



OFFICE OF  
THE SECRETARY

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

February 18, 1998

BY COURIER

The Honorable Al Gore  
President of the Senate  
Room S-212, the Capitol  
Washington, D.C. 20510

Dear Mr. President:

This constitutes the submission of a report to Congress on the Commission's General Policy Statement on the Establishment and Improvement of Standards Related to Auditor Independence, as required by 5 U.S.C. §801. A copy of that report is enclosed with this letter, as well as a copy of the General Policy Statement, which was promulgated by the Securities and Exchange Commission on February 18, 1998.

Simultaneously with the delivery of this letter and enclosures, the Commission is delivering a duplicate of this letter, on which we would appreciate that your office acknowledge the date of receipt of the original letter and enclosures.

Sincerely,

Jonathan G. Katz  
Secretary

*mh*  
By: Margaret H. McFarland  
Deputy Secretary

Enclosed: Report to Congress Pursuant to 5 U.S.C. §801.  
General Policy Statement, February 18, 1998, Release No. 33-7507.

cc: The Honorable Newt Gingrich  
The Speaker  
U.S. House of Representatives  
Room H-209, the Capitol  
Washington, D.C. 20515

James F. Hinchman  
Acting Comptroller General  
GAO Building  
441 G Street, N.W.  
Washington, D.C. 20548  
ATTN: Robert P. Murphy

SIGN & RETURN TO  
Office of The Secretary  
SECURITIES & EXCHANGE COMMISSION

*AMM Boring* 2/18/98  
*Sign* *Date*

## REPORT TO CONGRESS PURSUANT TO 5 U.S.C. §801

February 18, 1998

1. Rule promulgated by the Securities and Exchange Commission ("SEC" or "Commission"), and copy of the rule.

The Commission's General Policy Statement on the Establishment and Improvement of Standards Related to Auditor Independence ("General Policy Statement") is hereby submitted to each House of Congress and to the Government Accounting Office pursuant to 5 U.S.C. §801. A copy of the rule, Securities and Exchange Commission Release No 33-7507, is attached at tab A.

2. Concise general statement of the rule.

The General Policy Statement discusses the formation of a new private sector body -- the Independence Standards Board ("ISB"). The General Policy Statement states that the Commission expects to look to the ISB for leadership in establishing and improving standards related to auditors' remaining independent from public entities when they audit those entities' financial statements.

3. The rule is not a major rule.

This General Policy Statement has been determined by the Office of Management and Budget not to be a major rule.

As explained in the General Policy Statement, the ISB was formed to establish independence standards applicable to the audits of public entities. The ISB's standards are expected to serve the public interest by promoting investor confidence in the auditing, financial reporting, and capital formation processes and, in turn, the securities markets.

As in the areas of private sector auditing and accounting standard setting, the Commission retains full authority to supplement or modify ISB standards and to pursue enforcement and disciplinary proceedings in the area of auditor independence. In this regard, the Commission will consult with the ISB during the course of ISB consideration of draft standards and interpretations, including those dealing with matters addressed by existing SEC regulations. As the ISB effectuates changes in independence standards and practices that involve existing SEC regulations, the Commission will consider whether to modify or withdraw any conflicting SEC regulations. The Commission, of course, has the authority to decide not to amend its regulations to conform to the ISB's standards, in which case registrants must continue to comply with the SEC's regulations.

The General Policy Statement is not a "major rule." First, there will be no immediate change in the regulations in this area. At the outset, the ISB will adopt as its own the existing SEC regulations in this area. The General Policy Statement does not amend those regulations. Second, it is too speculative at this point to estimate what changes in regulations may occur. The impact of such changes may be addressed when, or if, the Commission engages in rulemaking to amend the SEC's regulations to conform to changes adopted by the ISB.

### No \$100 Million Annual Effect

The Commission's recognition in the General Policy Statement of the private sector body formed to establish and maintain auditor independence standards will not have a significant effect on the economy.

In general, having the ISB consolidate and resolve conflicting SEC and American Institute of Certified Public Accountants' ("AICPA") independence regulations,<sup>1</sup> update those regulations,<sup>2</sup> and bring a logical foundation to the independence criteria applicable to the audits of public companies, should reduce the costs of complying with those regulations. It is too early, however, to predict the nature or extent of the auditor independence standards that the ISB ultimately may adopt and what effect individual standards may have on the economy. Such issues may be addressed when, or if, the SEC considers amending its existing rules to conform to ISB pronouncements.

### No Major Cost Increase

Similarly, it is unlikely that the Commission's recognition of the ISB would impact the cost of audit or nonaudit services provided by firms or other organizations to the firms' SEC audit clients.<sup>3</sup>

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<sup>1</sup> Currently, both the SEC and the AICPA promulgate auditor independence regulations for auditors of public entities. Both have established a set of basic principles and issued additional (and rather extensive) guidance in the form of interpretations, rulings, and letters to various companies and the auditors of their financial statements. Some of the AICPA and SEC regulations conflict. In such cases, for SEC registrants, the Commission's regulations govern.

<sup>2</sup> The Commission's regulations last were amended in 1982. Since that time, telecommunications and high technology information systems have changed both business practices and the manner in which audits are conducted. In addition, the acceleration of the auditing profession's provision of nonaudit services and entrance into joint business ventures, and the merger and reorganization of auditing firms, have increased the potential for mutual and conflicting interests that could create auditor independence issues.

<sup>3</sup> The independence regulations apply only when a firm audits a client's financial statements, or provides another service for which the auditor must be "independent." Generally, if the firm does not audit the client's financial statements, the independence regulations do not apply.

As noted above, the ISB is expected to consolidate the Commission's and the AICPA's independence regulations, provide a central source for advice in this area, and establish a conceptual framework that will provide a logical foundation for the resolution of auditor independence issues. These efforts should reduce the cost of complying with the independence regulations.

It is conceivable, however, that an individual ISB standard eventually could impact whether a firm may provide certain services to an audit client without impairing its independence, and that such a result could impact competition for the provision of those services, which, in turn, could impact the cost for those services. At present, it is too early to speculate regarding what or when standards may be adopted by the ISB or whether such standards might expand, restrict, or not affect the provision of such services. Once again, the costs of such standards may be considered when, or if, the Commission proposes to amend its regulations to conform to pronouncements of the ISB.

#### No Significant Adverse Effects

The Commission's recognition of the ISB should not have an immediate effect on competition, investment, or innovation. As noted above, the ISB initially will adopt the SEC's independence regulations as its own, and the General Policy Statement does not change those regulations.

The potential impact on competition for audit and nonaudit services is discussed in the preceding section on potential cost increases.

Commission endorsement of the ISB could have a positive effect on investment because it may enhance investors' confidence in the audit process as an unbiased test of reported financial information, and thereby promote investment in the securities markets. Increased investor confidence in the reliability of financial information and in the markets also should facilitate market efficiency and the capital formation process.

Creation of the ISB was intended to facilitate innovation in addressing auditor independence issues. Future research and studies prepared or sanctioned by the ISB could promote innovation in the way services are provided to public companies by the auditors of their financial statements and by other service providers. The ISB should be a venue for consideration of new approaches to long-standing auditor independence issues. It is expected to inspire innovation, not impede it.

#### 4. Proposed effective date.

The General Policy Statement will become effective 30 days after publication in the Federal Register.

## 5. Cost/Benefit analysis.

As there will be no immediate change in the independence standards applicable to the audits of public entities, the Commission's recognition of the ISB in the General Policy Statement should have no impact on audit or other costs.

As noted above, it is expected that benefits of the Commission's recognition of the ISB will include the ISB's consolidation and resolution of conflicting SEC and AICPA independence regulations, updating those regulations, and bringing a logical foundation to the independence criteria applicable to the audits of public companies. These efforts should make the independence regulations easier for the public and members of the auditing profession to understand and reduce the costs of complying with those regulations.

In addition, Commission endorsement of the ISB could have a positive effect on investment because the ISB may enhance investors' confidence in the audit process as an unbiased test of reported financial information, and thereby promote investment in the securities markets. Increased investor confidence in the reliability of financial information and in the markets also should facilitate market efficiency and the capital formation process.

It is too early, however, to predict the nature or extent of the auditor independence standards that the ISB ultimately may adopt and what effect individual standards may have on costs of regulatory compliance. Such issues may be addressed when, or if, the SEC considers amending its existing rules to conform to ISB pronouncements.

## 6. Regulatory Flexibility Act.

General Policy Statements are not subject to the notice and comment provisions of the Administrative Procedure Act and, accordingly, the requirements of the Regulatory Flexibility Act do not apply. Nonetheless, because the issuance of the General Policy Statement does not amend existing auditor independence regulations, it would not have a significant economic impact on a substantial number of small entities.

## 7. Unfunded Mandates Reform Act.

The Unfunded Mandates Reform Act of 1995 is inapplicable to the Securities and Exchange Commission. See Public Law 104-4, Section 421(1), 109 Stat. 50.

8. Other relevant information.

The relevant sections of the Administrative Procedure Act have been satisfied. Because the General Policy Statement does not contain a collection of information, the Paperwork Reduction Act does not apply. The Commission also has considered the impact this rulemaking will have on competition, pursuant to Section 23(a) of the Securities Exchange Act of 1934. The Commission is unaware of any other relevant information or requirements under any other Act or any relevant Executive orders applicable to it that should be brought to the attention of the Congress or the Comptroller General in connection with the issuance of this General Policy Statement.