



SEC Guidance on Auditor Independence

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In remarks made in December 2018, the Securities and Exchange Commission's (SEC) Chief Accountant Wesley Bricker reaffirmed that auditor independence remains one of the SEC's areas of focus. Consultations with the SEC about specific auditor independence questions influence the staff's recommendations to the commission regarding updating or expanding the independence rules and existing staff guidance, Bricker said. Indeed, the SEC is currently considering amendments to those rules related to certain lending relationships as a result of these consultation trends.

Despite the SEC's affirmation of the importance of these consultations in identifying emerging and recurring auditor independence issues, the SEC does not make its specific guidance on individual consultations publicly available. It is important for public company audit committees to understand these limitations in this complex area. There also is an opportunity for the SEC to improve its process by making its specific guidance public.

The SEC has repeatedly emphasized that "maintaining the independence of auditors is crucial to the credibility of financial reporting." As such, auditors and audit committees constantly—both before and during an engagement—must be vigilant against impairment of their independence and devote substantial resources to verifying and maintaining that independence. The potential consequences to an issuer of violating auditor independence standards are severe. Violations may render previously filed financial statements noncompliant with the Securities Exchange Act of 1934 and related SEC rules, or they could adversely affect the timely filing of financial statements. A violation also could require the issuer to retain a new, fully independent auditor to re-audit the financial statements, which not only would be expensive and distracting, but could again lead to a failure to timely file financial statements. For an auditor, the consequences may be equally grave. The auditor may face regulatory penalties, loss of the engagement, remediation expenses and reputational harm.

The SEC, Public Company Accounting Oversight Board, American Institute of Certified Public Accountants and state accounting boards all maintain and enforce independence rules, but the SEC is the principal enforcer of auditor independence for public companies. According to SEC rules, the general standard of auditor independence is that it is impaired if a reasonable, fully informed investor would conclude that the auditor is not capable of exercising objective and impartial judgment on all issues encompassed within the audit engagement. Beyond this, the auditor independence standards are found in a patchwork of SEC rules, guidance documents,

enforcement orders and speeches. Few of these have been updated recently—most date to circa 2000. As a result, analyses of independence questions are often based on the application to specific facts of general principles and guidance, much like common law, rather than detailed regulations.

Although many independence issues are straightforward, others are more nuanced and difficult, due to the size and complexity of both the audit firm and the issuer. Often in these situations, which are complex and fact-specific, specific guidance does not exist. For example, an issuer may have its own auditor, while a separate firm audits a partially owned, remote subsidiary. The issuer's audit firm may have provided a negligible amount of bookkeeping services to the remote subsidiary, but the remote subsidiary's separate auditor is independent of the issuer and remote subsidiary. The issuer and its auditor need to determine whether the issuer's auditor's independence has been compromised as a result of the provision of the bookkeeping services, but cannot find directly applicable rules or published guidance that allows them to understand the SEC's position with similar fact patterns.

The SEC understands that “auditor independence matters often involve unique and complex fact patterns,” and because the SEC warns that its rules are for “general guidance only,” it encourages issuers and audit firms to consult with its Office of the Chief Accountant (OCA) on auditor independence questions. According to a [detailed written policy on such consultations](#), OCA accepts written correspondence on a particular question, after which OCA schedules a preliminary conference call between it, the issuer and the auditor. Once OCA reaches a conclusion, it communicates its view by phone to the issuer. At that point, if it so desires, the issuer may prepare and send a letter to OCA describing the issuer's understanding of the staff's position.

This process is valuable for the parties involved in a specific inquiry, and issuers and auditors routinely take advantage of it. But it is designed to develop no guidance that can be accessed, let alone relied on, by others who seek to understand and apply the rules. Indeed, in describing its consultation process, OCA states that it will “consider how OCA has previously addressed similar accounting or auditing issues to see if a precedent has been set for the issue at hand or if there is a past decision to which the current issue may be analogized.” The SEC intentionally does not make this rich source of information about auditor independence issues publicly available. This is somewhat of a reversal of prior practice, as the SEC previously published certain of these questions and OCA's responses (with the disclaimer that the responses represent the view of OCA and not the commission). The SEC last updated a publicly available document containing these questions and answers on December 13, 2011. It may be that it has since determined that OCA's guidance is so fact-specific that making it available as precedent would lead to misinterpretations and undue reliance.

In our experience, auditors and audit committees would benefit from more sources of guidance and clarification of the SEC's positions when conducting difficult analyses. OCA's procedure and the reasons underlying it highlight how difficult independence issues can be for auditors and audit committees to analyze and resolve. In particular, as Bricker, the chief accountant, explained in December 2018, the SEC receives and analyzes questions with recurring fact patterns. Disclosing the SEC's view of those situations would help those striving to comply with independence requirements.

As part of its efforts to improve its guidance, the SEC should take a fresh look at making its specific guidance publicly available. For example, state licensing boards in a variety of professions, such as boards of ethics or attorney disciplinary commissions, publish Q&A documents to assist practitioners in analyzing similarly highly fact-bound questions. It strikes us as a relatively sound way for the SEC to enhance its guidance on auditor independence.