The Honorable W. J. Tauzin  
U.S. House of Representatives  
2183 Rayburn House Office Building  
Washington, DC 20515

Dear Congressman Tauzin:

Thank you for your letter of July 20, 2000 regarding the Commission’s proposed rulemaking on auditor independence.

As you know, every day millions of people invest their savings in our markets in reliance on financial statements prepared by public companies and audited by independent auditors. The independence of public accountants who audit public companies’ financial statements is crucial to the credibility of financial reporting and the capital formation process.

In recent years, accounting firms have expanded dramatically the non-audit services that they provide to their audit clients. Investors and the Commission have become increasingly concerned about the dramatic growth in the volume and nature of non-audit services that auditors provide to their audit clients and other significant changes in the profession, particularly in the structures of accounting firms. These developments have real ramifications for auditor independence and investor confidence in our markets. We believe the rules need to be modernized to adapt to current conditions. The Commission’s auditor independence proposals reflect the Commission’s preliminary judgment as to the appropriate response. We are, of course, encouraging public debate and comment on the proposals.

Several private-sector studies have focused on a growing concern regarding the objectivity and independence of auditors in light of the expansion in non-audit services. For example, in the 1999 study sponsored by the Independence Standards Board, Earnscleive Research & Communications found that, “[m]ost [interviewees] felt that the evolution of accounting firms into multi-disciplinary business service consultancies represents a challenge to the ability of auditors to maintain the reality and the perception of independence… While some believe that perceptions of the independence of auditors is already suffering some corrosion, more people take the view that damage is inevitable in the future if greater precautions are not taken to protect the perception of independence.”

The Commission’s proposed rules would modernize our auditor independence requirements by providing governing principles for determining whether an auditor is independent in light of, among other things, the scope of services provided by audit firms.
to their audit clients. The proposals identify certain non-audit services that, if provided to an audit client, would impair an auditor's independence.

The impact of our proposals on accounting firms will be limited by several factors. For example, they target only the practice of providing certain non-audit services to audit clients. At present, 75% of SEC registrants do not purchase any non-audit services from their auditors. In addition, many of the non-audit services addressed by the proposals are either already prohibited or limited by the existing standards of the Commission and the American Institute of Certified Public Accountants. The proposals would not stop accounting firms from providing any service to non-audit clients.

We recognize that some accounting firms have strong objections to the proposals. We are eager to receive their comments. We will carefully consider them, as well as those of other segments of the public, in crafting final rules. We intend to be flexible and responsive in evaluating public comments. To date, we have received over 700 comment letters, and the Commission scheduled an extensive series of public hearings on the proposals, with hearings being held July 26, September 13, September 20 and September 21, to hear in person the views of accountants, lawyers, academics, analysts and other interested parties.

Your letter expresses concern about the Commission's analysis of the costs and benefits of the proposed rules. I have attached to this letter a copy of the cost-benefit and other regulatory analyses included in the Commission's proposing release. The attachment includes an analysis of the number of individuals and businesses that may be affected and the economic impact on those individuals and businesses. The proposing release requests comment on the Commission's analyses because we believe that inviting the public to participate in the analysis of a proposed rule's costs and benefits provides the Commission with the opportunity to obtain additional data and to refine our analysis.

Your letter asks the Commission to extend the comment period for the rulemaking. Since the comment period on the proposed rules does not end until September 25, 2000, I believe that any decision on whether to extend the comment period is premature at this time. Please be assured, however, that the Commission will carefully consider your request for an extension of the comment period.

I appreciate your interest in these issues and would be pleased to discuss them with you.

Sincerely,

Arthur Levitt
Chairman

Enclosure