

discussed earlier, the legislative history related to expert services is focused on the accountant's role when serving in an advocacy capacity.

Some commenters<sup>93</sup> believed that the prohibition on expert services should be limited to instances of public advocacy or public adversarial proceedings and should not extend to situations where the accountant is advising a client or its counsel on technical matters apart from a public proceeding. Other commenters<sup>94</sup> believed a distinction exists between serving as an expert witness and serving as a fact witness in a proceeding. Additionally, many commenters<sup>95</sup> simply raised concerns over the lack of clarity of the term "expert" indicating that, as proposed, the meaning of the term is unclear.

Clients retain experts to lend authority to their contentions in various proceedings by virtue of the expert's specialized knowledge and experience. In situations involving advocacy, the provision of expert services by the accountant makes the accountant part of the "team" that has been assembled to advance or defend the client's interests.<sup>96</sup> The appearance of advocacy created by providing such expert services is sufficient to deem the accountant's independence impaired. The prohibition on providing "expert" services included in this rule covers engagements that are intended to result in the accounting firm's specialized knowledge, experience and expertise being used to support the audit client's positions in various adversarial proceedings.<sup>97</sup>

The rules we are adopting prohibit an accountant from providing expert

opinions or other services to an audit client, or a legal representative of an audit client, for the purpose of advocating that audit client's interests in litigation or regulatory, or administrative investigations or proceedings. For example, under this rule an auditor's independence would be impaired if the auditor were engaged to provide forensic accounting services to the audit client's legal representative in connection with the defense of an investigation by the Commission's Division of Enforcement. Additionally, an accountant's independence would be impaired if the audit client's legal counsel, in order to acquire the requisite expertise, engaged the accountant to provide such services in connection with a litigation, proceeding or investigation.<sup>98</sup>

Our rules do not, however, preclude an audit committee or, at its direction, its legal counsel, from engaging the accountant to perform internal investigations or fact finding engagements. These types of engagements may include, among others, forensic or other fact-finding work that results in the issuance of a report to the audit client. The involvement by the accountant in this capacity generally requires performing procedures that are consistent with, but more detailed or more comprehensive than, those required by GAAS. Performing such procedures is consistent with the role of the independent auditor and should improve audit quality. If, subsequent to the completion of such an engagement,<sup>99</sup> a proceeding or investigation is initiated, the accountant may allow its work product to be utilized by the audit client and its legal counsel without impairing the accountant's independence. The accountant, however, may not then provide additional services, but may provide factual accounts or testimony about the work performed.

Accordingly, our rules would not prohibit an accountant from assisting the audit committee<sup>100</sup> in fulfilling its responsibilities to conduct its own

investigation of a potential accounting impropriety.<sup>101</sup> For example, if the audit committee is concerned about the accuracy of the inventory accounts at a subsidiary, it may engage the auditor to conduct a thorough inspection and analysis of those accounts, the physical inventory at the subsidiary, and related matters without impairing the auditor's independence.

We recognize that auditors have obligations under Section 10A of the Exchange Act and GAAS<sup>102</sup> to search for fraud that is material to an issuer's financial statements and to make sure the audit committee and others are informed of their findings. Auditors should conduct these procedures whether they become aware of a potential illegal act as a result of audit, review or attestation procedures they have performed or as a result of the audit committee expressing concerns about a part of the company's operations or compliance with the company's financial reporting system. In these situations, we believe that the auditor may conduct the procedures, with the approval of the audit committee, and provide the reports that the auditor deems appropriate. Should litigation arise or an investigation commence during the time period that the auditors are conducting such procedures, we would not deem the completion of these procedures to be prohibited expert services so long as the auditor remains in control of his or her work and that work does not become subject to the direction or influence of legal counsel for the issuer.

Furthermore, under this rule, an accountant's independence will not be deemed to be impaired if, in an investigation or proceeding, an accountant provides factual accounts or testimony describing work it performed. Further, an accountant's independence will not be deemed to be impaired if an accountant explains the positions taken or conclusions reached during the performance of any service provided by the accountant for the audit client.

## 11. Tax Services

Since the Commission issued its auditor independence proposal, there has been considerable debate regarding whether an accountant's provision of tax services for an audit client can impair the accountant's independence.

<sup>101</sup> An auditor's independence would, however, be impaired if its assistance to the audit committee included defending, or helping to defend, the audit committee or the company generally in a shareholder class action or derivative lawsuit, other than as a fact witness.

<sup>102</sup> See, SAS No. 99, "Consideration of Fraud in a Financial Statement Audit," AU § 316.

<sup>93</sup> See, e.g., letter from Sullivan & Cromwell LLP, letter from Deloitte & Touche LLP, dated January 10, 2003; letter from American Institute of Certified Public Accountants, dated January 9, 2003; letter from Federation des Experts Comptables Europeens, dated January 13, 2003.

<sup>94</sup> See, e.g., letter from Sullivan & Cromwell LLP, dated January 10, 2003; letter from California Public Employees' Retirement System, dated January 10, 2003; letter from Grant Thornton LLP, dated January 13, 2003; letter from American Academy of Actuaries, dated January 6, 2003.

<sup>95</sup> See, e.g., letter from Eli Lilly and Co., dated January 9, 2003; letter from Federation des Experts Comptables Europeens, dated January 13, 2003; letter from PG&E Corporation, dated January 10, 2003; letter from America's Community Bankers, dated January 13, 2003.

<sup>96</sup> The accountant becomes an advocate under such circumstances even if the accountant is working behind the scenes to advance the client's interests.

<sup>97</sup> As we discussed in our proposing release, virtually all services provided by an accountant may be perceived to be expert services. This prohibition, however, only applies to those services that involve advocacy in proceedings and investigations (as discussed in this section of the release) and does not apply to other permitted non-audit services, such as tax services.

<sup>98</sup> For purposes of this release, an investigation is an inquiry by a regulatory body, including by its staff.

<sup>99</sup> See, *infra*, discussion stating that if litigation arises or an investigation commences during the auditor's performance of such procedures, completion of the procedures is not prohibited provided the auditor remains in control of his or her work and that work does not become subject to the direction or influence of legal counsel for the issuer.

<sup>100</sup> For example, Section 301 of the Act stipulates that each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.