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Final Rules Adopted to Implement Title II of Sarbanes-Oxley Act

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After 2001's economic downturn was worsened by numerous Enron-type scandals, Congress passed the Sarbanes-Oxley Act of 2002, 15 U.S.C. §7201 *et seq.*, (the Act). The Act was signed into law by President George W. Bush July 30, 2002, and as a result, the U.S. Securities Exchange Commission (SEC), the agency charged with promulgating rules and regulations to implement the Act, experienced the most extensive rulemaking period in its 70-year history.

The SEC voted Jan. 22 to adopt final rules to implement Title II of the Act: auditor independence. Published in the *Federal Register* Feb. 5, (68 Fed. Reg. 6006) the rules became effective May 6. What follows is a discussion of these new rule provisions.

The SEC rules on audit independence can be organized into five key areas: (A) Prohibited Non-Audit Services; (B) Audit Committee Pre-Approval of Services; (C) Partner Rotation; (D) Conflict of Interest; and (E) Increased Communication and Disclosure.

Prohibited Non-Audit Services

Congress enumerated in Section 201 of the Act nine non-audit services that are prohibited from being contemporaneously performed for a public-company client by any registered public accounting firm that is also serving as auditor of the client. 15 U.S.C. §78j-1(g) (2003). The prohibited non-audit services are:

Bookkeeping. All bookkeeping services are prohibited from being performed by an auditing firm. A narrow exception allows such services where it is reasonable to conclude that the results would not be subject to audit. 68 Fed. Reg. 6006, 6010-6011 (to be codified at 17 C.F.R. §210.2-01(c)(4)(i)).

Financial Information System Design or Implementation. An accounting firm may not provide any service related to the audit client's information system, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the client's financial statements. *Id.* at 6011 (to be codified at 17 C.F.R. §210.2-01(c)(4)(ii)).

Appraisal and Valuation Services. An accounting firm is prohibited from performing services of appraising or valuing assets or liabilities or performing services involving a fairness opinion or contribution-in-kind report for an audit cli-

ent, unless it is reasonable to conclude that the results of the services will not be subject to audit procedures. *Id.* at 6012 (to be codified at 17 C.F.R. §210.2-0(c)(4)(iii)).

Actuarial Services. An accounting firm is prohibited from providing to an audit client any actuarially-oriented advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client other than assisting a client in understanding the methods, models, assumptions, and inputs used in computing an amount, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures. *Id.* at 6012-6013 (to be codified at 17 C.F.R. §210.2-01(c)(4)(iv)).

Internal Audit Outsourcing. An accounting firm is prohibited from providing to their audit client any internal audit service that has been outsourced by the audit client and that relates to the audit client's internal accounting controls, financial systems, or financial statements. *Id.* (to be codified at 17 C.F.R. §210.2-01(c)(4)(v)).

Management and Human Resources Functions. An accountant is prohibited from acting as a director, officer, or employee of an audit client or performing any decision-making, supervisory, or ongoing monitoring function for the audit client. 68 Fed. Reg. 6006, 6013-6014 (to be codified at 17 C.F.R. §210.2-01(c)(4)(vi)).

Investment Advising Services. It is impermissible for an accounting firm to perform brokerage, investment advising, or investment banking services for an audit client. *Id.* at 6014-6015 (to be codified at 17 C.F.R. §210.2-01(c)(4)(viii)).

Legal Services. An accounting firm is prohibited from providing to an audit client any service that could only be provided by someone licensed to practice law in the jurisdiction in which the service is provided. *Id.* at 6015 (to be codified at 17 C.F.R. §210.2-01(c)(4)(ix)).

Expert Services. An accountant is prohibited 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 administrative and regulatory proceedings. *Id.* at 6015-6016 (to be codified at 17 C.F.R. §210.2-01(c)(4)(x)).

Tax Services Exception. An accounting firm is permitted to provide tax services to audit clients and doing so is not deemed a violation of auditor independence. Such services cannot be performed without pre-approval by the audit committee, however, and such tax services could be a violation of other SEC rules on auditor independence. See 68 Fed. Reg. 6006, 6016-6017 (Feb. 5, 2003).