

example, would not be independent of an audit client for which it designed an integrated Enterprise Resource Planning ("ERP") or similar system since the system would serve as the basis for the audit client's financial reporting system.

Designing, implementing, or operating systems affecting the financial statements may place the accountant in a management role, or result in the accountant auditing his or her own work or attesting to the effectiveness of internal control systems designed or implemented by that accountant.⁵⁶ For example, if an auditor designs or installs a computer system that generates the financial records, and that system generates incorrect data, the accountant is placed in a position of having to report on his or her firms' own work. Investors may perceive that the accountant would be unwilling to challenge the integrity and efficacy of the client's financial or accounting information collection systems that the accountant designed or installed.

However, this prohibition does not preclude the accountant from evaluating the internal controls of a system as it is being designed, implemented or operated either as part of an audit or attest service and making recommendations to management. Likewise, the accountant would not be precluded from making recommendations on internal control matters to management or other service providers in conjunction with the design and installation of a system by another service provider.

3. Appraisal or Valuation Services, Fairness Opinions, or Contribution-in-Kind Reports

The Commission's previous independence rules stated that an accountant is deemed to lack independence when providing appraisal or valuation services, fairness opinions, or contribution-in-kind reports for audit clients. However, the previous rules contained certain exemptions that we proposed to eliminate.⁵⁷ The proposals provided that the auditor is not independent if the auditor provides appraisal or valuation services, or contribution-in-kind reports,⁵⁸ where it

is reasonably likely that the results of the service will not be subject to audit procedures by the auditor because the auditor is in a position of auditing his or her own work. Additionally, an accountant was not independent under the proposal if he or she provided a fairness opinion because to do so requires the accountant to function as a part of management and may require the accountant to audit the results of his or her own work.

Appraisal and valuation services include any process of valuing assets, both tangible and intangible, or liabilities. They include valuing, among other things, in-process research and development, financial instruments, assets and liabilities acquired in a merger, and real estate. Fairness opinions and contribution-in-kind reports are opinions and reports in which the firm provides its opinion on the adequacy of consideration in a transaction.

Some commenters⁵⁹ believe that our proposed prohibitions were appropriate and others would be even more restrictive.⁶⁰ Other commenters,⁶¹ however, believe that certain valuation services should be permissible.

We continue to believe that providing these services to audit clients raises several independence concerns. When it is time to audit the financial statements, it is likely that the accountant would review his or her own work, including key assumptions or variables that underlie an entry in the financial statements. Also, if the appraisal methodology involves a projection of future results of operations and cash flows, some⁶² believe that the accountant that prepares the projection may be unable to evaluate skeptically and without bias the accuracy of that valuation or appraisal. Accordingly, the rules we are adopting prohibit the accountant from providing any appraisal service, valuation service or

transactions of its audit clients, to provide contribution-in-kind reports that express an opinion on the fairness of the transaction, the value of a security, or the adequacy of consideration to shareholders.

⁵⁹ See, e.g., letter from Piercy, Bowler, Taylor & Kern, dated January 7, 2003; letter from Robert G. Beard, undated; letter from BDO Seidman LLP, dated January 13, 2003.

⁶⁰ See, e.g., letter from Stikeman Elliot, dated January 13, 2003; letter from California Public Employees' Retirement System, dated January 10, 2003.

⁶¹ See, e.g., letter from American Institute of Certified Public Accountants, dated January 9, 2003; letter from HSBC, dated January 1, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

⁶² See, e.g., letter from Aurora Group, dated January 13, 2003; letter from Cowhey, Girard Consulting, dated December 30, 2002.

any service involving a fairness opinion or contribution-in-kind report for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.

Our rules do not prohibit an accounting firm from providing such services for non-financial reporting (e.g., transfer pricing studies, cost segregation studies, and other tax-only valuations) purposes. Also, the rule does not prohibit an accounting firm from utilizing its own valuation specialist to review the work performed by the audit client itself or an independent, third-party specialist employed by the audit client, provided the audit client or the client's specialist (and not the specialist used by the accounting firm) provides the technical expertise that the client uses in determining the required amounts recorded in the client financial statements. In those instances the accountant will not be auditing his or her own work because a third party or the audit client is the source of the financial information subject to the audit. Additionally, the quality of the audit may be improved where specialists are utilized in such situations.

Some commenters⁶³ believe that a strict application of these rules related to contribution-in-kind reports may create conflicts in certain foreign jurisdictions. We are sensitive to these issues and, as we have done in the past,⁶⁴ we will continue to work with other regulatory agencies.

4. Actuarial Services

The previous rules generally bar auditors only from providing actuarial services related to insurance company policy reserves and related accounts. Our proposal provided that the accountant is not independent if the auditor provides any actuarial service involving the amounts recorded in the financial statements and related accounts for the audit client where it is reasonably likely that the results of

⁶³ See, e.g., letter from Japanese Institute of Certified Public Accountants, dated January 13, 2003; letter from The Hundred Group of Finance Directors, dated January 13, 2003; letter from European Commission, dated January 13, 2003.

⁶⁴ Letter of Lynn Turner, Chief Accountant, SEC, to Commissione Nazionale per le Società e la Borsa re: auditor independence (August 24, 2000). In that letter, the Chief Accountant did not deem the auditor's independence to be impaired where there were certain agreed-upon procedures for the contribution-in-kind report and the accountant represented in the report that the report did not express an opinion on the fairness of the transaction, the value of the security, or the adequacy of consideration to shareholders. This letter is available on our website.

⁵⁶ See, Section 404(b) of the Sarbanes-Oxley Act.

⁵⁷ Exemptions proposed to be eliminated included: (1) Firm's valuation expert can review the work of a client's specialist; (2) firm's actuaries can value a client's pension or other post-retirement benefit obligation provided that the client assumes responsibility for significant assumptions; (3) valuations performed for planning and implementing tax-planning strategies; and (4) valuations for non-financial purposes which do not affect the financial statements.

⁵⁸ Laws or regulations in certain foreign countries require the auditor in connection with designated