Money & Investing

Securities Regulators May Adopt
Hard Line Against Online Consulting

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WASHINGTON -- The Securities and Exchange Commission likely will take a hard line after all on limiting consulting services that auditing firms offer corporate clients, people close to the matter say.

In the second apparent about-face in less than three weeks, they say, the SEC's final rules aimed at reducing conflicts of interest in accounting firms' consulting services may include a ban on most computer-system consulting. Such a ban has been vigorously opposed by some major accounting firms.

SEC Chairman Arthur Levitt surprised the accounting industry last week when he scheduled a vote on the rules for Wednesday. A draft of the controversial final proposal of roughly 200 pages, which is still subject to change before Wednesday's meeting, is being circulated among the agency's four commissioners and staff. The commissioners are likely to endorse the proposal. Said Joseph Babits, counsel to Commissioner Isaac Hunt, "In my opinion, Commissioner Hunt is generally on board and has expressed no opposition to the ban."

Mr. Levitt has said that new standards are needed to maintain investor confidence in the reliability and accuracy of audited financial statements of public companies. Amid unsuccessful negotiations to reach a consensus proposal with the industry, the agency has decided to move ahead on its own.

There was no explanation for the SEC's apparent reversal on the computer-systems consulting issue. In late October, representatives from the accounting industry and the SEC said they believed a broad framework for a compromise was near, while negotiators continued to haggle over specific language, according to people familiar with the matter.

Among the key issues, the accountants said they understood that the SEC might be willing to allow auditors to continue providing computer-systems consulting services to audit clients, rather than banning the services as originally proposed. As an alternative, negotiators were discussing detailed public company disclosures about consulting and tighter board oversight.

After a Wall Street Journal article on Oct. 25 suggested that the SEC might be backing down on the key consulting issue, serious negotiations halted. In the past week, the SEC reverted to its early position on possible bans of certain consulting to audit clients, people with knowledge of the talks say. Late Monday, Mr. Levitt summoned Washington representatives from accounting firms to discuss the final proposal.

Capitol Hill staffers said the SEC also stepped up lobbying efforts to gain support for the initiative. A Hill staffer said the SEC asked key lawmakers to voice support for the auditor-independence rule,
including declaring the SEC the winner in the battle with accountants.

The SEC declined to comment.

The proposal is similar to restrictions the SEC offered in June on certain services, such as financial-information consulting, people close to the matter say. The measure includes a ban on computer-system consulting to audit clients and a partial ban on having an accounting firm perform both a corporate client's outside audit and preparing audits used internally by management and the board. The bans in the proposal don't apply to publicly traded companies with assets of less than $200 million. Such companies are audited primarily by small accounting firms, people close to the matter said.

The rules are based largely on a compromise proposal submitted Sept. 21 by Ernst & Young LLP and PricewaterhouseCoopers LLP, which have been the most supportive of the Big Five accounting firms to the SEC's efforts to improve auditor-independence standards. For instance, the final draft includes the two accounting firms' recommendation that publicly traded companies disclose consulting arrangements in proxy statements.

The SEC is considering adopting guidelines defining what kinds of arrangements would create an improper appearance of conflicts. The draft refers to "appearance" principles, such as prohibitions against an accounting firm auditing its own consulting work.

Key provisions could be modified if the SEC makes a last effort to reach a consensus with vocal critics, including the American Institute of Certified Public Accountants, Arthur Andersen LLP, Deloitte & Touche LLP and KPMG LLP. The firms believed they were close to an agreement two weeks ago that would have scaled back the ban on accounting firms' computer-systems consulting, people close to the negotiations said. Such consulting is a fast-growing business line in the industry.

In response to the scheduling of the final vote, Arthur Andersen, Deloitte & Touche, KPMG and the accountants' institute sent a strongly worded letter to the SEC, asking the agency to delay action until the public has had time to review the final version of the rules. Such a process likely would extend into January.

The letter also put the SEC on notice that the firms may be prepared to challenge final rules in court. Mr. Levitt's decision to press ahead with a final vote also flies in the face of recent requests by more than two dozen lawmakers to put off action for six months.

If final rules are perceived to go too far, lawmakers say the new Congress might pass legislation to block implementation.

In a statement last week about scheduling a vote, Mr. Levitt said that the "time has come for the commission to act," after months of negotiations, four days of public hearings and nearly 3,000 comment letters.

Alluding to a possible ban on certain types of consulting, he said "there are certain specific conflicts" in computer-systems consulting. He added that in writing final provisions, the SEC was "mindful of the fears expressed by small accounting firms."

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