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## Independence of accountants: Guidelines and examples of situations involving the independence of accountants

United States. Securities and Exchange Commission

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For RELEASE July 5, 1972

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

SECURITIES ACT OF 1933  
Release No. 5270

SECURITIES EXCHANGE ACT OF 1934  
Release No. 9662

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935  
Release No. 17636

INVESTMENT COMPANY ACT OF 1940  
Release No. 7264

ACCOUNTING SERIES  
Release No. 126

Independence of Accountants  
Guidelines and Examples of Situations  
Involving the Independence of Accountants

The Securities and Exchange Commission today announced the publication of an additional release in its Accounting Series on the subject of the independence of the certifying accountant. The primary purpose of this release is to set forth presently existing guidelines employed by the Commission in resolving the various independence questions that come before it. This release, therefore, is not intended to supersede Accounting Series Release No. 47 issued on January 25, 1944, or No. 81 issued on December 11, 1958, but should be read as complementing and implementing further the policy developed in those prior releases. However, to the extent that any inconsistency exists between these prior releases and the release presented herein, the latter should be regarded as indicative of the Commission's current position.

The Commission's authority and responsibility for determining that accountants are independent is found in the statutory language of the acts it administers. These acts, and the rules adopted pursuant to them, principally provide for the adequate and accurate disclosure of all material facts to the public. The concept of independence, as it relates to the accountant, is fundamental to this purpose because it implies an objective analysis of the situation by a disinterested third party. In order to assure public confidence in the objective reporting of these material facts, certain rules, particularly Rule 2(e) 1/ of the Commission's Rules of Practice and Rule 2-01 2/ of Regulation S-X, were adopted. Under Rule 2(e) "the Commission may deny, temporarily or permanently, the privilege of appearing

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1/ 17 CFR 201.2(e).

2/ 17 CFR 210.2-01.

or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws, or the rules and regulations thereunder." 3/ Contrasted with Rule 2(e), under which the Commission may impose sanctions once the issue of lack of independence or other improper professional conduct has been determined, is Rule 2-01 of Regulation S-X which deals with the qualifications of accountants and broadly illustrates how the qualification of independence can be impaired. Audited financial statements which are used in connection with an offering of securities within the Commission's jurisdiction, including those offerings which are exempted from certification under the Securities Act of 1933, must be audited by an accountant who satisfies the independence requirements of this rule.

In Rule 2-01(b) the use of the introductory words "[f]or example" implies that situations involving possible loss of independence include, but are not limited to, the relationships set forth therein. Rule 2-01(b) as amended states that " . . . an accountant will be considered not independent with respect to any person or any of its parents, its subsidiaries, or other affiliates (1) in which, during the period of his professional engagement or at the date of his report, he or his firm or a member 4/ thereof, had, or was committed to acquire, any direct financial interest or any material indirect financial interest; or (2) with which, during the period of his professional engagement, at the date of his report or during the period covered by the financial statements, he or his firm or a member thereof, was connected as a promoter, underwriter, voting trustee, director, officer, or employee." 5/ The Accounting Series Releases issued on the subject of independence attempt to clarify the intent of Rule 2-01 by applying these abstract principles to concrete factual situations.

The critical distinction which must be recognized at the outset is that the concept of independence is more easily defined than applied. As a result, the guidelines and illustrations presented in these releases cannot be, nor are they intended to be, definitive answers on any aspect of this subject. Rather, they are designed to apprise the practitioner of typical situations which have involved loss of independence, whether in appearance or in fact,

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3/ 17 CFR 201.2(e)(1).

4/ For the purposes of Rule 2-01 [17 CFR 210.2-01(b)] the term "member" means "all partners in the firm and all professional employees participating in the audit or located in an office of the firm participating in a significant portion of the audit."

5/ 17 CFR 210.2-01(b).

and by so doing to place him on notice of these and similar potential threats to his independence.

An important consideration in determining whether an accountant is independent is the relationship between the company, its stockholders and the accountants. Ratification of accountants by stockholder vote and attendance of accountants at the company's annual meeting to answer stockholder questions are desirable actions to strengthen the accountant's independent position. The existence of an audit committee of the board of directors, particularly if composed of outside directors, should also strengthen such independence. 6/

In Accounting Series Release No. 81 it was said that the growth of the accounting profession and the number of inquiries received from public accountants necessitated the publication of rulings in this category. We find ourselves today in a similar situation. Since the publication of Accounting Series Release No. 81 in 1958 technological advances have been considerable and have resulted in not only faster and more efficient means of rendering the customary services to clients but also in an expanded range of possible services which could be rendered. Consequently, although the principles affecting the determination of independence have remained unchanged, the application of these principles has been complicated by the difficulty in properly delineating the permissible scope of these expanded services. The Ethics Division of the American Institute of Certified Public Accountants has also recognized the need for further guidelines in this area. In April 1971 it issued Ethics Opinion No. 22, which deals with the "impact of data processing services on audit independence." This opinion supports the Commission's philosophy that "the fundamental and primary responsibility for the accuracy of information filed with the Commission and disseminated among investors rests upon management." 7/ It also recognizes that when "securities issued by the client are offered to the public and become subject to regulation by the Securities and Exchange Commission or other federal or state regulatory bodies, the matter of appearance, in addition to independence in fact, becomes more significant." 8/

A part of the rationale which underlies any rule on independence is that managerial and decision-making functions are the responsibility of the client and not of the independent accountant. It is felt that if the independent accountant were to perform functions of this nature, he would develop, or appear to develop, a mutuality of interest with his client which would differ only in degree, but not in kind, from that of an employee. And where

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6/ Securities Act Release No. 5237 (March 23, 1972); Accounting Series Release No. 123.

7/ Interstate Hosiery Mills, Inc., 4 S.E.C. 706, 721 (1939).

8/ Ethics Opinion No. 22: "Impact of Data Processing Services on Audit Independence," American Institute of Certified Public Accountants (April 1971).

this relationship appears to exist, it may be logically inferred that the accountant's professional judgment toward the particular client might be prejudiced in that he would, in effect, be auditing the results of his own work, thereby destroying the objectivity sought by shareholders. Consequently, the performance of such functions is fundamentally inconsistent with an impartial examination. However, it is the role of the accountant to advise management and to offer professional advice on their problems. Therefore, the problem posed by this dilemma is to ascertain the point where advice ends and managerial responsibility begins.

In this context, managerial responsibility begins when the accountant becomes, or appears to become, so identified with the client's management as to be indistinguishable from it. In making a determination of whether this degree of identification has been reached, the basic consideration is whether, to a third party, the client appears to be totally dependent upon the accountant's skill and judgment in its financial operations or to be reliant only to the extent of the customary type of consultation or advice. A particularly difficult situation arises when a small client for whom accounting services were performed desires to go public to meet the needs of its expanding business. If any of these services involved managerial functions or the maintenance of basic accounting records, the accountant may find himself unqualified to render an independent opinion on the financial statements for any period in which these services were performed. The financial statements are the responsibility of the client and all decisions with respect to them must ultimately be assumed by the client. Consequently, it is essential that the company and its accountant allow for an adequate transitional period to avoid this problem.

The Commission has said that the question of independence is one of fact, to be determined in the light of all the pertinent circumstances in a particular case. <sup>9/</sup> No set of rules or compilation of representative situations can embrace all the circumstances which could affect such a determination. But what they can do, and what they are intended to do, is act as a general notification which simultaneously educates the practitioner and places on him the responsibility for recognizing these general areas of potential loss of independence. The Commission is aware of the fact that situations arise which require judgment in determining whether the Commission's standards of independence have been met and that a company or its accountants may wish assurance that no question as to independence will be raised if the company files financial statements with the Commission. Where this is the case, the Commission urges the parties concerned to bring the problem to its attention so that a timely and informed decision on the matter may be made.

#### EDP AND BOOKKEEPING SERVICES

The Commission is of the opinion that an accountant cannot objectively audit books and records which he has maintained for a client. The performance of

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<sup>9/</sup> Accounting Series Release No. 47, January 25, 1944.

these services, whether accomplished manually or by means of computers and other mechanized instruments, ultimately places the accountant in the position of evaluating and attesting to his own recordkeeping. In some cases the amount of recordkeeping by the accountant may be limited and a strict application of the recordkeeping prohibition may cause an unreasonable hardship on companies going public for the first time. When no question relating to recordkeeping exists in the latest full year certified, the Commission may, in some cases, not raise a question as to independence in the earlier periods.

- a. Systems design is a proper function for the qualified public accountant. Computer programming is an aspect of systems design and does not constitute a bookkeeping service.
- b. Where source data is provided by the client and the accountant's work is limited to processing and production of listings and reports, independence will be adversely affected if the listings and reports become part of the basic accounting records on which, at least in part, the accountant would base his opinion. In this situation the accountant, by preparing basic accounting records, has placed himself in a position where he would be reviewing his own recordkeeping and could therefore appear to a reasonable third party to lack the objectivity and impartiality with respect to that client which an independent audit requires. On the other hand, if the processing results in the production of statistical summaries and analyses which do not become part of the basic accounting records, independence would not be adversely affected because the accountant, in the course of his audit, would not be put in the position, actual or apparent, of evaluating and attesting to the accuracy of his own recordkeeping.

Examples based upon situations brought to the attention of the staff are set forth below:

1. Accounting firm provided services to the client which included writing up the books, making adjusting entries, and preparing financial statements. Audited statements prepared under these circumstances are acceptable to the State Attorney General under that state's financing act. Conclusion, independence is adversely affected since the aggregate of these activities appears to place the basic responsibility for the accounting records and financial statements with the same accounting firm which is expected to perform an objective audit.

2. Accounting firm, through the use of their data processing equipment, maintained the sales, purchase, cash receipts and disbursements, and general journals for five of the client's subsidiaries. In addition, they posted the general ledger, coded and reclassified voucher checks, and reconciled certain accounts. The financial statements for the most recent year are to be audited by another accounting firm and those of the prior year by the subject accounting firm. Conclusion, the extent of the services performed is such as to cause the subject firm to be not independent either with regard to the parent or its subsidiaries.

3. In order to keep certain information confidential the client has asked the accounting firm to perform the following work:

- (1) Preparation of executive payroll.
- (2) Maintenance of selected general ledger accounts in a private ledger.

Conclusion, the performance of the foregoing work would adversely affect independence.

4. Client personnel will prepare from the books of original entry printed tapes that can be read on an optical scanner and will send the tapes to the accountant's office. The accountants will forward the tapes to a service bureau. The accountants will receive the print-outs of the financial statements and general ledgers and will send them to the client. The accountants will not edit input data prior to transmission to the service bureau. Conclusion, independence would be adversely affected. Although the function of the accountant appears totally mechanical, the service bureau appears to be acting as an agent of the accountant and this relationship should be changed so that the printed tapes will be transmitted directly to the service bureau by the client and the resulting print-out returned directly to the client.

5. Bookkeeping department of public accounting firm has kept and posted the client's general ledger from the start of the client's business. All other bookkeeping work has been done by the client's employees. Conclusion, since the accounting firm had control of the general ledger for the life of the company, their independence is adversely affected. However, another public accounting firm, if engaged to audit the company, could reduce its work by reference to the work papers and schedules of the present accountants but only to the extent that they could be accepted as the work of the client's bookkeeping staff.

6. Public accounting firm recorded the client's books of original entry, posted the general ledger, and determined the account classification of expenditures. The client was in the preoperating stage when this work was done and consequently had no need for a full-time bookkeeper. A controller has recently been hired by the client. Conclusion, accounting firm could not be considered independent for the purpose of auditing financial statements to be filed with the Commission. The maintenance of records in the absence of qualified personnel, as in this case, would not be considered an emergency situation which would permit such services.

7. Accounting firm proposed, by use of its computer, to perform certain data processing activities in connection with the client's stockholder ledger. Programming, keypunching and computer processing would be performed by personnel of the data processing department who are separate from the audit staff. The work proposed would consist of a complete restatement of the stockholder's ledger and its subsequent maintenance and updating to

reflect future transactions. In the course of restating the ledger accounts certain audit procedures would be applied which would lead to the correction of errors in the restated accounts. Conclusion, these services would adversely affect independence. The accountant has assumed the responsibility for maintaining the client's stock records.

8. Accounting firm did certain computer servicing work for a client during the period to be covered by their opinion. The client is not using the computer services of the accounting firm for the current fiscal year but still employs this firm as its accountants. The client's personnel had complete control over the preparation and coding of the vouchers. These vouchers were sent to the accounting firm but were not accompanied by the source data. These vouchers were fed into the computer and voucher registers and general journals were printed. All corrections were made by the client. The accountants performed only those services necessary to prepare the data for the computer. Conclusion, no question of independence will be raised because these services have been discontinued prior to the current fiscal year and appear to have been mechanical in nature involving neither the exercise of judgment nor the making of any decisions by the accounting firm, and the processing was subject to controls of the client.

#### FINANCIAL INTEREST

Rule 2-01(b) states that an accountant will be considered not independent if "he or his firm or a member thereof had, or was committed to acquire, any direct financial interest or any material indirect financial interest" in a client. For purposes of interpreting this section, any financial interest in a client owned by the accountant or by the accountant's spouse is considered to be a direct interest. Also, any financial interest in a client by someone other than the accountant may be treated as a direct financial interest of the accountant himself if, under the circumstances, it appears that the holder is subject to the accountant's supervision or control. On the other hand, if the interest is considered indirect, it is necessary to determine whether or not it is also material. And, in this context, the determination is primarily made with reference to the net worth of the accountant, his firm, and the net worth of his client.

9. Corporation A is acquiring Corporation B in a merger to be accounted for as a pooling of interests and proposes to pay the accountant for Corporation B for his audit services with stock of Corporation A. The accountant for Corporation B will not audit future reports of the acquiring company. Conclusion, independence would be adversely affected because of the receipt of stock.

10. Accounting Firm A is considering a merger with Firm B, one of whose partners owns stock in a client of Firm A. The partner proposed to put the stock in an irrevocable trust for the benefit of his children and controlled by two unassociated trustees. Conclusion, independence would be adversely affected if the shares were not sold. Putting the shares in an irrevocable trust would not be sufficient.



11. A partner in the accounting firm, whose proposed client was a wholly owned subsidiary of the registrant, owned one percent of the stock of the parent company. Conclusion, not independent.

12. A partner in an accounting firm owns stock in a company which has recently asked his firm to perform the audit for the current year. The partner would sell his stock prior to accepting the engagement. Conclusion, no question of independence would be raised.

13. Accounting firm received a five percent, ten-year debenture of the client in settlement of accounting fees pursuant to a plan of reorganization approved by the U. S. District Court. The firm intends to sell the debenture as soon as possible after issuance, providing any reasonable market exists. Conclusion, if securities taken in reorganization are disposed of promptly, no question as to independence will be raised. Although this is not an equity security, the debentures should be disposed of promptly.

14. A partner in an accounting firm is a member of an investment club. The club owns stock in a company which is a client of the accounting firm. Neither the number nor the value of the shares purchased is material to the club or the company. Conclusion, the firm's independence would be adversely affected as a result of the partner's interest in the investment club. In this regard, an investment club does not stand on the same footing as a mutual fund because the former is comprised of relatively few members and each member plays an active part in the selection of investments.

#### Accountant as Creditor of Client

When the fees for an audit or other professional service remain unpaid over an extended period of time and become material in relation to the current audit fee, it may raise questions concerning the accountant's independence because he appears to have a financial interest in his client. While no precise rules can be set forth, normally the fees for the prior year's audit should be paid prior to the commencement of the current engagement. When such unpaid fees become material the accountant cannot be considered independent because he may appear to have a direct interest in the results of operations of the company for the period to be audited.

15. Recent operations of a client company have not been profitable and in order to improve its current working capital ratio it has invited unsecured creditors to extent their settlement dates and subordinate their interests in exchange for receiving the first proceeds from a proposed offering. The accounting firm's fee was one of the debts to be subordinated. Conclusion, if the accounting firm subordinates the amount due them its independence would be adversely affected.

16. Pursuant to a plan of recapitalization, the existing debt of the company was to be exchanged for five-year promissory notes. The accounting firm was to receive these promissory notes in payment of its

audit fee. Conclusion, accountant should dispose of such notes as promptly as possible and, if material, before undertaking any additional auditing work for this company.

#### FAMILY RELATIONSHIPS

As a general rule, an accountant cannot be considered independent where the family relationship existing between the accountant or member of his firm and the client is such that, because of the strong bond which customarily exists in such a relationship, an outside party could reasonably question the accountant's impartial examination. In this context and in the absence of any other factors, the presumption of impairment to independence is greater in husband-wife or father-son relationships than in that of, for example, an uncle-nephew. In other words, the presumption is directly related to the presumed strength of the family bond. But, in resolving cases of this nature, attention is directed not only to the nature of the family relationship involved but also to such other factors, particularly the positions occupied by the parties in their respective employment, as may make the related parties appear to have the opportunity to mold the shape of the financial statements.

17. A is the controller of Company Z. He is not an elected officer nor does he have any stock holdings in Company Z. A's brother, B, is a partner in the public accounting firm that audits Company Z's books. However, B is not the partner in charge of this client. Conclusion, the accountant could not be considered independent because of this relationship.

18. Partner in a national public accounting firm has a brother-in-law who is sales vice president for a recently acquired client company. The brother-in-law is not directly involved in the financial affairs of the company and the partner would not be connected with the audit in any way. Conclusion, no question of independence would be raised because of this relationship.

19. An accountant has a sister-in-law whose husband is a 40 percent stockholder of a client company. There is no other business connection between the company, the stockholder, the accountant or his wife. Conclusion, independence is adversely affected because of the family relationship between the accountant and a major stockholder in a client company.

20. An attorney's father and brother are partners in an accounting firm. The law firm in which the attorney is a partner acts as counsel for several companies which are also clients of the accounting firm. As partial compensation for legal services, the law firm receives securities from the client. The attorney does not live in the same home or dwelling as either the father or brother and does not have any financial interest in their accounting firm. Nor do the accountants have any interests in the law firm. Conclusion, no question of independence will be raised.

21. The father of a partner in a public accounting firm was the chairman of the board and chief executive officer of a client company. The accounting firm had approximately 400 general partners and had offices throughout the U. S. The client was a large and diverse company with many consolidated subsidiaries. The partner's office was located over 500 miles from the client's home office and the partner was totally isolated from the audit engagement. This situation and the independence issue involved were presented to and reviewed by the company's board of directors. This body, which performs the functions typically delegated to an audit committee of directors, decided that if the son would not be involved in the audit in any way his association with the accounting firm would not be incompatible with the independent relationship. Conclusion, no question of independence was raised under these circumstances.

22. A client of the accounting firm acquired a 20 percent interest in a publicly held company and consequently could elect two members of the board of directors. One of the individuals they proposed to elect is the brother of a partner in the accounting firm as well as a senior partner in the law firm which acts as general counsel for the client. The offices of the law firm and accounting firm are located in the same city and, in addition, both brothers, their affiliations and relationships are well known in the community. Conclusion, independence would be adversely affected.

#### BUSINESS RELATIONSHIPS WITH CLIENT

Direct and material indirect business relationships other than as a consumer in the normal course of business with a client or with persons associated with the client in a decision-making capacity, such as officers, directors or substantial stockholders, will adversely affect the accountant's independence with respect to that client. Such a mutuality or identity of interests with the client would cause the accountant to lose the appearance of objectivity and impartiality in the performance of his audit because the advancement of his interest would, to some extent, be dependent upon the client. In addition to the relationships specifically prohibited by Rule 2-01(b), joint business ventures, limited partnership agreements, investments in supplier or customer companies, leasing interests, except for immaterial landlord-tenant relationships, and sales by the accountant of items other than professional services are examples of other connections which are also included within this classification.

23. Accounting firm will process the client's data on the firm's computer if the client's computer becomes inoperable. Conclusion, accountant's independence is not adversely affected if he assisted a client by maintaining books and records for a short period because of an emergency. The inoperability of the client's computer may be considered such an emergency.

24. Accounting firm plans to rent block time on its computer to a client if the client's computer becomes overburdened. Conclusion, renting excess computer time to a client, except in emergency or temporary situations, is a business transaction with a client beyond the customary professional relationship and would therefore adversely affect independence.

25. An individual owns 100 percent of the stock of a corporation which acts as the general partner in the limited partnership A and 51 percent of the stock of another corporation which acts as general partner for limited partnership B. The accounting firm, which has a one percent interest in partnership B, has been asked to audit partnership A. Conclusion, independence as to partnership A is adversely affected because partnership B, in which the accounting firm has an interest, was promoted under the same sponsorship as A. However, if the one percent interest is disposed of, no question will be raised.

26. Client of an accounting firm is engaged in the business of selling franchises. Two partners of this firm have invested approximately five percent of their personal fortunes to buy one half of the stock of a corporation which holds a franchise granted by this client. Except for the payment of a percentage of sales to the franchisor, the franchisee operates independently. Conclusion, the firm cannot be considered independent because the partners have a material investment in the franchise which has a close identity in fact and in appearance with the client.

27. A retired partner of an accounting firm plans to accept election as a director of one of the firm's clients. Under the terms of the partnership agreement this partner will continue to share in the earnings of the firm at a reducing rate but would be precluded from participating in the fees from this client if he were to become associated with it either as an employee, officer, director, or shareholder. Conclusion, when a retired partner of an accounting firm accepts a position with a client of that firm, all active connections with the firm must be severed if the firm is to remain independent. If this partner is still receiving retirement benefits from the firm, this severance requirement can be met only if the benefits flow from a fixed settlement payable in predetermined annual amounts.

28. Partner in accounting firm is also a financial vice president and stockholder of a real estate investment trust. In addition, he is a limited partner in a company which manages the trust. A client of his firm has asked him to help them get a loan from the investment trust. Conclusion, independence for future periods would be adversely affected if the company were to obtain the loan from the real estate investment trust. However, no question would be raised as to periods prior to the commencement of negotiations for the loan.

29. An accounting firm's client, a realtor corporation, is the general partner and ten percent owner in a limited partnership which owns unimproved land for appreciation. The accounting firm also owns a five percent interest in this limited partnership and a partner in the firm has a two percent interest. Conclusion, independence is adversely affected because of this joint investment with the client.

30. Partners in the accounting firm have a common investment with stockholders of a prospective client. These partners own approximately 11 percent of Company A and the other investors, who own approximately

78.5 percent of Company A, also own 22 percent of the prospective client. Conclusion, independence is adversely affected because the common investment which the partners of the firm have with the substantial minority shareholders of the prospective client is such a circumstance as could lead a third party to question the firm's objectivity.

31. A partner in an accounting firm manages a building owned by an audit client. Conclusion, independence is adversely affected.

32. An employee of an accounting firm was asked by an audit client to assume part-time management functions for the client. These services would be provided with the full knowledge and consent of the accounting firm and the employee would be paid a monthly retainer directly by the client. Conclusion, this would create an inappropriate relationship and would adversely affect independence.

33. A broker-dealer, an audit client, planned to manage a discretionary account for principals of the accounting firm. The account would be opened as a margin account with a different broker who is not a client. The client, however, would have discretionary authority to execute transactions for the account. No investment in this account could exceed \$25,000 nor would it represent a material portion of any of the participants' net worth. Conclusion, independence is adversely affected in those cases where the broker has extended credit to his accountant or where the accountant has given his client-broker discretionary authority to execute transactions for his account. However, no objection will be raised where an accountant executes his securities transactions in a regular cash account with a broker who is also his audit client if neither cash nor securities is left with the broker beyond a normal settlement period.

34. An accounting firm planned to construct office buildings in which it would occupy a relatively small portion of the space and would rent the remainder to other tenants, some of whom might be clients of the firm. Conclusion, the activity of owning and managing real property is more in the nature of a commercial business activity than of a professional service. Rental of a material amount of space to a client would raise a question of independence since the accounting firm would appear to have a material business relationship with the client. Some reasonable tests which would be applied in determining what constitutes a rental of material amount might be the relationship of a single lease to the fees earned in the office located in the building concerned, total lease rentals from all clients to the firm's total fees, and lease rentals from a particular client to the auditing fee paid by that client for the same period.

35. An accounting firm has its office in a building which is owned by a client. The accounting firm, which occupied approximately 25 percent of the available office space in the building, was the only tenant other than the client. Conclusion, the fact that the accounting firm was the only other tenant in the client's building and leased a substantial portion of the

available office space are circumstances that would lead a reasonable third party to question the firm's objectivity. Therefore, independence is adversely affected.

#### OCCUPATIONS WITH CONFLICTING INTERESTS

Certain concurrent occupations of certified public accountants engaged in the practice of public accounting involve relationships with clients which may jeopardize the certified public accountant's objectivity and, therefore, his independence. In general, this situation arises because the relationships and activities customarily associated with this occupation are not compatible with the auditor's appearance of complete objectivity or because the primary objectives of such occupations are fundamentally different from those of a public accountant. Acting as counsel or as a broker-dealer, or actively engaging in direct competition in a commercial enterprise are examples of occupations so classified and the following discussion relating thereto is intended to be illustrative only. The principles involved are equally applicable to any other undertaking which is similarly referable to them.

##### Accountant — Attorney

A legal counsel enters into a personal relationship with a client and is primarily concerned with the personal rights and interests of such client. An independent accountant is precluded from such a relationship under the securities acts because the role is inconsistent with the appearance of independence required of accountants in reporting to public investors.

36. A partner in an accounting firm also acted as legal counsel for an audit client. He received fees for such legal services and, through the accounting partnership, for accounting services rendered concurrently. Conclusion, independence is adversely affected.

##### Accountant — Broker-Dealer

Concurrent engagement as a broker-dealer is incompatible with the practice of public accounting. The functions customarily performed in such employment include the recommendation of securities, the solicitation of customers and the execution of orders, any one of which could involve securities transactions of clients either as issuer or investor and provide third parties with sufficient reason to question the accountant's ability to be impartial and objective.

37. A practicing accountant is also a broker-dealer and, functioning as a broker-dealer, makes a market in the stock of an audit client. Conclusion, accountant is not independent.

38. A partner in an accounting firm is also a principal for broker-dealer A. The accounting firm has been engaged to perform the audit for

broker-dealer B. Firm A, which is primarily involved in mutual fund sales, clears some transactions through Firm B. Conclusion, the accounting firm is not independent.

Accountant — Commercial Competitor

Occasionally accountants engage in a commercial business concurrently with the practice of public accounting. Where such commercial business is directly competitive with that of a client, there would appear to third parties to be a conflict of interests which might influence the firm's objectivity since the public accounting firm would have access to the records, policies and practices of a business competitor of that firm.

39. Four partners in an accounting firm were among the six founders of a company which was engaged in the same type of business and was directly competitive with an audit client. In addition to owning stock, they also served as directors and officers of this company. The accountants informed the president of the client-company of their investment in a business competitor but he did not object to the business venture and permitted them to continue as auditors. Both companies were located in the same geographical area. Conclusion, the accountants were not independent.

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APPENDIX

Principal References Concerning the Practice  
of Accountants Before the Commission

Opinions and Orders of the Commission

Cornucopia Gold Mines, 1 S.E.C. (1936)  
American Terminals and Transit Company, 1 S.E.C. 701 (1936)  
National Boston Montana Mines Corporation, 2 S.E.C. 226 (1937)  
Rickard Ramore Gold Mines, Ltd., 2 S.E.C. 377 (1937)  
Metropolitan Personal Loan Company, 2 S.E.C. 803 (1937)  
Interstate Hosiery Mills, Inc., 4 S.E.C. 706 (1939)  
A. Hollander & Son, Inc., 8 S.E.C. 586 (1941)  
Abraham H. Puder and Puder and Puder, Securities Exchange Act of 1934  
Release No. 3073 (1941)  
Southeastern Industrial Loan Company, 10 S.E.C. 617 (1941)  
Kenneth N. Logan, 10 S.E.C. 982 (1942) (Accounting Series Release  
No. 28)  
Associated Gas and Electric Company, 11 S.E.C. 975 (1942)  
C. Cecil Bryant, 15 S.E.C. 400 (1944) (Accounting Series Release  
No. 48)  
Red Bank Oil Company, 21 S.E.C. 695 (1946)  
Drayer-Hanson, Incorporated, 27 S.E.C. 838 (1948)  
Cristina Copper Mines, Inc., 33 S.E.C. 397 (1952)  
Coastal Finance Corporation, 37 S.E.C. 699 (1957)  
Sports Arenas (Delaware) Inc., 39 S.E.C. 463 (1959)  
American Finance Company, 40 S.E.C. 1043 (1962)  
Advanced Research Associates, Inc., 41 S.E.C. 579 (1963)  
South Bay Industries, Inc., Securities Act of 1933 Release No. 4702  
(1964)  
Idaho Acceptance Corp., Securities Exchange Act of 1934 Release  
No. 7383 (1964)  
Dixie Land and Timber Corporation, Securities Act of 1933 Release  
No. 4841 (1966) [For details see initial decision of Hearing  
Examiner, Administrative Proceeding File No. 3-215.]

Accounting Series Releases

No. 2 (1937) Independence of accountants—Relationship to registrant  
No. 19 (1940) McKesson & Robbins, Inc.  
No. 22 (1941) Independence of accountants—Indemnification by registrant  
No. 28 (1942) Kenneth N. Logan, 10 S.E.C. 982  
No. 47 (1944) Independence of certifying accountants—Summary of past  
releases of the Commission and a compilation of hitherto unpublished  
cases or inquiries  
No. 48 (1944) C. Cecil Bryant, 15 S.E.C. 400  
No. 51 (1945) Disposition of Rule II(e) proceedings against certifying  
accountant



- No. 59 (1947) Williams and Kingsolver
- No. 64 (1948) Drayer-Hanson, Incorporated, 27 S.E.C. 838
- No. 67 (1949) Barrow, Wade, Guthrie & Co., Henry H. Dalton and Everett L. Mangam
- No. 68 (1949) F. G. Masquelette & Co., and J. E. Cassel
- No. 73 (1952) Haskins & Sells and Andrew Stewart
- No. 77 (1954) Disposition of Rule II(e) proceedings against certifying accountant
- No. 78 (1957) Touche, Niven, Bailey & Smart, et al., 37 S.E.C. 629
- No. 82 (1959) Bollt and Shapiro, 38 S.E.C. 815
- No. 88 (1961) Myron Swartz, 41 S.E.C. 53
- No. 91 (1962) Arthur Levison and Levison and Company, 41 S.E.C. 150
- No. 92 (1962) Morton I. Myers, 41 S.E.C. 156
- No. 97 (1963) Harmon R. Stone
- No. 105 (1966) Homer E. Kerlin
- No. 108 (1967) Nicholas J. Raftery [Misspelled in release]
- No. 110 (1968) Meyer Weiner
- No. 112 (1968) Independence of accountants examining a nonmaterial segment of an international business

Changes in the Independence Rule

- Article 14, Rules and Regulations under the Securities Act of 1933, 1/ Federal Trade Commission, July 6, 1933
- Article 41, Rules, Regulations and Opinions under the Securities Act of 1933 as Amended, April 29, 1935
- Rule 650, General Rules and Regulations under the Securities Act of 1933, January 21, 1936
- Rule 2-01, Regulation S-X, Adopted February 21, 1940, Accounting Series Release No. 12
- Amendments of Rule 2-01:
  - Accounting Series Release No. 37, November 7, 1942
  - Accounting Series Release No. 44, May 24, 1943
  - Accounting Series Release No. 70, December 20, 1950
  - Accounting Series Release No. 79, April 8, 1958

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1/ The Securities and Exchange Commission was established under provisions of the Securities Exchange Act of 1934 and was authorized to continue in effect until modified all rules and regulations issued by the Federal Trade Commission under the Securities Act of 1933.