

did not object to the use of the term in the new rule.⁷²

“Engaged in the performance of an audit.” New rules 13b2–2(b)(1) and (c)(2) track the language in section 303(a) of the Act regarding the improper influence of an accountant “engaged in the performance of an audit” of the issuer’s financial statements. Both the Commission⁷³ and the accounting profession⁷⁴ have recognized that the need for an auditor to maintain an independent and unbiased attitude begins when the accountant is selected to perform audit or review services and continues until there is a formal or informal public notification that the professional relationship has ended.⁷⁵ To effectuate the intent of Congress, we believe the phrase “engaged in the performance of an audit” should be given a broad reading. We believe Congress intended that the phrase encompass the professional engagement period and any other time the auditor is called upon to make decisions or judgments regarding the issuer’s financial statements, including during negotiations for retention of the auditor and subsequent to the professional engagement period when the auditor is considering whether to issue a consent on the use of prior years’ audit reports. The new rules, therefore, would apply throughout the professional engagement and after the professional engagement has ended when the auditor is

considering whether to consent to the use of, reissue, or withdraw prior audit reports. In limited circumstances, the new rules also may apply before the professional engagement period begins. For example, the new rules would apply if an officer, director, or person acting under the direction of an officer or director, offers to engage an accounting firm subject to a condition that could result in rendering the financial statements materially misleading, such as a condition that the firm issue an unqualified audit report on financial statements that do not conform with generally accepted accounting principles, or a condition that the firm limit the scope or performance of audit or review procedures in violation of generally accepted auditing standards.

Commenters generally agreed with this approach.⁷⁶ Some suggested that we define in the rule the phrase “engaged in the performance of the audit.”⁷⁷ We believe, however, that the longer discussion in this release provides a better context to understand the meaning of the phrase.

“Rendering financial statements materially misleading.” One of the criteria that must be met in order for the improper influence on the auditor by officers, directors, or persons acting under their direction to be actionable under the new rule is that the improper influence, if successful, could result in “rendering [the issuer’s] financial statements materially misleading.”⁷⁸ Because the financial statements are prepared by management and the auditor conducts an audit or review of those financial statements, the auditor would not directly “render [the] financial statements materially misleading.” Rather, the auditor might be improperly influenced to, among other things, issue an unwarranted report on the financial statements,⁷⁹ including suggesting or acquiescing in

the use of inappropriate accounting treatments⁸⁰ or not proposing adjustments required for the financial statements to conform with generally accepted accounting principles.⁸¹ An auditor also might be coerced, manipulated, misled, or fraudulently influenced not to perform audit or review procedures that, if performed, might divulge material misstatements in the financial statements. Other examples of activities that would fall within the rule would be for an officer, director, or person acting under an officer or director’s direction, to improperly influence an auditor either not to withdraw a previously issued audit report when required by generally accepted auditing standards,⁸² or not to communicate appropriate matters to the audit committee.⁸³ New rule 13b2–2(b)(2) makes it clear that subparagraph (b)(1) would apply in such circumstances. As noted, the rule is not limited to the audit of the annual financial statements, but would include, among other things, improperly influencing an auditor during a review of interim financial statements⁸⁴ or in connection with the issuance of a consent to the use of an auditor’s report.⁸⁵ Conducting reviews of interim financial statements and issuing consents to use past audit reports are sufficiently connected to the audit process, and improper influences during those processes are sufficiently connected to the harms that the Act seeks to prevent, that they should be within the scope of the rule. The list of examples in the rule is only illustrative; other actions also could result in

⁷² See, e.g., letter from PwC dated November 25, 2002.

⁷³ Rule 2–01(f)(5)(ii) of Regulation S–X, 15 CFR 210.2–01(f)(5)(ii), which defines the “professional engagement period” to be: “The period of the engagement to audit or review the audit client’s financial statements or to prepare a report filed with the Commission,” and states: “(A) The professional engagement period begins when the accountant either signs an initial engagement letter (or other agreement to review or audit a client’s financial statements) or begins audit, review, or attest procedures, whichever is earlier; and (B) The professional engagement period ends when the audit client or the accountant notifies the Commission that the client is no longer that accountant’s audit client.”

⁷⁴ American Institute of Certified Public Accountants (“AICPA”) Code of Professional Conduct, ET § 101.02, which states:

The period of a professional engagement starts when the [AICPA] member begins to perform any professional engagement requiring independence for an enterprise, lasts for the entire duration of the professional relationship, which could cover many periods, and ends with the formal or informal notification of the termination of the professional relationship either by the member, by the enterprise, or by the issuance of a report, whichever is later. Accordingly, the professional engagement does not end with the issuance of a report and recommence with the signing of the following year’s engagement.

⁷⁵ Changes in the principal auditor of an issuer’s financial statements are reported under item 4 of Form 8–K, 17 CFR 249.308. See also item 304 of Regulation S–K, 17 CFR 229.304, and item 304 of Regulation S–B, 17 CFR 228.304.

⁷⁶ See, e.g., letters from Deloitte & Touche dated November 27, 2002, Independent Community Bankers of America dated November 25, 2002, the American Institute of Certified Public Accountants dated November 25, 2002, and Ernst & Young LLP dated November 25, 2002.

⁷⁷ See, e.g., letters from America’s Community Bankers dated November 25, 2002 and PwC dated November 25, 2002.

⁷⁸ There is no such requirement for Rule 13b2–1 or Rule 13b2–2.

⁷⁹ See Report of the Committee on Banking, Housing, and Urban Affairs, To Accompany S. 2673, “Public Company Accounting Reform and Investor Protection Act of 2002,” 107th Cong., 2d Sess., (S.R. 107–205), at 26 (Comm. Print, July 3, 2002), which states that section 303 makes it unlawful for any officer or director of an issuer, or any person acting under the direction of an officer or director, to fraudulently influence, coerce, manipulate, or mislead the auditor of the issuer’s financial statements “for the purpose of rendering the audit report misleading.” (Emphasis added.)

⁸⁰ For example, an auditor might be fraudulently influenced to allow an issuer to correct material misstatements over time, or not to restate prior period financial statements, in violation of generally accepted accounting principles.

⁸¹ See section 401(a) of the Act, which, among other things, adds section 13(i) to the Exchange Act, which requires that financial statements prepared in accordance with (or reconciled to) generally accepted accounting principles and filed with the Commission reflect all material correcting adjustments identified by a registered public accounting firm.

⁸² See, e.g., SAS 1, “Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report,” AU § 561.

⁸³ See, e.g., section 204 of the Act, which adds section 10A(k) to the Exchange Act and requires each registered public accounting firm to report certain matters to the audit committee, and AICPA, SAS 61, “Communication With Audit Committees” (as amended by SAS 89 and SAS 90).

⁸⁴ See Rule 10–01(d) of Regulation S–X, 17 CFR 210.10–01(d).

⁸⁵ See, e.g., section 7(a) of the Securities Act of 1933, 15 U.S.C. 77g, which states in part, “If any accountant * * * is named as having prepared or certified any part of the registration statement, the written consent of such person shall be filed with the registration statement”; Rule 436 under the Securities Act of 1933, 17 CFR 230.436.