

ORAL TESTIMONY OF

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U.S. SECURITIES AND EXCHANGE COMMISSION

CONCERNING THE COMMISSION'S
AUDITOR INDEPENDENCE PROPOSAL

BEFORE THE SUBCOMMITTEE ON SECURITIES
COMMITTEE ON BANKING, HOUSING, AND URBAN
AFFAIRS

UNITED STATES SENATE

September 28, 2000

Chairman Grams and Members of the Subcommittee:

Thank you for the opportunity to present my views here this morning. Let me begin with a concept that may seem obvious, but which cannot be too often emphasized: high-quality, transparent, and trustworthy financial reporting is the cornerstone of healthy, efficient, and resilient markets. Sound and verifiable financial reporting is to our markets what oxygen is to breathing.

The high-quality work of this country's accountants forms the very bedrock of our financial reporting system. But like no other, the accounting profession has been handed an invaluable, but fragile, *franchise*. Enactment of the 1933 and '34 Securities Acts established the need for accountants to function as independent auditors, and over the years, the profession has prospered greatly from this federal mandate. But as an edict for the public good, this franchise is only as valuable as the public service it provides, and as fragile as the public confidence that gives it life.

In recent years, the transformation of the accounting industry has been marked by seismic changes, including a dramatic rise in the types of non-audit services firms provide their audit clients. Auditors who now provide consulting services for their audit clients must serve *two* masters: the public obligation to shareholders, and the professional duty to management. And when the interests of the two come into conflict, the independent audit -- dwarfed by the more lucrative consulting businesses -- too often may be compromised. The suggestion that auditing and consulting do not come into conflict is inconsistent with the AICPA's own literature. We've made available to the Committee excerpts from the AICPA's manual entitled "Make Audits Pay: Leveraging the Audit Into Consulting Services."

This past June, the Commission issued a rule proposal which addresses these accelerating concerns. Since that time, the Commission has spearheaded a comprehensive public dialogue, collecting upwards of 2,000 comment letters and hosting 4 public hearings. The bulk of the Commission's proposal is widely-recognized as a sensible response to the changing nature of today's workforce and workplace.

Under the proposal, firms would still be able to provide consulting services to non-audit clients. And this is where they derive an overwhelming majority of their non-audit revenue. The rule does not prohibit most of the services auditors perform for their audit clients. Rather, the proposal identifies ten services that impair independence, eight of which are *already* severely or totally restricted under current profession and SEC rules.

Unfortunately, instead of coming to the table to craft flexible, long-term rules that will serve America's markets and investors, some have chosen to form alliances and fight, showing an apparent willingness to reap the benefits of this *public-mandated* franchise, but largely ignore the premise of its responsibilities. Some seem content to construct arguments that hide behind the dazzle of the so-called New Economy, but ignore the very principles that make our markets the most sound and respected in the world.

There are those who would prefer that we do nothing. One leader in the profession went so far as to suggest that we wait for a train wreck or a market crash before taking action. In my judgment, we should no more wait for a train wreck than we should wait to recall faulty tires. Only by acting now do we protect America's investors, prevent foreseeable disasters, and preserve the public trust.

I care deeply about this issue, about its implications for America's marketplace and for sustained public confidence. Most of you know me well. And I believe we have developed a relationship based on mutual respect and credibility. I would ask you, then, to consider whether this is really the occasion to intervene, as some would have you do, for the first time in the Commission's 65 year history.

I am proud of, and greatly respect, the accounting profession. America's accountants have helped lay the foundation for the most transparent and resilient capital markets in the world. The Commission's proposal does nothing more, and nothing less, than take steps to ensure that the preeminence of America's capital markets remains a beacon to the world in years and decades to come.

Thank you.