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U.S. Public Interest Research Group

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Leading National Consumer Groups Charge Audit Firm with Undermining Key Auditor Independence Reform, Urge SEC To Investigate, Call a Halt to Abusive Practices

WASHINGTON, D.C. – At least one of the Big Four audit firms is exploiting loopholes in the recently adopted auditor independence rules to systematically undermine the requirement that audit committees review and pre-approve any non-audit services to be provided by the company's independent auditor, five of the nation's leading consumer groups have charged.

In a letter sent to members of the Securities and Exchange Commission this week, Consumer Federation of America, U.S. Public Interest Research Group, Consumers Union, Consumer Action, and Common Cause said a document apparently being used by Ernst & Young to advise its audit clients on how to implement the Sarbanes-Oxley Act requirement that audit committees pre-approve all non-audit services "makes a mockery of Congress's intent that this process serve to ensure the independence of the audit."

The groups called on the SEC to clarify that the approach being recommended by Ernst & Young is not acceptable, to investigate to determine whether other firms are advocating a similar approach, and to call a halt to such practices where it finds them. "Given the vehemence of Big Four firm opposition to meaningful auditor independence reforms and their virtual unanimity in arguing for weakening amendments to the auditor independence rules, we are concerned that the other firms are likely advocating an equally misleading view to their clients of audit committee responsibilities," the groups wrote.

The pre-approval requirement was included in the Sarbanes-Oxley Act to supplement the list of services auditors were prohibited from providing because they violated basic principles of auditor independence. Recognizing that no such list will ever be all-inclusive, the legislation's

authors made clear that audit committees were responsible for reviewing all non-audit services proposed to be provided by the company's auditor to determine whether they created similar conflicts.

Quoting from the Ernst & Young document, the consumer group letter outlines how Ernst & Young is using concessions won from the Commission during the rule-making process to undermine this central reform of the Sarbanes-Oxley Act. It does so by encouraging audit committees to rubber stamp whole categories of services, by dismissing independence concerns related to any services but those that were specifically prohibited by Congress, by suggesting that the SEC did not intend audit committees to consider the principles of auditor independence in reviewing non-audit services, and by encouraging audit committees to group virtually all non-audit services in the audit or audit-related fee categories when calculating whether fees for non-audit services create an unacceptable conflict.

The groups noted that the audit committee that faithfully followed the approach advocated by Ernst & Young would give the kind of specific review and approval anticipated by Congress for all non-audit services to only a handful of services and would review those services without regard to the basic principles of auditor independence. "The idea that the pre-approval process would have any value in assuring the independence of the audit under such an approach would be a joke, if recent experience hadn't shown just how painful a lack of auditor independence can be for average retail investors," they wrote.

The groups called on the SEC to rectify a problem it helped to create, by:

- * rescinding the rule provision allowing pre-approval of non-audit services through policies and procedures;
- * codifying as part of the rule language the basic principles for determining auditor independence;
- * clarifying that audit committees are expected to review all proposed non-audit services with an eye toward determining whether they violate these basic principles;
- * adding tax planning services and tax services for company executives to the list of non-audit services auditors are prohibited from providing; and
- * revising the audit fee disclosure rules to, at a minimum, remove fees for services not directly related to the audit from the audit fee category and rename the audit-related fee category to more accurately reflect its content.

"Although it may not have realized it at the time, the Commission handed the audit firms a roadmap for evading the audit committee pre-approval requirement when it issued its auditor independence rules," the groups wrote. "The Commission must now step in to restore this important auditor independence reform."

A copy of the letter is available at <http://www.consumerfed.org/E&Yletter.pdf>.