

commenters⁴¹ acknowledged, however, that it was in investors' interests to prevent audit engagement team members from leaving the firm and assuming a financial reporting oversight role at an entity in the investment company complex that had responsibility for the financial reporting or operations of the investment company audit client. One commenter⁴² suggested the rule should not apply to positions at service providers solely because they are in the investment company complex.

Due to the unique structure of investment companies, where the normal operating activities, including activities related to the preparation of financial statements, are provided by outside service providers, we believe the rules need to extend beyond the investment company itself. After considering the comments, we agree, however, that the reach of the rule as proposed was too broad and have determined to tailor the scope of the rule with respect to investment companies to those situations where independence could be impaired. As adopted, an accounting firm would not be independent if a former audit engagement team member is employed in a financial reporting oversight role with not only the registered investment company, but also with any entity in the same investment company complex that is responsible for the financial reporting or operations of the registered investment company or any other registered investment company in the same investment company complex. The adopted rule prohibits employment in positions at an investment company complex that would allow a former audit engagement team member to bring undue influence over the audit process of an investment company. The rule recognizes that certain positions exist at an entity in the investment company complex that would be considered financial reporting or oversight positions but those positions have no direct influence in the financial reporting or operations of an investment company in the investment company complex. In these instances, we believe tailoring the focus of this rule will not harm investor interests.

We recognize the need to provide for orderly transition. We believe it would be unfair to expect those who began employment before the effective date of these rules to be asked to sever those

employment relationships. Accordingly, these rules are effective for employment relationships with the issuer that commence after the effective date of these rules.

B. Scope of Services Provided by Auditors

Section 201(a) of the Sarbanes-Oxley Act adds new Section 10A(g) to the Securities Exchange Act of 1934. Except as discussed below, this section states that it shall be unlawful for a registered public accounting firm that performs an audit of an issuer's financial statements (and any person associated with such a firm) to provide to that issuer, contemporaneously with the audit, any non-audit services, including the nine categories of services set forth in the Act. Additionally, the Act provides that the provision of "any non-audit service, including tax services, that is not described" as a prohibited service, can be provided by the auditor without impairing the auditor's independence "only if" the service has been pre-approved by the issuer's audit committee. The nine categories of prohibited non-audit services included in the Act are:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client;
- Financial information systems design and implementation;
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management functions or human resources;
- Broker or dealer, investment adviser, or investment banking services;
- Legal services and expert services unrelated to the audit; and
- Any other service that the Board⁴³ determines, by regulation, is impermissible.

The Commission's principles of independence with respect to services provided by auditors are largely predicated on three basic principles, violations of which would impair the auditor's independence: (1) An auditor cannot function in the role of management, (2) an auditor cannot audit his or her own work, and (3) an auditor cannot serve in an advocacy role for his or her client.⁴⁴

Some commenters⁴⁵ stated that the Commission should prohibit the audit

firm from performing most, if not all, non-audit services. Other commenters⁴⁶ supported a less strict approach. Consistent with our proposing release,⁴⁷ we are adopting rules related to the scope of services that independent accountants can provide to their audit clients. In adopting these rules, the Commission is clarifying the scope of the prohibited services. The prohibited services contained in these rules only apply to non-audit services provided by independent accountants to their audit clients. These rules do not limit the scope of non-audit services provided by an accounting firm to a non-audit client. Under the Act, the responsibility falls on the audit committee to pre-approve all audit and non-audit services provided by the accountant.

Recognizing that audit clients may need a period of time to exit existing contracts our rules provide that until May 6, 2004 the provision of services described in § 210.2-01(c)(4) will not impair an accountant's independence *provided* those services are pursuant to contracts in existence on May 6, 2003.⁴⁸

1. Bookkeeping or Other Services Related Accounting Records or Financial Statements of the Audit Client

Previously, an auditor's independence was impaired if the auditor provided bookkeeping services to an audit client, except in limited situations, such as in an emergency or where the services are provided in a foreign jurisdiction and certain conditions were met. The current Rule 2-01(c)(4)(i) continues the prohibition on bookkeeping, but we have eliminated the limited situations where bookkeeping services could have been provided under the previous rules.

Some commenters⁴⁹ suggested that bookkeeping services should be permitted, especially under the previous exceptions. However, our independence

2003; letter from William E. Fraser, dated November 26, 2002; letter from Ellen Sweet, dated November 26, 2002; letter from Council on Institutional Investors, dated January 10, 2003.

⁴⁶ See, e.g., letter from Chamber of Commerce of the United States of America, dated January 9, 2003; letter from America's Community Bankers, dated January 13, 2003; letter from Deloitte & Touche LLP, dated January 10, 2003; letter from American Society of Corporate Secretaries, dated January 13, 2003.

⁴⁷ 17 CFR parts 210, 240, 249 and 274.

⁴⁸ Additionally, in the unusual instance where additional time is needed to exit an existing contract, the staff in the Office of the Chief Accountant or the Public Company Accounting Oversight Board may be consulted on a case by case basis.

⁴⁹ See, e.g., letter from American Institute of Certified Public Accountants, dated January 9, 2003; letter from Radin, Gloss & Co., dated December 31, 2002; letter from Grant Thornton LLP, dated January 13, 2003; letter from International Federation of Accountants, dated January 10, 2003.

⁴¹ See, letter from Investment Company Institute, dated January 13, 2003; letter from Deloitte & Touche, dated January 10, 2003.

⁴² See, letter from PricewaterhouseCoopers dated January 8, 2003.

⁴³ As used in this section of the Act, the term Board refers to the Public Company Accounting Oversight Board.

⁴⁴ See, Preliminary note to Rule 2-01 of Regulation S-X, 17 CFR 210.2-01.

⁴⁵ See, e.g., letter from California Public Employees' Retirement System, dated January 10,