

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 210, 240, 249 and 274

[Release No. 33-8183; 34-47265; 35-27642; IC-25915; IA-2103, FR-68, File No. S7-49-02]

RIN 3235-A173

### Strengthening the Commission's Requirements Regarding Auditor Independence

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission ("SEC" or "Commission") is adopting amendments to its existing requirements regarding auditor independence to enhance the independence of accountants that audit and review financial statements and prepare attestation reports filed with the Commission. The final rules recognize the critical role played by audit committees in the financial reporting process and the unique position of audit committees in assuring auditor independence. Consistent with the direction of Section 208(a) of the Sarbanes-Oxley Act of 2002, we are adopting rules to: revise the Commission's regulations related to the non-audit services that, if provided to an audit client, would impair an accounting firm's independence; require that an issuer's audit committee pre-approve all audit and non-audit services provided to the issuer by the auditor of an issuer's financial statements; prohibit certain partners on the audit engagement team from providing audit services to the issuer for more than five or seven consecutive years, depending on the partner's involvement in the audit, except that certain small accounting firms may be exempted from this requirement; prohibit an accounting firm from auditing an issuer's financial statements if certain members of management of that issuer 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 of an issuer's financial statements report certain matters to the issuer's audit committee, including "critical" accounting policies used by the issuer; and require disclosures to investors of information related to audit and non-audit services provided by, and fees paid to, the auditor of the issuer's financial statements. In addition, under the final rules, an accountant would not be independent from an audit client if

an audit partner received compensation based on selling engagements to that client for services other than audit, review and attest services.

As described further in the release, these rules also will have an impact on foreign accounting firms that conduct audits of foreign subsidiaries and affiliates of U.S. issuers, as well as of foreign private issuers. Many of the modifications to the proposed rules, such as those limiting the scope of partner rotation and personnel subject to the "cooling off period," have the added benefit of addressing particular concerns raised about the international implications of these requirements. Moreover, additional time is being afforded to foreign accounting firms with respect to compliance with rotation requirements. The release also provides guidance on the provision of non-audit services by foreign accounting firms, including the treatment of legal services and tax services.

**DATES:** *Effective Date:* May 6, 2003.

*Transition Dates:* Provided the following relationships did not impair the accountant's independence under pre-existing requirements of the Commission, the Independence Standards Board, or the accounting profession in the United States, an accountant's independence will not be deemed to be impaired:

(1) By employment relationships described in § 210.2-01(c)(2)(iii)(B) that commenced at the issuer prior to May 6, 2003;

(2) By compensation earned or received, as described in § 210.2-01(c)(8), during the accounting firm's fiscal year that includes May 6, 2003;

(3) Until May 6, 2004 by the provision of services described in § 210.2-01(c)(4) provided those services are pursuant to contracts in existence on May 6, 2003;

(4) Until May 6, 2003 by the provision of services that have not been pre-approved by an audit committee as required in § 210.2-01(c)(7);

(5) An accountant's independence will not be deemed to be impaired until the first day of the issuer's fiscal year beginning after May 6, 2003 by a "lead" partner and other audit partner (other than the "concurring" partner) providing services in excess of those permitted under § 210.2-01(c)(6); and

(6) An accountant's independence will not be deemed to be impaired until the first day of the issuer's fiscal year beginning after May 6, 2004 by a "concurring" partner providing services in excess of those permitted under § 210.2-01(c)(6).

For the purposes of calculating periods of service under § 210.2-01(c)(6):

(1) For the "lead" and "concurring" partner, the period of service includes time previously served as the "lead" or "concurring" partner prior to May 6, 2003; and

(2) For audit partners other than the "lead" partner or "concurring" partner, and for audit partners in foreign firms, the period of service does not include time served on the audit engagement team prior to the first day of issuer's fiscal year beginning on or after May 6, 2003.

#### FOR FURTHER INFORMATION CONTACT:

Samuel L. Burke, Associate Chief Accountant, Paul Munter, Academic Fellow, or Robert E. Burns, Chief Counsel, at (202) 942-4400, Office of the Chief Accountant, or, with respect to questions about investment companies, Brian D. Bullard, Chief Accountant, at (202) 942-0590, Division of Investment Management, U.S. Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** We are adding Rule 2-07 to Regulation S-X,<sup>1</sup> amending Rule 2-01 of Regulation S-X,<sup>2</sup> amending Item 9 of Regulation S-K,<sup>3</sup> amending Forms 10-K, 10-KSB, 20-F and 40-F,<sup>4</sup> amending Form N-CSR<sup>5</sup> and adding new Exchange Act Rule 10A-2.<sup>6</sup>

#### I. Introduction and Background

On July 30, 2002, the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act" or "the Act") was enacted.<sup>7</sup> Title II of the Sarbanes-Oxley Act, entitled "Auditor Independence," requires the Commission to adopt, by January 26, 2003, final rules under which certain non-audit services will be prohibited, conflict of interest standards will be strengthened, auditor partner rotation and second partner review requirements will be strengthened, and the relationship between the independent auditor and the audit committee will be clarified and enhanced.

We are adopting amendments to our current rules regarding auditor independence.<sup>8</sup> The final rules advance our important policy goal of protecting the millions of people who invest in our securities markets in reliance on financial statements that are prepared by public companies and other issuers

<sup>1</sup> 17 CFR 210.2-07.

<sup>2</sup> 17 CFR 210.2-01.

<sup>3</sup> 17 CFR 240.14a-101.

<sup>4</sup> 17 CFR 249.310; 17 CFR 249.310b; 17 CFR 249.220f; 17 CFR 249.240f.

<sup>5</sup> 17 CFR 249.331; 17 CFR 274.128.

<sup>6</sup> 17 CFR 240.10A-2.

<sup>7</sup> Pub. L. 107-204, 116 Stat. 745 (2002).

<sup>8</sup> The amendments were proposed in Securities Act Release No. 8154 (December 2, 2002) 67 FR 76779-76817.