

specialists retained by counsel for the issuer) and attorneys, securities professionals, or other advisers who, for example, pressure an auditor to limit the scope of the audit, to issue an unqualified report on the financial statements when such a report would be unwarranted,²⁵ to not object to an inappropriate accounting treatment, or not to withdraw an issued audit report on the issuer's financial statements. In the case of a registered investment company, persons acting under the direction of officers and directors of the investment company may include, among others, officers, directors, and employees of the investment company's investment adviser, sponsor, depositor, administrator, principal underwriter, custodian, transfer agent, or other service providers.²⁶

Commenters on this discussion in the proposing release were divided. Some believe that some form of specific instruction or direction from an officer or director should be required before the rule should apply to "other persons."²⁷ Others expressed the opposite view that no specific direction should be required,²⁸ that the conduct should be considered illegal whether or not the person was acting under the direction of an officer or director,²⁹ and that the rule should apply to anyone who lies to or misleads the auditor³⁰ and to all those who have responsibilities or activities relevant to the financial statements.³¹ Still others suggested that we neither define the term "under the direction" nor provide examples.³² As noted

above, we continue to believe that "direction" encompasses a broader category of behavior than supervision, and may include the activities of third parties who participate in an effort to improperly influence the auditor when those third parties knew or should have known that the effect of their conduct would be to render an issuer's financial statements materially misleading.

Some commenters were concerned that including customers, vendors and creditors in the discussion of those persons who, in appropriate circumstances, might be considered to be acting under the direction of an officer or director would have a chilling effect on communications between those persons and the auditors.³³ Other commenters noted that this chilling effect would be enhanced by the Commission's position in the proposing release that negligently misleading the auditor was sufficient conduct to trigger application of the rule.³⁴ In particular, some commenters noted that a misleading legal analysis should violate the rule only if accompanied by fraudulent or "bad" intent on the part of the attorney providing the analysis.³⁵ These comments would appear to be based on the premise that in the past the Commission has not addressed the negligent communication of misleading information to auditors and that the new rule, therefore, would chill communications during the audit process and thereby lower the quality of the audit process. To the contrary, for many years we have initiated enforcement actions against those who, by negligently providing misleading confirmations to auditors, cause³⁶ an

issuer to violate the financial reporting or books and records provisions of the Securities Exchange Act of 1934.³⁷ The new rule, by providing an additional means of addressing such conduct, should provide more credibility and integrity to the audit process. We believe that third parties providing information or analyses to an auditor should exercise reasonable attention and care in those communications.³⁸ A primary purpose for enactment of the Sarbanes-Oxley Act is the restoration of investor confidence in the integrity of financial reports, which will require the cooperation of all parties involved in the audit process. We do not intend to hold any party accountable for honest and reasonable mistakes or to sanction those who actively debate accounting or auditing issues. We do believe, however, that those third parties who, under the direction of an issuer's officers or directors, mislead or otherwise improperly influence auditors when they know or should know that their conduct could result in investors being provided with misleading financial statements or a misleading audit report, should be subject to sanction by the Commission.³⁹

respect to whether its conduct would contribute to PORTA's violations, Peat Marwick is liable under Section 21C(a) as a cause of those violations."

³⁷ See, e.g., *In the Matter of Donald F. Marcus and In the Matter of Harry P. Adler*, AAER 1715 (February 10, 2003); *SEC v. John F. Mortell, et al.*, AAER 1569 (June 5, 2002); *In the Matter of Ronald G. Davies*, AAER 1281 (June 29, 2000); and *In the Matter of Terry R. Kuntz and Richard J. Scheer*, AAER 720 (September 26, 1995), which states, in part,

Kuntz and Scheer knew or should have known that their conduct contributed to the fraudulent activities of Assix management. The September 13, 1991 letter supplied by Kuntz, coupled with the invoices provided by Scheer, assisted Assix in filing a materially false and misleading Annual Report and Quarterly Report with the Commission * * *.

Accordingly, Kuntz's conduct in providing the September 13, 1991 letter and Scheer's conduct in providing the invoices to the company caused Assix to violate Sections 10(b), 13(a) and 13(b) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13 and 13b2-2 thereunder. By falsifying these documents, Kuntz and Scheer also caused Assix's violation of Rule 13b2-1 and Section 13(b)(2)(A). Further, Kuntz and Scheer also caused Assix's controller to violate 13b2-2 by providing materially false and misleading documents which were used by Assix's auditors * * *.

In this instance, Kuntz and Scheer subverted the audit process by creating false documents which assisted Assix in filing materially false and misleading statements, recording false revenue, and lying to its auditors. The Commission will not tolerate conduct by third party vendors such as that described herein, which poses a very real threat to the integrity of the disclosure process.

³⁸ *Id.*

³⁹ See, e.g., *In the Matter of Terry R. Kuntz and Richard J. Scheer*, AAER 720 (September 26, 1995), which states, in part, "The Commission will not tolerate conduct by third party vendors * * *, which poses a very real threat to the integrity of the disclosure process."

²⁵ An "unqualified opinion" [or unqualified report] states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles." AICPA, Statement on Auditing Standards No. ("SAS") 58, "Reports on Audited Financial Statements," ¶ 10; Codification of Statements on Auditing Standards ("AU") § 508.10.

²⁶ Some of these individuals also would be covered under provisions of the rule tailored to investment companies. See section II.C. of this release, *Issues Related to Investment Companies*.

²⁷ See, e.g., letters from Sidley Austin Brown & Wood dated December 30, 2002, BDO Seidman LLP dated November 25, 2002, Plains All American Pipeline L.P. dated November 25, 2002, Dechert dated November 25, 2002, National Association of Real Estate Investment Trusts dated November 25, 2002, and Compass Bancshares, Inc. dated November 25, 2002.

²⁸ See, e.g., letter from Transparency International—USA, dated November 8, 2002.

²⁹ See, e.g., letter from America's Community Bankers dated November 25, 2002.

³⁰ See, e.g., letter from the American Institute of Certified Public Accountants dated November 25, 2002.

³¹ See, e.g., letter from PwC dated November 25, 2002.

³² See, e.g., letters from the American Bar Association dated December 13, 2002 and The Business Roundtable dated November 29, 2002.

³³ See, e.g., letters from Wells Fargo dated November 22, 2002, Dorsey & Whitney dated November 25, 2002, Deloitte & Touche dated November 27, 2002, Sidley Austin Brown & Wood dated December 30, 2002, America's Community Bankers dated November 25, 2002, and BDO Seidman LLP dated November 25, 2002.

³⁴ See, e.g., letter from Ernst & Young LLP dated November 25, 2002.

³⁵ See, e.g., letters from Wells Fargo dated November 22, 2002, American Bar Association dated December 13, 2002, America's Community Bankers dated November 25, 2002, National Association of Real Estate Investment Trusts dated November 25, 2002, Intel Corporation dated November 26, 2002, and Compass Bancshares, Inc. dated November 25, 2002.

³⁶ *KPMG LLP v. Securities and Exchange Commission*, 289 F. 3d 109, 126 (D.C. Cir. 2002), which states, "We affirm the Commission's determination that negligence is an appropriate basis for violations underlying a Section 21C cease-and-desist order. * * *" See *In the Matter of KPMG Peat Marwick LLP*, AAER 1360 (January 19, 2001), which states, "We hold today that negligence is sufficient to establish "causing" liability under Exchange Act section 21C(a), at least in cases in which a person is alleged to "cause" a primary violation that does not require scienter. Therefore, if Peat Marwick acted at least negligently with