

University of Mississippi

eGrove

---

Association Sections, Divisions, Boards, Teams

American Institute of Certified Public Accountants (AICPA) Historical Collection

---

1998

## Authorizing SEC Release (FRR-50)

United States. Securities and Exchange Commission

Follow this and additional works at: [https://egrove.olemiss.edu/aicpa\\_assoc](https://egrove.olemiss.edu/aicpa_assoc)

---

### Recommended Citation

United States. Securities and Exchange Commission, "Authorizing SEC Release (FRR-50)" (1998). *Association Sections, Divisions, Boards, Teams*. 633. [https://egrove.olemiss.edu/aicpa\\_assoc/633](https://egrove.olemiss.edu/aicpa_assoc/633)

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Association Sections, Divisions, Boards, Teams by an authorized administrator of eGrove. For more information, please contact [egrove@olemiss.edu](mailto:egrove@olemiss.edu).

## Authorizing SEC Release (FRR-50)

Authorizing SEC Release (FRR-50) SECURITIES AND EXCHANGE COMMISSION 17 CFR Parts 210 and 211 [Release No. 33-7507; 34-39676; IC-23029; FR-50 ] Commission Statement of Policy on the Establishment and Improvement of Standards Related to Auditor Independence AGENCY: Securities and Exchange Commission ACTION: Policy Statement SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") today reaffirmed that maintaining the independence of auditors of financial statements included in filings the Commission is crucial to the credibility of financial reporting and, in turn, the capital formation process. In so doing, the Commission recognized the establishment of the Independence Standards Board ("ISB") and indicated that, consistent with its continuing policy of looking to the private sector for leadership in establishing and improving accounting principles and auditing standards, the Commission intends to look to the ISB for leadership in establishing and improving auditor independence regulations applicable to the auditors of the financial statements of Commission registrants, with the expectation that the ISB's conclusions will promote the interests of investors. EFFECTIVE DATE: (30 days after publication in the Federal Register) FOR FURTHER INFORMATION CONTACT: Robert E. Burns or W. Scott Bayless, Office of the Chief Accountant, at (202) 942-4400, Mail Stop 11-3, Securities and Exchange Commission, 450 Fifth Street, N.W. Washington, D.C. 20549. SUPPLEMENTARY INFORMATION I. Background The various securities laws enacted by Congress and administered by the Securities and Exchange Commission underscore the crucial function of independent auditors in protecting public investors by requiring, or permitting the Commission to require, that financial statements filed with the Commission by public companies, investment companies, broker-dealers, public utilities, investment advisers, and others be certified (or audited) by "independent" public accountants . 1 They also give the Commission the authority to define the term " independent " . 2 Since the Commission's creation in 1934, it consistently has emphasized the need for auditors to remain independent. The Commission's regulations are set forth in Rule 2-01 of Regulation S-X 3 and in the extensive interpretations, guidelines, and examples for registrants and auditors to use in evaluating specific independence questions that are collected in Section 600 of the Codification of Financial Reporting Policies ("Codification"), entitled "Matters Relating to Independent Accountants ." 4 The Commission also makes publicly available the staff's written responses to requests for informal advice on its independence requirements. Pursuant to the Commission's regulations, the basic test for auditor independence is whether a reasonable investor, knowing all relevant facts and circumstances, would perceive an auditor as having neither mutual nor conflicting interests with its audit client and as exercising objective and impartial judgment on all issues brought to the auditor's attention . 5 In determining whether an auditor is independent, the Commission considers all relevant facts and circumstances, and its consideration is not confined to the relationships existing in connection with the filing of reports with the Commission . 6 In certain matters, the Commission also has referred registrants and their auditors to independence requirements adopted by the American Institute of Certified Public Accountants ("AICPA"), to the extent those standards do not conflict with those of the Commission . 7 Day-to-day, the Commission's staff receives inquiries regarding the application of the Commission's independence regulations to specific situations confronting registrants and their auditors. In recent years, these situations have become more complex as auditors have entered into new service areas for their clients, auditing firms have merged and restructured their operations, and business practices and technology have become more sophisticated and,

increasingly, more global in scope. Some of the Commission's auditor independence regulations, written years ago, do not provide obvious guidance in today's business environment. The Commission recognizes, therefore, that an update of the Commission's regulations may be in order. II. The Independence Standards Board After careful consideration, and without abdicating its statutory responsibilities, the Commission intends to look to a standard-setting body designated by the accounting profession - known as the Independence Standards Board ("ISB") - to provide leadership not only in improving current auditor independence requirements, but also in establishing and maintaining a body of independence standards applicable to the auditors of all Commission registrants . 8 The Commission has taken a similar course in developing its relationship with the Financial Accounting Standards Board ("FASB"), a standard-setting body designated by the accounting profession that provides leadership in establishing and improving accounting principles . 9 Although the Commission expects to look to the ISB as the private sector body responsible for establishing independence standards and interpretations for auditors of public entities, the Commission's existing authority regarding auditor independence is not affected. This includes the Commission's authority to institute such enforcement actions as it deems appropriate, such as actions or proceedings instituted pursuant to Rule 102(e), 17 CFR 102(e). The Commission also retains ultimate authority to not accept, or to modify or supplement, ISB independence standards and interpretations in the same manner that the Commission can modify or supplement accounting standards and interpretations issued by the FASB. Moreover, the functioning of the ISB does not affect the authority of state licensing or disciplinary authorities regarding auditor independence. The Commission expects that the public interest will be served by having the ISB take the lead in establishing, maintaining, and improving auditor independence requirements; and that operation of the ISB will promote efficiency, competition, and capital formation. The ISB, which is composed equally of public members (from which the ISB chairman must be elected) and practicing accountants, has undertaken to develop an institutional framework that will permit prompt and responsible actions by the ISB and its staff flowing from research and objective consideration of the issues. Collectively, the ISB members bring substantial experience and expertise to the process. In addition, the accounting profession's commitment of financial resources to the ISB is evidence of the private sector's willingness and intention to support the ISB. Under these circumstances, the Commission expects that determinations of the ISB will preserve and enhance the independence of public accountants, and thereby promote the interests of investors. The central mission of the ISB will be to establish independence standards applicable to auditors of public entities that serve the public interest by promoting investor confidence in the securities markets. To further that goal, ISB standard-setting meetings will be open to the public, and proposed standards will be exposed for public comment before they are issued, in a process similar to that used by the FASB. In addition, the Commission will provide timely oversight of the ISB consistent with the Commission's statutory mandate to protect investors and safeguard the integrity of the capital markets . 10 As noted, in the exercise of its statutory authority the Commission has the responsibility to ensure that independent audits of registrants' financial statements protect the interests of investors. In reviewing questions related to the fact or appearance of an auditor's independence from an audit client, the Commission will consider an auditor to be not independent unless the auditor has substantial authoritative support for the position that the questioned transaction, event, or other circumstance, does not impair the auditor's independence. In this regard, the Commission will consider principles, standards, interpretations, and practices established or issued by the ISB as having substantial authoritative support for the resolution of

auditor independence issues . 11 Conversely, the Commission will consider principles, standards, interpretations, and practices contrary to such ISB promulgations as having no such support . 12

III. Review of ISB Operations Since the formation of the ISB, there have been public announcements of mergers of several of the "Big 6" accounting firms. The impact of these mergers, and the accelerating trend toward consolidation of auditing firms generally, on foreign and domestic self-regulatory programs is being discussed within the United States, other countries, and international organizations. These events will be monitored closely and may prompt the Commission to reconsider certain of the accounting profession's self-regulatory programs, including the ISB. In view of the significance of auditor independence to investor confidence in the securities markets, the Commission also will review the operations of the ISB as necessary or appropriate and, within five years from the date the ISB was established, will evaluate whether this new independence framework serves the public interest and protects investors.

IV. Regulatory Requirements This general policy statement is not an agency rule requiring notice of proposed rulemaking, opportunities for public participation, and prior publication under the provisions of the Administrative Procedure Act ("APA") . 13 " Similarly, the provisions of the Regulatory Flexibility Act , 14 which apply only when notice and comment are required by the APA or another statute, are not applicable.

V. Codification Update The "Codification of Financial Reporting Policies" announced in Financial Reporting Release No. 1 (April 15, 1982) [47 FR 21028] is updated to: Add a new Section 601.04, captioned "Statement of Policy on the Establishment and Improvement of Standards Related to Auditor Independence" to include the text in topics I., II., and III. of this release . The Codification is a separate publication of the Commission. It will not be published in the Federal Register/Code of Federal Regulations.

VI. Conclusion The Commission believes that the foregoing statement of policy provides a sound basis for the Commission and the ISB to make significant contributions to meeting the needs of investors and the capital markets. By the Commission. Jonathan G. Katz Secretary February 18, 1998

1 Certain provisions of the Securities Act of 1933 ("Securities Act") and Securities Exchange Act of 1934 ("Exchange Act") expressly require that financial statements be audited by independent public or certified accountants. Securities Act Schedule A, items 25 and 26, 15 U.S.C. §§ 77aa(25) and (26); Exchange Act § 17(e), 15 U.S.C. § 78q. Various provisions of the securities laws authorize the Commission to require the filing of financial statements audited by independent accountants. Exchange Act §§ 12(b)(1)(J) and (K) and 13(a)(2), 15 U.S.C. §§ 781 and 78m, Public Utility Holding Company Act of 1935 ("PUHCA"), §§ 5(b)(H) and (I), 10(a)(1)(G), and 14, 15 U.S.C. § 79e(b), 79j, and 79n; Investment Company Act of 1940, §§ 8(b)(5) and 30(e), 15 U.S.C. § 80a-8 and 80a-29; Investment Advisers Act of 1940, § 203(c)(1)(D), 15 U.S.C. § 80b-3(c)(1). In accordance with these provisions, the Commission has required that certain financial statements be audited by independent accountants. See, e.g ., Article 3 of Regulation S-X, 17 CFR 210.3-01 et seq . (1996). 2 Various provisions of the securities laws grant the Commission the authority to define accounting, technical, and trade terms. Securities Act § 19(a), 15 U.S.C. § 77s(a); Exchange Act § 3(b), 15 U.S.C. § 78c(b); PUHCA § 20(a), 15 U.S.C. § 79t(a); and Investment Company Act § 38(a), 15 U. S.C. § 80a-37(a). 3 17 CFR 210.2-01 (1996). 4 Financial Reporting Codification, Section 600-Matters Relating to Independent Accountants, reprinted in SEC Accounting Rules (CCH) ¶ 3,851, at 3,781. 5 This test encompasses an evaluation of an auditor's independence in both fact and appearance. See Codification § 601 .01 (quoting Accounting Series Release No. 296). 6 Rule 2-01(c), 17 CFR 210.2-01 (c) (1996). 7 See, e.g ., Office of the Chief Accountant, Staff Report on Auditor Independence , Appendix II at 5-7 (1994) (discussing AICPA

requirements regarding loans to or from an audit client or its officers, directors, or stockholders; and stating that Commission has not adopted additional requirements in this area). 8 The Commission generally has required foreign issuers and the auditors of their financial statements to comply with United States independence requirements when foreign issuers' audited financial statements are filed with the Commission. Accordingly, the ISB's pronouncements would apply to foreign as well as domestic audit reports that are filed with the Commission. 9 See Accounting Series Release No. 150 (Dec. 20, 1973) (recognizing establishment of FASB); Accounting Series Release No. 280 (Sept. 2, 1980) (commenting on FASB's role in establishing and improving accounting principles). 10 The Commission and its staff will consult with the ISB during the course of ISB consideration of standards or interpretations, including those dealing with matters addressed by existing SEC guidance. As the ISB reconsiders and effectuates changes in independence standards and practices that involve existing SEC guidance, the Commission will consider modifying or withdrawing its conflicting guidance unless the Commission determines that it should not accept the ISB position in a particular area. 11 Positions of the ISB staff and consensuses of a permanent task force that will assist the ISB, the Independence Issues Committee, will not be considered authoritative unless or until ratified by the ISB. Positions issued by the ISB staff to a particular party, however, may be relied upon by that party in accordance with the ISB Operating Policies. 12 Entities that may issue such principles, standards, or interpretations include the AICPA's Professional Ethics Executive Committee. 13 5 U.S.C. § 553. 14 5 U.S.C. §§ 601-602. © 1998 ISB

No Microsoft Word™ version or web version is currently available.

Return to the [Main Page](#).

Copyright © 1998, 1999, 2000, 2001 [Independence Standards Board](#)  
All Rights Reserved.