

Summary of Levin-McCain-Baucus Auditor Independence and Tax Shelters Act

The Auditor Independence and Tax Shelters Act would have two key provisions:

(1) Ban on Auditors Providing Tax Shelter Services. The bill would strengthen auditor independence by prohibiting auditors from providing tax shelter services both to the publicly traded corporations they audit and to the corporation's officers and directors, thereby preventing auditors from auditing their own work and eliminating conflicts of interest. Auditors would still be able to market tax reduction strategies to other companies and individuals, just not to the companies they are responsible for auditing. The bill defines "tax shelter services" in the same way as Section 6111 of the tax code which, among other provisions, restricts the definition to tax shelter services earning fees in excess of \$100,000.

(2) Codification of Auditor Independence Principles. The legislation would also reduce potential auditor conflicts of interest by codifying four auditor independence principles to guide the audit committees of the Board of Directors of a publicly traded company, when that committee is required by the Sarbanes-Oxley Act to decide whether the company auditor may provide certain non-audit services to the corporation. These principles have been repeatedly cited as providing the foundation for SEC and Congressional initiatives to strengthen auditor independence. They state that auditors should not:

- (1) audit their own work;
- (2) perform management functions for their clients;
- (3) act as advocates on behalf of their clients; or
- (4) act as promoters of their clients' stock or other financial interests.

The bill would require a company's audit committee to apply the above principles when considering what services an auditor may provide to the company. If the audit committee were to find that a proposed service would reasonably result in an impairment of the auditor's independence by violating one or more of the above principles, the audit committee would be unable to approve the proposed service.

Similar Initiatives. Financial and accounting experts have advocated banning auditors from providing tax shelter services to their audit clients in other settings. In January 2003, for example, The Conference Board's blue-ribbon Commission on Public Trust and Private Enterprise, co-chaired by current Treasury Secretary John Snow, concluded the following:

"[P]ublic accounting firms should limit their services to their clients to performing audits and to providing closely related services that do not put the auditor in an advocacy position, such as novel and debatable tax strategies and products that involve income tax shelters and extensive off-shore partnerships or affiliates. . . . Auditors' development and recommendations of new tax strategies for their clients is not closely related to the audit, and, in our opinion, removes focus from their audit work and poses a potential conflict of interest. . . . [T]hese strategies, if implemented, were often then subject to an audit by the firm. This practice, in our opinion, is highly undesirable. The firm's need for impartiality in conduct of the audit is in direct conflict with the financial incentives to provide tax strategies which themselves must be audited."

In early 2003, the SEC proposed banning auditors from providing tax shelter services to their audit clients, but then dropped the proposal from its final regulation on auditor independence. The Public Company Accounting Oversight Board is now considering whether to propose a similar ban.