

1958

## Amendment of rule 2-01 of regulation s-x

United States. Securities and Exchange Commission

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For IMMEDIATE Release Tuesday, April 8, 1959

SECURITIES AND EXCHANGE COMMISSION  
Washington 25, D. C.

SECURITIES ACT OF 1933

Release No. 3916

SECURITIES EXCHANGE ACT OF 1934

Release No. 5671

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Release No. 13720

INVESTMENT COMPANY ACT OF 1940

Release No. 2693

ACCOUNTING SERIES

Release No. 79

AMENDMENT OF RULE 2-01 OF REGULATION S-X

On January 28, 1958, the Securities and Exchange Commission announced that it had under consideration certain proposed amendments to Rule 2-01 of Regulation S-X (see Securities Act Release No. 3893). The Commission has considered all of the views and comments received on the proposals and has adopted the amendments in the form stated below.

Purpose of Amendment

When the Committee on Banking and Currency of the United States Senate was holding hearings on the Securities Act of 1933, a representative of the accounting profession appeared before the Committee and suggested requiring certification by independent public accountants of financial statements included in the registration statements under the Act. The committee considered at some length whether the additional expense to industry of having an impartial audit by accountants independent of the company and management was justified by the expected benefits to the investor and the public. The proposal to require certification by independent public accountants was incorporated in the principal statutes administered by this Commission, either as a requirement or as authority to require certification.

The Commission in the past has considered that relationships such as promoter, underwriter, voting trustee, director, officer, and employee of, and ownership of any direct or indirect financial interest in, the registrant or any affiliate thereof were incompatible with the independent status of a certifying accountant. The Commission has therefore refused to recognize an accountant as independent with respect to any person with whom he has any one of these relationships. Since certification by an independent accountant is required because of the value of an independent review, we believe that the prohibition of these relationships is justified and should be continued. However, in the ascertainment of whether accountants or members of their families have entered into one of these relationships with remote affiliates of the persons whose statements are being certified, and whether, in some instances, they hold indirectly any financial interest in the registrant or any of its parents or subsidiaries, there is an area in which some latitude for judgment is necessary in order to avoid undue hardship and expense to registrants and to accounting firms having a widespread accounting practice or whose clients have numerous affiliates. We have therefore revised the rule to permit the application of a test of materiality to these borderline areas. The change in the rule does not permit any of these relationships with close affiliates as we consider such relationships to prejudice materially the independent status of an accountant.

Situations arise in which it is not necessary to make a finding of lack of independence even though an accountant may have held a financial interest during the period of report but at a time when his independence was not a factor. For example, an accountant may be called upon to furnish a certificate in a registration statement for a former client in whom he now has a financial interest but with whom he maintained an independent relationship during the period covered by the audit and up to the date he issued his original certificate. Another example is where an accountant held stock in a company for which he had never had an engagement but sold it upon accepting an engagement. In these and other situations where it is clear from the facts that the independent status of the accountant is not prejudiced by a particular relationship, we will upon request advise the accountant that no action will be taken because of this relationship.

The rule has also been revised to make it clear that where the relationships described in the rule exist the Commission finds that an accountant is in fact not independent with respect to the company involved but does not find that he is in fact independent in instances where it fails to find that one of these relationships exists.

These revisions give formal recognition to administrative practices which have been in the process of development for some time. They make no material change in the policy as enumerated in prior decisions of the Commission and in published opinions of the Chief Accountant.

Text of Amendment of Rule

The amendments are in the form of a revision of paragraphs (b) and (c) of Rule 2-01. The paragraphs as amended read as follows:

"(b) The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent. For example, an accountant will be considered not independent with respect to any person or any of its parents or subsidiaries in whom he has, or had during the period of report, any direct financial interest or any material indirect financial interest; or with whom he is, or was during such period, connected as a promoter, underwriter, voting trustee, director, officer, or employee.

"(c) In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission."

Statutory Basis

The foregoing action is taken pursuant to the Securities Act of 1933, particularly Sections 6, 7, 8, 10 and 19(a) thereof, the Securities Exchange Act of 1934, particularly Sections 12, 13, 15(d) and 23(a) thereof, the Public Utility Holding Company Act of 1935, particularly Sections 5(b), 14, and 20(a) thereof, and the Investment Company Act of 1940, particularly Sections 8, 30, 31(c) and 38(a) thereof.

Since the revision clarifies the rule to reflect interpretations now in effect, it shall become effective April 8, 1958.

By the Commission.

Orval L. DuBois  
Secretary