

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

January 28, 2003

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

The Securities and Exchange Commission approved rules to strengthen the Commission's requirements regarding auditor independence to implement the relevant provisions of the Sarbanes-Oxley Act of 2002, which are hereby submitted to each House of Congress and to the Government Accounting Office pursuant to 5 U.S.C. §801. A copy of the rules and the adopting release, Securities and Exchange Commission Release No. 33-8183, are attached as Exhibit A.

2. *Concise general statement of the rule.*

The rules:

- Revise the Commission's regulations related to the non-audit services that will impair an accounting firm's independence;
- Require that an audit committee pre-approve all audit and non-audit services provided by the auditor;
- Prohibit certain partners on the audit engagement team from providing audit services for more than five or seven consecutive years, depending on the partner's involvement in the audit (except that certain small accounting firms are provided an alternative from this requirement);
- Prohibit an accounting firm from auditing financial statements if certain members of management had been members of the accounting firm's audit engagement team within the one-year period preceding the commencement of audit procedures;
- Require that the auditor report certain matters to the issuer's audit committee;
- Require disclosures to investors about the audit and non-audit services provided by, and fees paid to, the auditor; and
- Provide that an accountant is not independent from an audit client if an audit partner received compensation based on selling services to that client other than for audit, review or attest services (except that certain small accounting firms are exempted from this requirement).

3. *The rules are major rules.*

The Office of Management and Budget ("OMB") has determined that the rule amendments are major rules. Major rules are defined as rules that the OMB determines have resulted in: (i) an

annual effect on the economy of \$100,000,000 or more; (ii) a major increase in costs or prices for consumers or individual industries; or (iii) significant adverse effects on competition, investment or innovation.

### Annual Effect on the Economy

The final rules may have at least a \$100 million annual effect on the economy. These rules may impose costs on issuers that engage, or would like to consider engaging, their auditor to perform non-audit services. Issuers may incur costs from having to use a separate vendor for certain services, which could result in the possible loss of synergistic benefits of using one provider for both audit and non-audit services. Accounting firms may lose one or more sources of revenue because they will no longer be able to sell certain non-audit services to their audit clients. The new requirement that an audit committee pre-approve all audit and non-audit services to be provided by the auditor may increase an issuer's cost to maintain an audit committee. There may be increased costs as a result of more frequent audit committee meetings, increased workload on members, and the need to hire counsel to review the audit committee's policies and procedures for engaging auditors for non-audit services. The final rules requiring partner rotation may increase training, travel, and relocation costs for accounting firms, which may be passed on to issuers in the form of higher audit fees. Many of these costs are difficult to quantify and we did not receive any specific estimate of costs from commenters.

### Major Increase in Costs and Prices

The final rules are not likely to cause a major increase in costs and prices for consumers, but they may for auditors and their public company clients. One commenter indicated the rules would not result in an increased cost to companies while another commenter stated that non-national companies would be able to absorb the costs necessary to comply with the final rules. Several commenters expressed concern for small accounting firms and small companies. One commenter indicated that rotation of partners would possibly double the audit costs to small mutual funds. We modified the final rule to mitigate these concerns by creating an alternative and exemption for certain small accounting firms. Despite this modification, the costs of many accounting services may increase as a result of these rules.

### Significant Adverse Effects on Competition or Investment

The final rules may effect competition. Several commenters noted that small accounting firms would be unable to meet the partner rotation requirements and may be driven out of business of auditing public companies. This could affect smaller companies by limiting their ability to retain auditors and access the capital markets. The final rules have been revised to provide an alternative from the partner rotation requirements and an exemption from the compensation requirements for certain small accounting firms in an effort to address these concerns. We note that the accounting industry on a whole may become more competitive as a result of these rules. Since accounting firms will now be limited in providing certain non-audit services to their audit clients, there may be greater competition among firms as companies attempt to find alternate providers for non-audit services.

4. *Proposed effective date.*

The rule amendments will become effective 90 days after publication in the Federal Register. The Commission, however, has delayed the need to comply with several of the rules in order to provide for an efficient transition to the new rules. These provisions are set forth in the adopting release under the caption "DATES."

5. *Cost/Benefit analysis.*

The Commission considers generally the costs and benefits of its Rules. Section 3(f) of The Exchange Act expressly requires 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. The Commission may not adopt a rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. As discussed in Section 3, above, the Commission does not believe that the rules will have any adverse effect on competition.

6. *Regulatory Flexibility Act.*

The Commission prepared an Initial Regulatory Flexibility Analysis ("IRFA") when the rule amendments were proposed, which was included in the Commission's proposing release and published in the Federal Register on December 13, 2002. The Commission also prepared a Final Regulatory Flexibility Analysis ("FRFA"), which is in Part VI of the adopting release.

We recognize that some of the proposed rules may have imposed a burden on certain smaller firms and/or smaller businesses. Accordingly, we have provided that firms with fewer than five audit clients and fewer than ten partners may be exempted from the partner rotation and compensation provisions. Firms that use this exemption, however, must submit each of these engagements to a special review of the Public Company Accounting Oversight Board at least once every three years.

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 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.

Exhibit:

A - Release No. 33-8183