



TOOLS AND RESOURCES FOR FINANCIAL EXECUTIVES

SEC Warns Auditors on Contingency Fees

The statement by the commission's top accountant seems to be another sign of increased regulatory interest in auditor independence.

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The Securities and Exchange Commission's chief accountant warned the major accounting firms to stop charging contingency fees for handling the tax work of companies they audit or else face enforcement action, according to Bloomberg.

The wire service said SEC Chief Accountant Donald Nicolaisen recently met privately with the seven biggest firms, urging them to fully disclose contingency-fee arrangements to the company audit committees that oversee their work.

He also warned the firms that they might face SEC investigations over the contingency fees, which are payments based on a percentage of tax savings, according to Bloomberg. "Auditor independence is critical," Nicolaisen reportedly said in a statement. "Billing arrangements that are contingent are inappropriate and I would expect any such practice to cease."

Nicolaisen's meeting and warning of enforcement action is one of a number of recent indications that auditor independence is increasingly becoming a focus among regulators.

In the last few months, Ernst & Young was banned from accepting new clients because of prior auditor-independence violations and PricewaterhouseCoopers paid a \$50 million fine as part of a settlement for one alleged violation and is being investigated for another potential infraction.

Just last week, Korn/Ferry International said the SEC is conducting an informal inquiry into certain independence issues arising out of payments made by Ernst & Young.

Lynn Turner, a former SEC chief accountant who wrote the SEC's rule on contingency fees, told Bloomberg that Nicolaisen's order to the firms to disclose their billing arrangements to audit committees could cause an uproar. That's because the committees might not be aware of them.

"The question is going to become, 'What are the audit committees going to do about it?'" said Turner, now managing director of research at proxy adviser Glass Lewis & Co., in the wire-service story. "First they have to immediately renegotiate the fees. Then they may be facing an enforcement action. If you're an audit committee, you've now had your auditor place you in a position of danger or risk, rather than protecting your backside."

Nicolaisen reportedly met with the accounting industry's leaders to explain a May 21 letter he recently sent to Bruce Webb, chair of the professional ethics executive committee of the American Institute of Certified Public Accountants. The letter said that auditors shouldn't follow an incorrect guidance on contingency fees that had been written by the accounting trade group.

The AICPA had advised accounting firms that they could collect contingency fees if a client's tax returns are being reviewed by a government agency such as the Internal Revenue Service, according to Bloomberg.

In the letter, Nicolaisen stated that the commission's rules define "contingent fee" as follows: "Contingent fee means, except as stated in the next sentence, any fee established for the sale of a project or the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service. Solely for the purposes of this section, a fee is not a 'contingent fee' if it is fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies. Fees may vary depending, for example, on the complexity of services rendered."