8 2-8

U.S. Securities and Exchange Commission

Office of Public Affairs

Briefing Paper: Relationships Between Registrants and Independent Accountants

[This summary has been prepared to assist persons attending the open Commission meeting scheduled for January 28, 1982, at which time the draft release will be considered. Users of the summary should be aware that it is neither exhaustive nor definitive and that the Commission may determine to make changes in the recommendation described herein.]

The Commission will consider whether to rescind Item 8(g) of the proxy rules requiring disclosure in proxy statements about nonaudit services performed by independent accountants for their audit clients. In addition, the Commission may consider the recommendations of some commentators and a petition sent to the Commission that it reinstate Accounting Series Release No. 264 ("ASR 264") (June 14, 1979) and hold hearings on or sponsor an investigation of the nonaudit service activity of independent accountants.

Last year, the Commission issued Accounting Series Release No. 296 ("ASR 296") (August 20, 1981) in which it proposed to rescind Item 8(g) of the proxy rules. Item 8(g) requires a registrant to (1) describe nonaudit services provided by the independent accountant during the most recent fiscal year; (2) state certain percentage relationships that the fees for the nonaudit services bear to the audit fee; and (3) state whether the audit or similar committee or board of directors approved in advance each service provided by the independent accountant and considered the possible effect of the performance of each such service on the independence of the accountant. In ASR 296, the Commission reiterated its views as to the critical importance of accountants' independence and on the continuing need for registrants and accountants to carefully evaluate their

relationships to ensure that public confidence in the integrity of financial reporting is maintained. Although the Commission stated that specific information about nonaudit services is important, it proposed rescission of the disclosure rule because it thought that the required disclosure might not be of sufficient utility to investors to justify continuation of the disclosure requirement. It also stated that the self-regulatory mechanism established by the accounting profession should be able to generate sufficient information to enable the Commission, the accounting profession and other interested users to monitor the services performed by accountants.

Shortly after the issuance of ASR 296, the SEC Practice Section of the Division for Firms of the American Institute of Certified Public Accountants revised its membership requirements. Accounting firms that are members of the Section will be required to report in annual reports filed with the Section for years ending on or after January 1, 1982 additional aggregate information about the management advisory services they provide to clients that file with the Commission. They will report the number of such clients from which they receive fees for management advisory services that, when expressed as a percentage of the audit fees for such clients, are in the ranges of 1 to 25%, 26 to 50%, 51 to 100% and over 100%, and will provide certain additional information about the clients in the over 100% category.

Over 140 letters of comment were received on this proposal. A substantial majority of the commentators expressed support for the rescission of Item 8(g).

The staff has recommended that the Commission rescind Item 8(g) for the reasons set forth in ASR 296. In addition, it believes that appropriate information about nonaudit services performed by accountants will continue to be available to interested persons because of the SEC Practice Section's recent action.

In ASR 296, the Commission also explained its withdrawal of ASR 264. ASR 264 discussed factors relevant to an evaluation of the impact on auditor independence of the performance of nonaudit services. The Commission stated that it was withdrawing that release "because it may confuse independent accountants, audit committees and others who are trying to evaluate services performed or to be performed by independent accountants" and because it "believes it has achieved its objective in issuing ASR 264." It stated:

> Accountants and their self-regulatory structure, audit committees, boards of directors and managements are aware of the Commission's views on accountant's independence and should be sensitive to the possible impact on independence of nonaudit services performed by accountants. The Commission believes it should be able to rely on these persons to ensure adequate consideration of the impact on accountants' independence of nonaudit services because they share the responsibility to assure that the public maintains confidence in the independence of accounts.

Opponents to the proposal to rescind Item 8(g) also expressed concern about the withdrawal of ASR 264 because of their views that accountants who perform certain services for their audit clients cannot be independent and have an unfair advantage over their competitors. Some of these commentators urged the Commission to reinstate that release, hold hearings on or sponsor

an investigation of the nonaudit service activity of independent accountants, or prohibit accountants from performing certain services.

The staff is recommending that the Commission state in the release announcing rescission of Item 8(g) that it has rejected those recommendations. The staff believes that the Commission's views on accountants' independence are articulated in ASR 296 and registrants understand and appreciate that accountants' independence must be carefully evaluated and preserved.