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United States General Accounting Office  
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B-286930

December 18, 2000

The Honorable Phil Gramm  
Chairman  
The Honorable Paul S. Sarbanes  
Ranking Minority Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Thomas J. Bliley, Jr.  
Chairman  
The Honorable John D. Dingell  
Ranking Minority Member  
Committee on Commerce  
House of Representatives

Subject: Securities and Exchange Commission: Revision of the Commission's  
Auditor Independence Requirements

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (SEC), entitled "Revision of the Commission's Auditor Independence Requirements" (RIN: 3235-AH91). We received the rule on November 21, 2000. It was published in the Federal Register as a final rule on December 5, 2000. 65 Fed. Reg. 76008.

The SEC is adopting rule amendments regarding auditor independence in this final rule. The amendments modernize the SEC's rules for determining whether an auditor is independent in light of investments by auditors or their family members in audit clients, employment relationships between auditors or their family members and audit clients, and the scope of services provided by audit firms to their audit clients.

Enclosed is our assessment of the SEC's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review indicates that the SEC complied with the applicable requirements.

If you have any questions about this report, please contact James W. Vickers, Assistant General Counsel, at (202) 512-8210. The official responsible for GAO evaluation work relating to the subject matter of the rule is Tom McCool, Managing

**Director, Financial Markets and Community Investments. Mr. McCool can be reached at (202) 512-8678.**

**Kathleen E. Wannisky  
Managing Associate General Counsel**

**Enclosure**

**cc: The Honorable Jonathan Katz  
The Secretary of the Securities  
and Exchange Commission**

ANALYSIS UNDER 5 U.S.C. § 801(a)(1)(B)(i)-(iv) OF A MAJOR RULE  
ISSUED BY THE  
SECURITIES AND EXCHANGE COMMISSION  
ENTITLED  
"REVISION OF THE COMMISSION'S AUDITOR  
INDEPENDENCE REQUIREMENTS"  
(RIN: 3235-AH91)

(i) Cost-benefit analysis

The Securities and Exchange Commission considered the costs and benefits of the rule and its impact on efficiency, competition, and capital formation as required by section 3(f) of the Exchange Act and section 23(a) of the Securities Exchange Act of 1934.

SEC estimates the aggregate cost to the U.S. economy to be approximately \$16.6 million for the first year and \$12.4 million for subsequent years. SEC quantified one primary benefit of the rule as increased investor confidence that may lead to a reduction in the rate of return. According to the SEC, even if the rule leads to only a small change in that rate of return, the annual benefit could be in the range of one half to two billion dollars.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607, and 609

The SEC prepared an Initial and a Final Regulatory Flexibility Analysis in connection with the proposed and final rules, respectively. The conclusion of the Final Analysis is that the final rule will not have a significant economic impact on a substantial number of small entities. However, the SEC did make certain changes to the proposed rule to lessen the impact on small entities.

For some small entities, the company's auditor may be the only reasonably available provider for certain services. Therefore, the final rule takes into account that small entities may need internal audit services from their auditors and provides an exception for companies under \$200 million in assets, subject to certain conditions.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the SEC is not subject to title II of the Unfunded Mandates Reform

**(iv) Other relevant information or requirements under acts and executive orders**

**Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.**

The final rule was issued using the notice and comment procedures contained at 5 U.S.C. 553. On July 12, 2000, the SEC published a Notice of Proposed Rulemaking in the Federal Register. 65 Fed. Reg. 43148. The Notice resulted in more than 3,000 comments being received and, in addition, the SEC held four days of public hearings on the matter. The preamble to the final rule contains a discussion of the issues raised by the comments.

**Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520**

The final rule contains information collections that are subject to review by the Office of Management and Budget under the Paperwork Review Act. OMB has reviewed and approved the collections under Rule 14A and assigned control no. 3235-0059 and under Rule 14C and assigned control no. 3235-0057.

**Statutory authorization for the rule**

The final rule is promulgated under the authority contained in sections 7, 8, 10, 19, and 28 of the Securities Act; sections 3, 10A, 12, 13, 14, 17, 23, and 36 of the Exchange Act; sections 5, 10, 14, and 20 of the Public Utility Holding Company Act of 1935; sections 8, 30, 31, and 38 of the Investment Company Act of 1940; and sections 203 and 211 of the Investment Advisors Act of 1940.

**Executive Order No. 12866**

As the rule is promulgated by an independent regulatory agency, it is not subject to the review requirements of the order.