

SEC Approves Revised Rule for Auditor Communications to Audit Committees About Independence

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On August 22, 2008, the Securities and Exchange Commission approved a new auditor independence rule adopted by the Public Company Accounting Oversight Board (PCAOB).¹ New Ethics and Independence Rule 3526, *Communication with Audit Committees Concerning Independence*, requires a registered public accounting firm, prior to its initial acceptance of an engagement, to provide written disclosures to the audit committee of the potential client of relationships that may reasonably be thought to bear on the independence of the accounting firm and to discuss the potential effects of these relationships on independence. Rule 3526 also requires the registered public accounting firm to provide similar communications to the audit committee on at least an annual basis, and to document the substance of those discussions.

Rule 3526 supersedes Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees* (ISB No. 1), and two related interpretations, which were adopted by the PCAOB in 2003 on an initial, transitional basis. ISB No. 1 provided that, at least annually, an auditor shall: (a) disclose to the audit committee of the company, in writing, all relationships between the auditor and its related entities and the company and its related entities that may reasonably be thought to bear on the auditor's independence; (b) confirm in the letter that, in its professional judgment, it is independent of the company within the meaning of the "Securities Acts administered by the" SEC; and (c) discuss the auditors' independence with the audit committee. ISB No. 1 did not, however, require a registered public accounting firm to provide disclosures to, or engage in discussions with, the audit committee about independence before it was first engaged by the company. The new rule eliminates the apparent anomaly that a firm could be engaged without having to communicate about independence to the audit committee, even though after it was engaged it had to communicate about the matter annually.

Because independence is a fundamental prerequisite to an accounting firm's ability to render an audit report, it was common practice for accounting firms to communicate with audit committees about independence matters in connection with potential engagements of a registered public accounting firm even though they were not required to do so by ISB No. 1. Accordingly, Rule 3526's

codification of the existing requirements for annual independence communications to the audit committee, and its new requirement for pre-engagement independence disclosures, should not materially alter current practice or impose an undue burden on companies considering the engagement of a new accounting firm.

SEC rules required a company's proxy statement for its annual meeting to include an audit committee report that, among other things, states whether the committee has received written disclosures and a letter from independent accounts required by ISB No. 1, and has discussed with the independent accountant the independent accountant's independence.²

On September 26, 2008, the SEC adopted technical amendments to its rules to reflect that ISB No. 1 has been superseded by Rule 3526.³ The revised rules require that written disclosures and the letter from the independent accountants satisfy "applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence."

¹ SEC Release No. 34-58415 (Aug. 22, 2008); 73 Fed. Reg. 50,843 (Aug. 28, 2008). Under Section 103(b) of the Sarbanes-Oxley Act of 2002, the PCAOB has the power to establish rules regarding auditor independence. The SEC also has the power to establish auditor independence rules. The PCAOB adopted proposed Rule 3526 on April 22, 2008, and notice of the proposed rule was published in the Federal Register on July 14, 2008. SEC Release No. 34-58121 (Jul. 9, 2008); 73 Fed. Reg. 40,418 (Jul. 14, 2008). As part of these rulemakings, the SEC also approved amendments to Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles.

² Schedule 14A, Item 7(d), 17 C.F.R. § 240.14a-101, Item 7(d); Regulation S-K, Item 407(d)(3)(i)(C), 17 C.F.R. § 229.407(d)(3)(i)(C).

³ SEC Release Nos. 33-8961; 34-58656 (Sept. 26, 2008).

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