

REPORT TO CONGRESS AND THE GENERAL
ACCOUNTING OFFICE ON A MAJOR RULE
PURSUANT TO 5 U.S.C. §801

November 21, 2000

1. Rule promulgated by the Securities and Exchange Commission, and copy of the rule.

On November 15, 2000, the Securities and Exchange Commission adopted rule amendments under the Securities Act of 1933 ("Securities Act"), the Securities Exchange Act of 1934 ("Exchange Act"), The Public Utility Holding Company Act of 1935, the Investment Company Act of 1940 ("Investment Company Act"), and the Investment Advisers Act of 1940 that modify the Commission's requirements for auditor independence. This rule is hereby submitted to each House of Congress and the General Accounting Office pursuant to 5 U.S.C. §801. A copy of the Securities and Exchange Commission Release No. 33-7919, which contains the rule, is attached at Exhibit A.

2. Concise general statement of the rule.

We are adopting amendments to our current rules regarding auditor independence. The amendments advance our important policy goal of protecting the millions of people who invest their savings in our securities markets in reliance on financial statements that are prepared by public companies and other issuers and that, as required by Congress, are audited by independent accountants. The release has three basic components: 1) financial and employment relationships of auditors with audit clients, 2) the scope of non-audit services that auditors may provide to audit clients, and 3) disclosure in proxy statements of certain information concerning audit and non-audit services provided by an accountant to an audit client. The amendments identify certain relationships that render an accountant not independent of an audit client under the standard in Rule 2-01(b) of SEC Regulation S-X. The relationships addressed include, among others, financial, employment, and business relationships between auditors and audit clients, and relationships between auditors and audit clients where the auditors provide certain non-audit services to their audit clients.

3. The rule is a major rule.

The Office of Management and Budget ("OMB") has determined the rule to be a major rule. The Small Business Regulatory Enforcement Fairness Act of 1996 defines a major rule as any rule that the OMB determines is likely to result in (1) an annual effect on the economy of \$100 million or more, (2) a major increase in costs or prices for consumers or individual industries, or (3) significant adverse effects on competition, investment or innovation.

This rule is likely to have an annual effect on the economy of \$100 million or more. The rule promotes investor confidence in the reliability and integrity of financial statements. If an increase in investor confidence generated by this rule leads to a decrease in the required rate of return, we can estimate the benefits based on the current market capitalization. For example, a decrease in the cost of capital as small as a single basis point (or one one-hundredth of one percent) would lead to an aggregate annualized impact of approximately \$2 billion. Although increased confidence should benefit the entire market, even if we measure the impact based upon the estimated 25% of companies most directly affected by the rule, a one basis point reduction in the required rate of return would result in an annual benefit of approximately \$500 million.

The provision governing the scope of non-audit services that an auditor may provide to an audit client may affect the revenue of individual accounting firms. We estimate that this provision may affect how approximately \$251.3 million is distributed among accounting firms and others providing similar non-audit services. This figure does not, however, represent a cost to the economy. Rather, we expect that this revenue will, as a result of the rule, be redistributed among accounting firms and other providers of consulting services.

The rule may also impose some costs on the economy. Public accounting firms and their employees will require some time to familiarize themselves with and understand the new rules governing employment and financial relationships. Accounting firms and issuers of securities may incur some transition costs because some issuers may have to terminate existing relationships with providers of consulting services and commence new relationships with other such providers. In addition, some commenters suggested that the rule would affect what some contend are synergies (or "knowledge spillovers") that arise from providing non-audit services to an audit client. If they exist, spillovers could provide issuers with a more efficient audit or provide the auditor with additional knowledge that will enhance not only the concurrent audit, but other audits as well. Research on such synergies is indirect and inconclusive. The rule requires companies to disclose certain limited information in their proxy statements.

We do not believe the rule imposes any major cost increase, nor do we believe that the rule will have a significantly adverse effect on competition, investment or innovation. We believe that the rule will bolster investor confidence in the integrity of financial reporting. This, in turn, may lead to increased investment. By enhancing confidence and investment in the markets, these rules may increase liquidity, promote capital formation, and help to reduce the costs of capital. We also expect the rule to promote competition between both auditors and providers of certain consulting services. We expect that the rule will increase competition by reducing any competitive advantage the auditor has in bidding on or otherwise obtaining non-audit work from an audit client. In addition, more firms will be able to compete for the services currently provided by the company's auditor.

4. Proposed effective date.

The rules will become effective sixty days after their publication in the Federal Register, although we are providing a transition period for certain parts of the rules.

5. Cost/Benefit analysis.

The Commission considers generally the costs and benefits of its rules. Section 2(b) of the Securities Act, Section 3(f) of the Exchange Act and Section 2(e) of the Investment Company Act expressly require the Commission to consider whether an action will promote efficiency, competition, and capital formation. In addition, pursuant to Section 23(a) of the Exchange Act, the Commission is directed to consider, among other matters, the impact any rule would have on competition. These matters are discussed at greater length in Sections V and VIII of the Release that is attached at Tab A.

6. Regulatory Flexibility Act.

The Commission prepared an Initial Regulatory Flexibility Analysis ("IRFA") when the rules were proposed. The IRFA was included in the Commission's Proposing Release, which was published in the Federal Register on July 12, 2000. In addition, the Secretary of the Commission sent a copy of the IRFA to the Chief Counsel for Advocacy of the Small Business Administration. The Commission also prepared a Final Regulatory Flexibility Analysis ("FRFA"), which is attached at Tab B.

The FRFA notes that the amendments to the Commission's auditor independence requirements will not have a significant 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 Procedures Act and the Paperwork Reduction Act have been satisfied. 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 this rulemaking.

Tab A: Release No. 33-7919

Tab B: Final Regulatory Flexibility Analysis