such as
improving its ability to control costs or enabling it to better monitor its compliance system.

Proxy Disclosure Requirements The proposals would require issuers to disclose in their
proxy statements information relating to non-auditing services provided by the auditor and
the associated fee paid for each such service. The draft letter supports the proposed

disclosures but suggests a few modifications to enable the disclosure to effectively provide useful information to investors and others concerned with auditor independence. Financial Relationships The proposals would significantly reduce the number of audit firm employees and their family members whose investments in audit clients impair an auditor's independence. Such restrictions would generally be limited to those who work on or can influence the audit. The proposals also provide a limited exception from independence violations to an accounting firm if the firm satisfies certain criteria. The draft letter supports these proposals but suggests certain modifications in order to better reflect the changes in the accounting profession as well as demographic changes in our society (e.g., increase in dual-career families and the substitution of defined-contribution pension plans for defined-benefit pension plans in the workplace). Exceptions to Independence Violations The proposals would establish a limited exception for accounting firms that maintain certain quality controls and satisfy certain conditions, in recognition that inadvertent independence violations may occur from time to time that are beyond the control of the accounting firm and the covered persons. The Institute's draft letter strongly supports this proposal but recommends that the Commission consider a similar limited exception for audit client issuers, in order to protect them from being unduly penalized for their auditors' missteps. Barry E. Simmons Assistant Counsel Attachment

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