

110-19

ACTION MEMORANDUM

March 20, 1981

TO: The Commission

FROM: Office of the Chief Accountant

SUBJECT: Interpretative release dealing with independence of accountants and rescission of Staff Accounting Bulletin No. 39.

RECOMMENDATION: That the Commission authorize the issuance of an interpretative release indicating that in certain circumstances an accountant's independence will not be deemed to have been impaired if a foreign office of or a foreign firm associated with the domestic accounting firm performs limited bookkeeping services for a foreign division, subsidiary or investee of a domestic client of that firm. Additionally, this release would rescind Staff Accounting Bulletin No. 39 which deals with this matter.

ACTION REQUESTED BY: Week of March 30, 1981

TENTATIVE SUNSHINE ACT STATUS: Open Meeting

NOVEL, IMPORTANT, OR COMPLEX ISSUES: None

VIEWS OF OTHER OFFICES OR DIVISIONS CONSULTED: Division of Corporation Finance Concurr (Jack Shinkle and Howard Hodges 272-2553)

Division of Enforcement Concurr (Ted Levine, 272-2230)

Office of the General Counsel Concurr (David Schwiesow, 272-2437)

REGULATORY FLEXIBILITY ACT STATUS: This is an interpretative release and is not subject to the Regulatory Flexibility Act.

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PRIOR COMMISSION

ACTION: None

PERSONS TO CONTACT: Clarence Sampson (272-2050)
Rita Gunter (272-2133)

SUMMARY

The staff recommends that the present interpretations dealing with accountant's independence be supplemented to allow in certain circumstances a foreign office of or a foreign firm associated with the domestic accounting firm to perform limited bookkeeping services for a foreign division, subsidiary or investee of a domestic client of that firm without affecting the firm's independence. Staff Accounting Bulletin No. 39 ("SAB 39") deals with this subject; however, that guidance is at variance with the above recommendation and is proposed to be rescinded.

DISCUSSION

The Commission has issued at various times interpretations relating to Rule 2-01 of Regulation S-X, Qualifications of Accountants, and in particular the effect on accountant's independence of providing bookkeeping services for client companies. Four separate Accounting Series Releases ("ASR") provide guidance on when an independent accountant may perform bookkeeping services for a client registered with the Commission. These ASR's are numbers 47, 81, 126 and 234. The bookkeeping provisions of such are discussed in the attached draft release. The Commission has taken a strict position with respect to its prohibition against bookkeeping services and has not allowed these services except in emergency or other unusual situations.

The staff took a similar strict position when it issued SAB 39 which was aimed at bookkeeping services for a registrant's foreign subsidiaries. The staff reviewed various 1980 proxy disclosures regarding the registrants' relationships with their independent accountants (i.e., disclosures required by ASR No. 250) and, in connection with such review, noted several instances where the accountant was performing bookkeeping services for a foreign subsidiary of the registrant. After noting these disclosures, the staff issued SAB 39 to alert accountants to our strict interpretation of the bookkeeping proscription. The staff expressed the view that the general proscription against routine bookkeeping services and the preparation of financial statements by independent accountants was applicable irrespective of whether a constituent entity is located within or outside the U.S. and whether or not the involved entity was material to the total enterprise.

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Shortly after the issuance of SAB 39, the accounting profession pointed out various hardships caused by this strict interpretation. Subsequently, the Chief Accountant met with certain members of the AICPA Committee on SEC Regulations ("the Committee"). They discussed the Committee's position on when accountants should be allowed to perform bookkeeping services for clients. (The position of the Committee is set forth in a letter from the Committee Chairman, J. Michael Cook, to Clarence Sampson. A copy is attached.)

The Committee as spokesmen for the accounting profession asserts that these bookkeeping services primarily are performed as an accommodation to clients. The operations of the foreign location involved are almost always of an insignificant size so that it is not practical for the client to employ its own accounting personnel; however, it is necessary that accounting records be maintained for the foreign operation. Foreign statute may require the registrant to maintain the subsidiary's original books and records in that country. The foreign country may also require the subsidiary to file statutory financial statements or reports. If the operation in the foreign country is insignificant, or possibly even inactive, the registrant may find it difficult to employ a capable accountant who is willing to perform the necessary bookkeeping work. If the operations are not sufficient to justify employing full or even part-time accounting personnel, the independent accountant normally would not perform audit procedures on the operation in connection with the annual audit or if procedures are performed, such procedures may be limited or performed on a rotating basis. Thus, the independent auditor or the foreign firm associated with the auditor generally is not put in a position of auditing their own work. Additionally, the operations and assets of the foreign operation would be insignificant when compared to the consolidated amounts.

At the time of the issuance of SAB 39, the staff believed that a foreign operation could easily obtain the services of another accountant or firm to perform the necessary bookkeeping functions. The accounting profession has argued that the solution to these problems may not be as simple as switching the services to another accounting firm. There may be instances where there is no other reputable firm in the particular foreign area. However, even if there is another reputable firm in the area, such firm may not wish to perform this kind of routine work because of minimal fees.

The staff now believes that the potential for real or apparent independence problems in these situations is sufficiently low to allow a specific exception to the general prohibition against providing bookkeeping services. This exception would be very narrow and the fees charged for such services would have to be insignificant when compared to the total audit fee. We are recommending a cutoff of one percent

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of the total audit fee. Additionally, \$1,000 would be used as a de minimis cutoff to allow for a very small amount of foreign bookkeeping in instances where the total audit fee is not particularly large. 1/ All of the above amounts are arbitrary but seem to be reasonable in the circumstances, while at the same time they appear to be low enough to assure that there is no impact on the accountant's independence.

The release indicates clearly that the accountant should not be engaged to perform bookkeeping services for the foreign operation unless it is impractical for the registrant to make other arrangements. Also, the foreign division, subsubsidiary, or investee should be immaterial to the registrant's consolidated financial statements and generally would not have employees capable or competent to perform the bookkeeping services. In addition, the local professional ethics rules must allow the accountant to perform the contemplated bookkeeping services, and thus an informed observer in the foreign location would have no cause to question the fact or appearance of independence of the accountant.

It should be pointed out that although not related to bookkeeping services, the Commission has in the past made one other special provision in its independence determinations for foreign subsidiaries and accountants. In ASR No. 112 the Commission took a less restrictive position with respect to security investments in a U.S. registrant or its subsidiary by a member of another accounting firm (other than the principal auditor) which is engaged to audit a nonmaterial division or subsidiary of a U.S. registrant. The provisions of ASR No. 112 are discussed in greater detail in the attached draft release.

CONCLUSION

The staff recommends that the Commission approve the issuance of the attached draft release and by so doing allow a foreign office of or a foreign firm associated with a domestic accounting firm to perform limited bookkeeping services for a foreign division, subsidiary or investee of a domestic audit client of that firm.

Attachments:

1. Draft Release.
2. Letter from Chairman of AICPA Committee on SEC Regulations.

1/ The one percent and \$1,000 tests were suggested by the AICPA Committee on SEC Regulations.