

United States Senate

WASHINGTON, DC 20510

May 25, 2000

The Honorable Arthur Levitt
Chairman
Securities and Exchange Commission
405 Fifth Street, NW
Washington, DC 20007

Dear Chairman Levitt:

We noted with interest your May 10 comments at New York University on the subject of financial reporting, and in particular your announcement that the SEC would commence rulemaking to address "conflicts created by the [accounting] profession's ever-expanding menu of services offered to public company audit clients."

As members of the Securities Subcommittee of the Senate Banking Committee, we have an ongoing interest in the regulation of capital markets upon which such a significant rulemaking would have an impact. In keeping with our oversight responsibility, we are eager to understand the basis for the Commission's proposal – specifically, the foundation for the premise that providing additional services conflicts with audit quality.

In addition, we are concerned that corporate disclosure, critical to investor protection, keep pace with changes in the economy. It has been widely noted – including, to your credit, by the Commission – that the current model of corporate reporting and review is geared toward a previous economic era and does not satisfy investor information needs in a digital, knowledge-based economy. Development of a new, forward-looking model will obviously entail the role of the independent auditor.

Attached are questions that address these important issues. We hope to receive your response by July 1, 2000. As you will note, several of the questions relate to a significant policy question posed by these various developments – namely, the propriety of proceeding with the kind of major rulemaking outlined in your speech prior to a thorough examination, by both the Commission and the Congress, of the changes wrought by the New Economy, their impact on the existing securities regulatory framework, and the different roles and responsibilities that they may entail for the various participants in that framework, including, but not limited to, the accounting profession.

Thank you, and we look forward to your response.

Sincerely,

Charles Schumer
U.S. Senate

Robert F. Bennett
U.S. Senate

Evan Bayh
U.S. Senate

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1. Please identify and provide all studies or analyses undertaken by the Commission assessing whether existing corporate reporting and financial disclosure models need to be modernized in light of changes in technology, globalization and the like. In particular, please identify any provisions of the 1933 and 1934 Securities Acts that should be amended to reflect such need for modernization.
2. Please identify and provide all studies or analyses undertaken by the Commission assessing whether existing disclosure requirements adequately identify all necessary information pertaining to the recognition and measurement of the assets and liabilities of organizations.
3. Has the Commission undertaken any studies during the past three years of the degree of investor reliance on historical financial statements for investor decisions? Has the Commission undertaken any studies during the past three years of the degree of investor reliance on Internet-based information for investor decisions? Please provide all such studies.
4. As investors and other market participants increasingly rely in their decisionmaking on information outside traditional historical financial statements, what consideration has the Commission given to the role of auditors in providing assurance on such information?
5. In particular, what studies or analyses has the Commission undertaken to identify the range of skills that accounting firms will need to provide additional assurance to investors?
6. How would scope of practice restrictions impact audit firms' ability to provide assurance against nontraditional financial measurements, e.g. intangibles? against nonfinancial measurements?
7. How would these restrictions impact audit firms' ability to provide real-time assurance against company information made available online?
8. Please identify all empirical studies or analyses undertaken by the Commission to evaluate whether the provision of each of the following services by accounting firms to their audit clients has increased the number of financial reporting problems.
 - a) Information technology services.
 - b) Computer risk management services.
 - c) Financial and commodity risk services
 - d) Fraud and integrity risk services
 - e) Valuation services.
 - f) Tax services.
 - g) Internal audit outsourcing services.

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9. Please identify all empirical studies or analyses undertaken by the Commission to evaluate whether the provision of each of the following services by accounting firms to their audit clients has reduced the number of financial reporting problems.
 - a) Information technology services.
 - b) Computer risk management services.
 - c) Financial and commodity risk services
 - d) Fraud and integrity risk services.
 - e) Valuation services.
 - f) Tax services.
 - g) Internal audit outsourcing services.
10. What studies has the Commission undertaken to evaluate the impact of your proposal on competition in the consulting sector? Please also provide the Committee with your legal analysis to demonstrate that this proposal does not constitute a restraint of trade.
11. What empirical studies have been performed to demonstrate a negative correlation between nonaudit services and audit quality? Specifically, please provide a complete list of all audit failures attributable to the provision of nonaudit services to audit clients for the last 10 years.
12. Compromising audit quality because a firm provided nonaudit services to audit clients risks lawsuits and firm reputation. Please identify all studies or analyses undertaken by the Commission to evaluate the effectiveness of these disincentives to compromised audit objectivity.
13. Please identify all studies or analyses evaluating whether insurance brokers or insurance companies associate increased liability risk with accounting firms that perform nonaudit services for audit clients. Please provide any historical evidence compiled by the Commission in this regard.
14. Please detail how your proposal would account for the planned divestitures and partial divestitures of consulting practices by large audit firms
15. What regulatory analysis have you undertaken that shows that any benefits outweigh the costs?