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**TESTIMONY OF**

**ARTHUR LEVITT, CHAIRMAN**  
**U.S. SECURITIES AND EXCHANGE COMMISSION**

**CONCERNING THE COMMISSION'S**  
**AUDITOR INDEPENDENCE PROPOSAL**

**BEFORE THE SUBCOMMITTEE ON SECURITIES**  
**COMMITTEE ON BANKING, HOUSING,**  
**AND URBAN AFFAIRS**

**UNITED STATES SENATE**

**SEPTEMBER 28, 2000**

U. S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

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Chairman Grams and Members of the Subcommittee:

I am pleased to testify today on behalf of the Securities and Exchange Commission ("Commission" or "SEC") about the Commission's proposal to modernize its requirements regarding the independence of public accountants who audit the financial statements of public companies. I view the Commission's proposal as one of the most important, and perhaps most long-overdue, initiatives that we have pursued during my tenure. The Commission appreciates this Subcommittee's interest in the issue of auditor independence and welcomes the opportunity to discuss the rule proposal.

Let me begin with a concept that may seem obvious, but which I believe cannot be too often stated or too forcefully emphasized: sound, transparent, and trustworthy financial reporting is the cornerstone of healthy, efficient, and resilient markets. I have said in the past that sound and verifiable financial reporting is to financial markets what oxygen is to breathing. I do not think that comparison overstates the case. Investors are willing to commit capital to our securities markets because they have confidence in the quality and integrity of financial statements prepared by public companies and certified by independent auditors. Investor

confidence in that financial information does not merely fuel markets – it makes markets possible.

In prosperous times, it can be easy to take investor confidence for granted. For some, perhaps, it is a little difficult these days to imagine a marketplace where investors do not readily invest in new companies, new technologies, and new ideas, or a marketplace without instant liquidity and oversubscribed IPOs. But as those of us old enough to remember a bear market know, investor confidence can be lost in the blink of an eye. We dare not pay too little heed to developments with the potential to undermine this confidence.

One of those developments is the transformation of the accounting industry, marked by seismic changes in the structure of the largest firms, an increasingly complex web of business and financial relationships between the firms and their audit clients, and a dramatic rise in the number and types of, and revenues from, non-audit services that firms provide to their audit clients. These changes – which have given rise to important issues about auditor independence that have been debated for over two decades – have accelerated in the past few years. Accordingly, in June of this year, we issued a rule proposal to address these issues.<sup>1</sup>

Because our proposed response to the development of non-audit relationships between auditors and their audit clients has been the most vigorously debated aspect of our proposal – including in testimony before this Subcommittee – I will focus most of my remarks on that aspect of the proposal. But I would like to begin by pointing out that the bulk of our proposal is not only relatively uncontroversial, it is widely-recognized as sensible modernization in response to the changing nature of family and economic relationships. Specifically, the proposal would

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<sup>1</sup> See “Revision of the Commission’s Auditor Independence Requirements,” Release Nos. 33-7870; 34-42994; 35-27193; IC-24549; IA-1884; File No. S7-13-00 (June 30, 2000) (“Proposing Release”).

significantly loosen restrictions on the financial and investment relationships that accounting firm personnel and their families may have with the firm's audit clients without impairing the auditor's independence. The proposal similarly would ease restrictions on the employment relationships that the families of accounting firm personnel may have with the firm's audit clients. Loosening these restrictions will provide greater investment and employment opportunities to firm personnel and their families, and it will also reduce firms' administrative burdens because the restrictions will apply to fewer firm personnel.

These restrictions once made good sense, but may no longer be necessary in today's world. We propose to loosen these restrictions not because doing so will itself enhance independence, but because a fundamental precept of our approach to independence is that we not impose restrictions beyond those that are truly necessary to foster investor confidence in the independence of auditors.

Another major aspect of our proposed rule concerns disclosure. The proposal would require companies to disclose in their annual proxy statements certain information about the non-audit services provided by their auditors – information that has grown increasingly important but that is not currently available to investors. This disclosure rule would shine much-needed sunlight on the relationships between public companies and their auditors.

Clearly, the piece of our proposal that has attracted the most attention and generated the most debate concerns the scope of services that firms today provide to their audit clients. But to understand what rests at the heart of the debate, one must first appreciate the franchise that Congress granted to this nation's public accountants, the special trust that is the bedrock of this franchise, and the changes in the accounting profession since that franchise was first established.

## The Special Role of Auditors and the Duty of Independence

The federal securities laws give independent auditors a unique and vital role in our markets. A critical element of the legislative framework enacted by Congress in the 1930s was the requirement that certain financial information be certified by independent public accountants.<sup>2</sup> In mandating that public companies obtain an opinion from an independent auditor before selling their securities to the public, Congress knew it was creating a stable and potentially lucrative market for the services provided by accountants. At the same time, however, Congress imposed a duty of unqualified independence on those accountants, establishing a framework that depends on accountants' fidelity to that duty.

In the last six decades, trust in the judgment and independence of the public accountant has helped our country develop and maintain the strongest and most robust capital markets in the world. The auditor's opinion provides investors with critical assurance that financial statements have been subjected to rigorous examination by impartial and skilled professionals, and that investors can rely on the information as sound. The need for independence in the auditor's examination – both in fact and appearance – is ingrained in our thinking, and has been treated as an indisputable fundamental by the Supreme Court, which wrote:

It is therefore not enough that financial statements be accurate, the public must also perceive them as being accurate. Public faith in the reliability of a corporations' financial statements depends upon the public perception of the outside auditor as an independent professional. . . . If investors were to view the auditor as an advocate for the corporate client, the value of the audit function itself might well be lost.<sup>3</sup>

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<sup>2</sup> See, e.g., Items 25 and 26 of Schedule A to the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77aa(25) and (26); Section 17(e) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78q.

<sup>3</sup> *United States v. Arthur Young & Co.*, 465 U.S. 805, at 819 n.15 (1984) (emphasis in original).

The accounting profession's own standards recognize that "[i]ndependent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence."<sup>4</sup> In his testimony at our public hearings, Philip A. Laskawy, the Chairman of Ernst & Young, plainly stated that "the *appearance* of independence is perhaps as important as is *actual* independence."

### Changes in the Profession Raise Independence Concerns

While the general principle that auditors must be independent meets with universal agreement, consensus on what it means to be "independent" is harder to come by. In the 1930s, defining independence may have seemed a relatively simple task. Today, it is anything but simple. Dramatic changes in the accounting profession have caused increasing concern over whether both auditor independence and the appearance of independence have been eroded, and whether investor confidence in the reliability of financial statements is being undermined. By statute, it falls to the Commission to define "independence,"<sup>5</sup> and we are committed to keeping the definition relevant, effective, and fair in a fast-changing world.

Since the Commission last amended the auditor independence requirements almost eighteen years ago, the biggest accounting firms have transformed themselves into multidisciplinary professional service organizations. For example:

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<sup>4</sup> AICPA SAS No. 1, AU § 220.03.

<sup>5</sup> See Section 19(a) of the Securities Act, 15 U.S.C. § 77s(a); Section 3(b) of the Exchange Act, 15 U.S.C. § 78c(b).

- consulting and other management advisory services now represent 50 percent of the revenues of the five largest firms – up from just 13 percent in 1981;<sup>6</sup>
- U.S. revenues for management advisory services for the five largest public accounting firms amounted to more than \$15 billion in 1999;<sup>7</sup> and
- from 1993 to 1999, the average annual growth rate for revenues from management advisory and similar services has been 26%, nearly three times the comparable growth rate for audit services (9%) and double the growth rate for tax services (13%).<sup>8</sup>

While not all of the growth in non-audit services comes from providing these services to audit clients, a significant portion does. In addition, a growing number of companies now pay their auditors more money for non-audit services than for audit services.

These dramatic changes coincide with another trend about which I have often voiced concern – the increasing pressure on management to satisfy Wall Street’s earnings expectations. This pressure all too often leads to a “gamesmanship” where short-term numbers take precedence over long-term performance, a gamesmanship that may place real pressure on auditors not to rock the boat. In this environment – where, for example, tweaking the costs for obsolete inventory or product returns can make or break a company’s quarterly results and change its market capitalization by billions of dollars – the emergence and growth of incentives for auditors to be advocates for management, or to solicit management’s favor, presents particular peril.

As auditing becomes an ever-smaller portion of a firm’s business with an audit client, it becomes harder to assume that the auditor will challenge management when he or she should,

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<sup>6</sup> See Proposing Release, Appendix B, Tables 1 and 2. The underlying data in these tables are reported in “Special Supplement: Annual Survey of National Accounting Firms – 2000,” *Public Accounting Report* (Mar. 31, 2000).

<sup>7</sup> See Proposing Release, Appendix B, Table 1.

<sup>8</sup> See *id.*

if to do so might jeopardize a lucrative consulting contract for the auditor's firm. Similarly, when an auditor's compensation is tied to his or her ability to cross-sell the firm's non-audit services to the audit client, the auditor has a direct economic incentive to avoid friction with management. Moreover, by providing consulting services to an audit client, a firm puts itself in the position of simultaneously serving two masters – as a consultant serving management, and as an auditor serving the public.<sup>9</sup> In addition, certain services by their very nature raise independence issues. If, for example, an auditor is hired by an audit client to value an asset, to establish the amount of a reserve for an insurance company, or to prepare the accounting records, when the time comes for the same auditor to examine the financial statements, the auditor now must review his or her own work. In any of these situations, the auditor cannot, in any meaningful sense, be considered to be independent of the client.

For these reasons, the changes in the accounting industry demand a renewed focus on the ongoing and difficult questions surrounding independence – questions that have been studied and discussed for years. Our proposing release cites Commission, industry, academic, and congressional reports that wrestle with these issues and express growing concern over the conflict created by the provision of non-audit services to audit clients. Among other things, these studies point to the damaging effect that such a conflict can have on investor confidence – a concern made even more concrete by the testimony of many witnesses at our hearings, including John H. Biggs, Chairman, President and CEO of TIAA-CREF, and Kayla J. Gillan, General Counsel of the California Public Employees' Retirement System.

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<sup>9</sup> As stated in written testimony by Bevis Longstreth, former SEC Commissioner and a member of the Panel on Audit Effectiveness (more commonly known as the "O'Malley Panel"), "It is obvious, and a matter of common experience, that in serving these different clients the firm will be regularly subject to conflicts of interest."



While committee after committee and panel after panel have struggled with these issues, no recommendations to date have been implemented. Most recently, the O'Malley Panel was divided on the issue of non-audit services. In the face, then, of more than twenty years of deadlock and inaction, it necessarily falls to the Commission to fulfill its statutory mandate and take definitive action. Though some have called for us to look to the Independence Standards Board ("ISB") to address these questions, the four public members of the ISB have asked the Commission to address these issues with a rulemaking. The Chairman of the ISB, William T. Allen, testified that making a rule on this subject "is not well-suited for a board of our character. It's really a public policy choice that the government needs to make." The former chairman and CEO of Deloitte & Touche, J. Michael Cook also testified at our public hearings and echoed that view, saying, "Some action by the SEC is probably the only practical and feasible way to deal with the issue." James J. Schiro, the CEO of PricewaterhouseCoopers, testified that "the time for action is at hand."

### **The Commission's Proposal Is A Measured Response**

Our proposal starts from the premise that investor confidence in auditor independence turns on whether auditors are independent both in fact and in appearance. The proposal articulates four principles that would govern whether an accountant is determined to be independent of an audit client. Specifically, an accountant's independence would be called into question if the accountant: (i) has a mutual or conflicting interest with the audit client; (ii) audits the accountant's own work; (iii) functions as management or an employee of the audit client; or

(iv) acts as an advocate for the audit client.<sup>10</sup> The “scope of services” portion of the proposal identifies certain services which, in light of these principles, would impair an accountant’s independence if provided to an audit client.

I emphasize three points about our scope of services proposal. First, our proposal would restrict an accounting firm only with respect to non-audit services provided to clients whose publicly-filed financial statements are audited by the accounting firm. This means that a very significant portion of accounting firms’ non-audit business would not be affected by our proposal at all. Second, most of the non-audit services addressed in our proposal are already proscribed by the AICPA or the Commission, or are the subject of restrictions proposed by the ISB. Only two of the ten services identified in the proposal – internal audit services and information technology services – are not already the subject of restrictions.

Third, our proposal would allow accounting firms to continue to provide many non-audit services to their public company audit clients. Some, including Mr. Biggs of TIAA-CREF and some members of the O’Malley Panel, have advocated a ban on providing any non-audit services to audit clients. We have not, however, proposed a blanket restriction because we do not believe that all non-audit services pose the same risk to independence.

This Committee has heard from witnesses who criticize the proposed provisions concerning non-audit services. Some say that we are attempting to fix something that isn’t broken – or at least to fix something that we can’t prove is broken. They ask us to point to conclusive empirical evidence that a non-audit service relationship has ever tainted an auditor’s

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<sup>10</sup> These principles are articulated at the outset of the proposed rule and would govern not only non-audit services but all independence issues, including the financial and employment relationships discussed earlier. The principles are currently articulated in the Codification of Financial Reporting Policies at §§ 601.01, 601.04, 602.02.c.i, 602.02.d, and 602.02.e.i and ii. The fourth principle is also recognized in *United States v. Arthur Young & Co.*, *supra* note 3, at 819 n. 15.

work in any way that resulted in a materially deficient audit. The CEO of one of the major accounting firms has even been quoted as suggesting that we should not propose these restrictions on non-audit services unless and until there has been, in his words, “a train wreck or a stockmarket crash.”<sup>11</sup>

But to criticize our proposal on this basis oversimplifies the issues in a way that the Commission does not have the luxury of doing. As the Public Oversight Board has recognized, and the O’Malley Panel recently reiterated, “specific evidence of loss of independence through [management advisory services], a so-called smoking gun, is not likely to be available even if there is such a loss.”<sup>12</sup> In testimony supporting our proposal to restrict internal audit outsourcing, the Comptroller of the Currency, John D. Hawke, pointed out that independence matters are “extremely subtle,” and that it is “difficult to show actual impairment of independence.” Similarly, in his testimony supporting our proposal, Paul A. Volcker, the former Chairman of the Federal Reserve Board, noted the real threat posed by the “insidious, hard-to-pin down, not clearly articulated or even consciously realized, influences on audit practices” that flow from non-audit relationships with audit clients. Robert M. Morgenthau, the District Attorney for the County of New York, also supporting our proposal, voiced a similar view based on his thirty-three years of law enforcement experience and several cases involving unlawful and questionable conduct by auditors: “in most cases, it was impossible to tell whether financial considerations played a role in the auditor’s issuing the opinion he did.”

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<sup>11</sup> “The Ties That Bind Auditors,” *The Economist* (Aug. 12, 2000) at 63 (quoting James Copeland, CEO of Deloitte & Touche).

<sup>12</sup> POB, *Scope of Services by CPA Firms* (March 1979), at 34 n. 103. See also *The Panel on Audit Effectiveness, Report and Recommendations* (August 31, 2000), at 110.

What we can and do know is that certain types of non-audit relationships create palpable economic incentives for the accounting firm. When that firm turns to audit that same client, there is an unmistakable risk that some judgments may not be entirely disinterested. The extent to which the decent and hardworking men and women in the accounting profession can consistently rise above these influences is hard, if not impossible, to measure. But we do know for certain that no one has repealed the basic laws of human nature: where the economic incentive to make close calls in favor of management has been vastly increased, elementary economics tells us that more people will inevitably follow this course. The question for us is, are we to tell investors that they will simply have to live with this enhanced risk. The wiser course – as well as the statutorily required course – is to do what we can to reduce pragmatically the risk.

We must not be lulled into waiting for the “train wreck” before we act. Knowing how complex these issues are, how fine the judgments involved in drawing the line in the right place, we are very concerned about what might happen tomorrow if we fail to thwart the erosion of independence with a carefully calibrated rule today. Testifying in support of our proposal, Richard Blumenthal, the Attorney General of Connecticut, described his experience on a case in which he believed that a significant audit failure was tied to non-audit relationships. Mr. Blumenthal is hardly alone in his perception of a link between certain audit failures and non-audit relationships.<sup>13</sup> If we fail to take reasonable steps now to stave off future cases giving rise to that perception, the day will surely come when we all will face substantial pressure to craft a rule much more far-reaching than our current proposal. Measured action now can go a long way toward preventing a later groundswell for unwise over-regulation.

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<sup>13</sup> Other witnesses testified to similar observations. These witnesses include Charles R. Drott, CPA and Certified Fraud Examiner, and Stuart M. Grant, director of a law firm that primarily represents institutional investors.

Our proposal also has been criticized for failing to value properly the ways in which audits are enhanced by the knowledge an auditor gains about his or her client by providing various other services. The fact is, the vast majority of public companies do not purchase any non-audit services from their auditors. In the most recent year for which data are available, approximately 75% of the public company clients of the Big 5 accounting firms, and 80% of the public company clients of other firms, received no non-audit services from their auditor. In all, the financial statements of more than 12,000 public companies were audited by firms who provided no non-audit services to the company. We do not believe that anyone would argue that the audits those companies received were somehow inadequate because those companies did not receive non-audit services from their auditors. Speaking to this point in his testimony before us, Ernst & Young's Chairman, Mr. Laskawy, reflecting on Ernst & Young's recent sale of its consulting practice, stated,

[N]ow that we have sold this practice, we have not discovered that we are somehow enfeebled, unable to perform effective audits or to maintain a top-notch audit and tax practice. In fact, we have found the opposite to be true: without a large consulting practice to manage, we are now more targeted and more focused on our core audit and tax business.

Others, such as PricewaterhouseCoopers' CEO, Mr. Schiro, and Andersen Consulting's General Counsel, Douglas Scrivner, supplied testimony that addressed the question of whether proposed restrictions on providing information technology services to audit clients would impair the audits of those clients. Mr. Schiro stated, "The notion that we will not be able to conduct quality audits without an IT consulting practice is simply wrong." Mr. Scrivner, speaking of information systems design and other services, testified that "in our experience there is no meaningful cross-over of personnel between the audit divisions and these other business consulting functions."

It may be that, in some circumstances, certain services do result in a familiarity with the client that produces audits that seem smoother and more efficient. Our proposal takes this into account and is a principal reason for our trying to draw the line to restrict no more services than necessary. But when the asserted efficiency flows from the fact that the auditor spends less time reviewing systems and substance that the auditor had a hand in generating, then the term “efficiency” is really just shorthand for “shortcut,” and important data may get reported without a genuinely independent review.

We must not dilute the meaning and value of independence by coming at these issues backwards. That is, we should not identify practices that seem to provide desirable efficiencies and then strain to persuade ourselves that those practices are consistent with the independence framework that has served us so well. We need to ask ourselves honestly whether a practice compromises independence and investor confidence, and then act accordingly. Laurence H. Meyer, a Governor of the Federal Reserve Board, put it plainly in supporting our proposed restriction on internal audit outsourcing: “auditor independence is more valuable than these asserted efficiencies.”

We must bring this same perspective to bear on the suggestion that the proposed rule will exacerbate difficulties in recruiting and retaining highly qualified young professionals. Competition for the brightest young talent is intense in all sectors of the economy today. That’s one consequence of our prosperity. But we should not overlook the extent to which the challenge of recruiting auditors is a result of the firms’ own business decisions effectively de-emphasizing the value of the audit business. The O’Malley Panel, for example, found that the leaders of the largest accounting firms “treat the audit negatively – like a commodity.” Mr. Scrivner, of Andersen Consulting, testified at our hearings that “some of the firms have diverted

investment and resources out of the audit function and into non-audit services, thereby reducing the attractiveness of the audit function as a career path.”

The history of our economic system surely teaches us that where a substantial and persistent demand for a service exists, competition will produce persons and institutions who supply the service with great skill. In today’s world, accounting firms – like many other businesses – may need to find new ways to attract the talent that they want. From a business perspective, we might sympathize with the challenge they face. But as public servants entrusted to preserve and foster confidence in the integrity of our financial markets, we cannot view this business challenge as a reason for cutting corners on auditor independence.

I know that you have heard a more general criticism that our proposal reflects adherence to an outdated regulatory model that will thwart progress in the New Economy. I could not disagree more strongly. Indeed, what is truly outdated – outdated by some seventy years – is the notion that any good can come from winking at independence requirements that are seen as inconvenient. Anyone who tries to sell that notion is not promoting progress but is inviting us to slip back in time to a day before our present securities laws, when investors could only cross their fingers and hope that reported financial data was reasonably accurate and untainted by self-interest. Even the most modern, technologically advanced financial reporting system is no substitute for an independent audit of the financial information that the system reports.

Our financial markets are the strongest and most stable in the world. But they didn’t get that way by luck, and they didn’t get that way by accident. They got that way because of the dynamism and ingenuity of the private sector and, just as importantly, because of dogged insistence on fidelity to certain bedrock principles – insistence by the Congress and insistence by

he Commission. Genuinely independent auditing is one of those bedrock principles. We must never give it short shrift purportedly in the name of progress.

### The Likely Economic Effect of the Proposed Rule

You have asked that I address the likely economic effect of the proposed rule on accounting firms, businesses, consumers, and the economy in general. I hope that my remarks up to this point have made clear that the most significant economic effect – at least for businesses, consumers, and the economy generally – lies in the economic activity that is encouraged by confidence that the \$16 trillion stock market value of U.S. companies is based on sound and transparent financial reporting.

We also anticipate significant benefits from our proposed easing of restrictions on investment and employment opportunities available to auditors and their family members. The benefits to those persons themselves will be immediate and direct. Accounting firms will benefit from the reduced administrative burden.

The disclosure aspect of our proposal would provide benefits for all investors. The proposed disclosure regarding non-audit services provided by auditors to audit clients would give investors important insight into the relationship between a company and its auditor.<sup>14</sup> This information may help shareholders decide, among other things, how to vote their proxies in selecting or ratifying management's selection of an auditor.

Our proposal will clearly have other economic effects. In 1999, approximately 4,100 public companies – or 25% of all public companies – purchased non-audit services from their auditors. Under our proposal, those companies could continue to receive many of those services

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<sup>14</sup> A recent poll commissioned by the AICPA found that 89% of investors agreed that "it would be important for shareholders to know if a company's auditor also provides consulting services to that company." Penn, Schoen & Berland Associates, National Investor Survey (Sept. 12, 2000), at 15.



from their auditors. As to certain services, however, our proposal would require that the company either end its audit relationship with that firm or obtain the non-audit services from someone else. We anticipate that those public companies that must sever one of those relationships will incur initial costs associated with developing a relationship with a new auditor or service provider.

Under our proposal, some accounting firms would no longer be able to provide certain services to their public company clients. We cannot predict the extent to which any particular firm will compensate for that revenue loss by gaining new clients; however, every company that stops receiving a non-audit service from its auditor would be a potential new client for everyone else who provides that service, including other audit firms. Accounting firms that can successfully compete to provide those services to non-audit clients would continue to provide those services and hone skills that they could also draw upon in performing audits for their audit clients. In the broadest terms, the proposal can be expected to create more competition and opportunities to provide non-audit services. James Wadia, the former CEO of Arthur Andersen LLP, has been quoted as saying that if the rule is adopted, "it's going to be a merry-go-round. . . . We'll swap markets."<sup>15</sup>

In considering the benefits of the proposal, our approach has been to view audit failures as imposing a meaningful cost, and the prevention of audit failures as constituting a meaningful economic benefit. We recognize that there are those who would downplay the economic impact of an audit failure by arguing that even when a company's stock price falls dramatically after a restatement, there is no net loss to market participants; that is, every investor loss is offset by a corresponding investor gain. In our view, however, that approach completely fails to

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<sup>15</sup> "Breakup of Andersen Firm Approved," *The Washington Post* (August 8, 2000) p. E3.

comprehend the very real loss suffered by individual investors who have relied on the financial data certified by an ostensibly independent auditor. In recent years, countless investors have suffered significant losses as market capitalizations have dropped by billions of dollars due to restatements of audited financial statements. We cannot soften that blow by reminding those investors that the market suffered no net loss, and that their wealth has merely been redistributed.

We anticipate that our proposal would have little, if any, impact on smaller accounting firms. Most smaller firms do relatively little auditing of financial statements of public companies. When smaller firms do have public company audit clients, they generally do not also provide those clients with non-audit services. In 1999, accounting firms with fewer than 1,000 SEC registrants as audit clients earned less than 1% of their total fees from providing management consulting services to those clients. And while some critics of our proposal have expressed concern that states, attempting to follow our lead, will apply similar restrictions to smaller firms who do not audit SEC registrants, we fully expect that the states will exercise independent thought and judgment when considering whether to apply similar restrictions outside the public company context. Our regulatory scheme regarding non-audit services provided to public companies has co-existed with substantively different AICPA regulation regarding non-audit services provided to non-public companies, and can continue to do so.

We continue to consider the costs and benefits of our proposal, and we have specifically asked the largest accounting firms to provide us with certain data that could further inform our analysis. In addition to our own analysis, we will not adopt a final rule without carefully considering the comments that we have received concerning various costs and benefits.

## The Commission Has Had a Thorough and Open Debate

I would like to conclude by addressing some remarks to our process in this rulemaking, which has been as thorough as any I have seen in my tenure as Chairman. The independence issues related to non-audit services have been debated and studied for years. We did not intend for our proposal to end that debate, but we did intend to focus and facilitate the debate and help move it toward a long overdue resolution.

We have made very serious efforts to understand everyone's views. In the year leading up to the proposal, the Commission's staff had frequent discussions with many in the profession to try to identify advantages and disadvantages to different approaches to a rule. Once we issued the proposal, we established a longer comment period than for the great majority of the Commission's rulemakings over the past year, and we supplemented the written comment process by taking the extraordinary step of holding four days of public hearings. At those hearings, we heard support, we heard concerns, we heard ideas, and we heard opposition. In all, we heard from, and had dialogue with, more than 100 witnesses, including investors, investment professionals, public companies, the Big 5 accounting firms, smaller accounting firms, the AICPA, banking regulators, consumer advocates, state accounting board officials, academics, the Independence Standards Board, and others. We have also received more than 1,000 comment letters.

Thanks to thoughtful and constructive public input, we see ways to revise the proposed rule to avoid unintended consequences and to address other legitimate concerns. I anticipate that we will make changes that address at least some of the concerns of even the most ardent critics of the proposal. And while the final rule may not please everyone, it will be the result of a broad dialogue and a thoughtful process.

## Conclusion

We all face significant challenges in our efforts to ensure that our markets remain vital and keep pace with the changing nature of the economy. The Commission has been at the forefront in addressing these challenges head-on, working to adapt regulatory models for an ever-changing economy. In all of these efforts, we give high priority to fostering investor confidence. That confidence is not a commodity that can be mandated or purchased. Its vitality or erosion is a function of beliefs and convictions, determined by perceptions and experience. Robust confidence makes good markets possible; wavering confidence makes markets anemic or worse.

The concept of the “independent auditor” has been a critical source of investor confidence. I hope and believe that it will continue to foster that confidence. But for that to happen, investors must be able to know that an audit is not an accountant’s means to some other goal, and is not subordinate to some other relationship, but is an end in itself – a service provided by a disinterested professional for the benefit of the public.

Thank you.