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1998

# Staff Recent Interpretation Ratified: Coopers & Lybrand of Australia

Richard H. Towers

David E. Birenbaum

Independence Standards Board

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# Staff Recent Interpretation Ratified: Coopers & Lybrand of Australia

**This interpretation was ratified by the ISB at its November 3, 1998 meeting**

July 22,1998

Time-Limited Confidentiality Granted
(Subsequently released)

David E. Birenbaum, Esq.
Fried, Frank, Harris, Shriver & Jacobson
1001 Pennsylvania Avenue, N.W., Suite 800
Washington, DC 20004-2505

Dear Mr. Birenbaum:

This letter is to confirm to you, for your client Coopers & Lybrand Australia (and its successor firm PricewaterhouseCoopers Australia), the conclusions reached during the June 23 telephone conference call with the ISB staff, the SEC staff and your firm with regard to the share registry service independence issues described primarily in your memorandum dated May 21, 1998.

Your memorandum describes a likely unique set of facts in which Coopers & Lybrand Australia, through a now separate but affiliated entity, has for one or two years performed certain share registry services for Telstra Corporation Limited and certain related entities, which have not been audit clients. However, during July 1998, Coopers & Lybrand Australia is expected to form PricewaterhouseCoopers Australia by merging with Price Waterhouse of Australia, which under contract from and in coordination with the Auditor General of Australia, is the auditor of Telstra in connection with its U.S. SEC registrant status.

The Coopers & Lybrand Australia share registry services, while stated in your memorandum to be acceptable under Australian independence standards, normally would cause an impairment of independence with

regard to an audit client that is a U.S. SEC registrant, as you are aware from your reference to the SEC staff's 1993 Western Mining correspondence. You believe, however, that in the Telstra case there exist a number of mitigating and other circumstances, some involving potential significant hardship to Telstra, which warrant a different, transition period, approach. Specifically, you have proposed that your client and the merged firm in these circumstances be deemed not to have impaired their independence with respect to the Telstra audit until June 30, 1999, with the expectation that the independence concern would be eliminated by the sale of the services entity before that date. The ISB staff has addressed this issue from two viewpoints: first, whether there is sufficient support for some type of transitional approach and if so, then, how long a transition period would be appropriate in these circumstances.

When considering whether a transitional approach is appropriate, the ISB staff believes that several conceptual threats arise with respect to the performance of the share registry services when the same firm is auditing Telstra's financial statements. That is, a reasonable investor might consider the firm, to a degree, to be auditing its own work, or to be acting as management or in the role of an employee, or creating a mutuality of interest with the client.

However, you have represented that several mitigating factors exist in these circumstances to significantly counter those threats. For example:

- The Telstra audit is performed by personnel from Price Waterhouse of Australia, rather than from Coopers & Lybrand Australia – and even with respect to Coopers & Lybrand Australia the share registry services have been moved into a separate entity;
- No Price Waterhouse Australia personnel have any financial interest in that separate entity before or after the merger;
- Especially because of the aggregate sale of shares through the use of traded instalment receipts, the share registry services in question have no direct effect on the financial statements under audit; and
- The Auditor General of Australia is heavily involved in the Telstra audit, particularly including as to areas relating to the share registry services. In addition, as to registration services for TIRT (the Telstra Instalment Receipt Trustee Limited), a new Clearing House Electronic Sub-Register System ("CHESS Sub-Register") for the market trades of the Australian Stock Exchange automatically communicates virtually all of TIRT's transfer information, and that CHESS Sub-Register is reviewed by a different major auditing firm. Further, the Bank of New York, not Coopers & Lybrand Australia, serves as Telstra's transfer agent with respect to the ADRs traded on the New York Stock Exchange.

In addition, we note that in certain circumstances – e.g., the Western Mining case referred to in your memorandum - the SEC staff previously has granted limited relief relating to Australian share registry services. We also note that Regulation S-X, Rule 2-01 (c) provides that in considering independence matters "the Commission will give appropriate consideration to all relevant circumstances," and that elsewhere in the SEC literature there is provision allowing auditors to provide certain otherwise problematic services on a temporary or emergency basis, and this limited transition situation is temporary.

Considering the above mitigating circumstances and precedent, the ISB staff concludes that there is sufficient support in these circumstances for the implementation of a transition period approach.

As to the appropriate length of the transition period, as we discussed with you on June 23, the ISB staff does not agree that the firm should be considered independent throughout Telstra's entire fiscal year ended June 30, 1999, as you requested. Instead, we believe that, in these facts and circumstances and as to this matter only, the merged firm, continuing through a related entity to provide the services in question, should be considered independent after July 1, 1998 for a limited transitional period, but only up until the date it starts substantive "interim" work procedures (e.g., internal controls testing) for that fiscal year June 30, 1999 audit, which you indicated likely would be in March or April of 1999. As you described in your memorandum, the firm expects to resolve this independence concern prior to that date through appropriately disposing of the entity providing those services. Further, until the independence concern is resolved, the previously described separation of the services entity, and of (former) Coopers & Lybrand Australia personnel from the (former) Price Waterhouse Australia audit should be enforced.

Several other factors you have presented, and upon which representations we rely in forming our conclusions, were helpful as follows:

- This independence concern arises in July 1998 solely due to completion of the merger – no services causing impairment were knowingly undertaken. In addition, once identified, even before completion of the merger the firm has taken responsible and prompt action (i.e., to sell the entity providing those services) to eliminate the concern;
- Resignation of the share registry services engagement does not appear reasonably practicable in a period shorter than that in which the firm is expected to sell the entity performing the services (for reasons expressed in your memorandum); and

- Resignation of the audit engagement in the near future would appear likely to cause serious disruption to the registrant at times of important activity (for reasons expressed in your memorandum).

Our analysis also notes that Regulation S-X, Rule 2-01 (b), as to financial interests, defines in the authoritative literature the relevant independence period as "during the period of his professional engagement to examine the financial statements being reported on or at the date of his report…." While the above described independence threats conceptually exist from the date of the merger, we believe that those threats would become significantly stronger when the share registry services were being performed during the period in which the completely merged firm was performing substantive audit procedures. Therefore, in these circumstances, the ISB staff considers it necessary to require that the transition period threats be negated before the commencement of substantive (interim) procedures for the June 30, 1999 audit, scheduled to start in March or April 1999.

The above ISB staff conclusions relate solely to the specific facts and circumstances of this highly unusual situation; different facts may lead to different conclusions, and our conclusions rely upon the representations you have made to us.

- In addition, the ISB staff does not necessarily agree with all arguments made in your correspondence – in particular (but not only) your statement in item 8.1 of your May 21 memo that "Until the Share Transfer in early December 1998, the SRS Entity will provide registry services primarily to TIRT and the ESOP Trustee, and these services will not impair the Merged Firm's independence in relation to Telstra."
- Further, as agreed, this response to your issue addresses only the situation in which the sale of the share registry services entity is made to an independent party and involves no earnout, guarantee of future revenue, or similar contingency. Any such contingencies introduced into the sale would be new facts to be separately evaluated; as we discussed, the ISB staff has significant reservations with regard to the effectiveness of a "sale" as a resolution to an underlying independence concern when such contingencies are present.

As we discussed in our June 23 conference call that included the SEC staff, we confirm our understanding that under the SEC's Financial Reporting Release 50 and the ISB's Operating Policies, the conclusions stated in this letter may be relied upon, as to this case, only by the parties directly affected by them. You listed the following as expected affected parties: Coopers & Lybrand Australia, Price Waterhouse of Australia, TIRT, the ESOP Trustee, Telstra, and the Commonwealth of

Australia. We presume that PricewaterhouseCoopers Australia also soon should be viewed as an affected party.

Please notify us upon the occurrence of the first of any of the determinative events referred to above (such as the sale of the share registry services entity), or of any other relevant and important matters (such as the public announcement of the intent to sell the share registry services entity as described in our agreement to time-limited confidentiality). Also, please remember that this interpretive letter, and the memoranda you have submitted to us on this matter, will be subject to being made public in accordance with ISB policies and practices at the end of the agreed-upon limited confidentiality period.

Sincerely,

Richard H. Towers
Technical Director

May 22, 1998

David E. Birenbaum, Esq.
Fried, Frank, Harris, Shriver & Jacobson
1001 Pennsylvania Avenue, N.W., Suite 800
Washington, D.C. 20004-2505

CONFIDENTIAL
(Subsequently released)

Dear Mr. Birenbaum:

The ISB staff has received your Request for Interpretation/Advice dated May 21, 1998, on behalf of your client, Coopers & Lybrand of Australia, and your request for confidential treatment. The ISB staff agrees to provide confidential treatment as described below.

- The private business information and strategies disclosed in your request provide appropriate basis for limited confidential treatment.

- However, that basis substantially expires at the earlier of: the public announcement by Coopers & Lybrand or certain of its partners of the intent to sell the share registry services entity, or the abandonment of C&L efforts to sell that entity accompanied by

resolution of the independence question in another manner, but in no case later than July 1, 1999. (Because this business is located in Australia, we request you to notify us if, and when, such a public announcement, or an abandonment of such efforts to sell, occur.)

- Upon reaching the appropriate date as described directly above, the ISB staff will deem its grant of confidential treatment to be ended. Thereafter, the typical information for our formal interpretive consultations could, and likely would, be made public by the ISB staff, including on our website. Information subject to being made public would include our response letter (not yet prepared), your memo dated May 21, 1998, including attachments (specifically including certain previous correspondence relating to "Western Mining"), and any further information you send to us as part of this consultation.

  - As to any such ISB staff publication, we would be willing to consider, although not committing to accept, any requests you might make to "redact" any specific numbers or information that you at that time believe still to be of a confidential nature.

- In addition, you have requested that the SEC staff be involved in the consultations on this issue. Your May 21 memo indicates that you will arrange confidential treatment of your materials with the SEC staff and their appropriate access to these materials.

We will proceed with our review of your request and coordinate comments with the SEC staff, and will contact you as soon as reasonably possible for additional information or discussions to lead to a resolution.

Sincerely,

Richard H. Towers
Technical Director

### Index to Public File Contents of Requester Documents Relating to ISB Staff Interpretive Letter Dated 7/22/98

Letters/ Memos of Fried, Frank, Harris, Shriver, & Jacobson

1. 5/8/98 (7 p.) – partly amended by 5/21/98 memo
   (- 1 p. transmittal memo – hardcopy file only)

2. 5/21/98 (26p.)
   (- 40 p. Appendices A-B-C-D [less A4-redacted] – hardcopy file only)
   (- 1 p. transmitted memo – hardcopy file only)

3. 6/8/98 (3 p.)

4. (-1 p. 7/22/98 – hardcopy file only)

5. 9/10/98 (1 p.)

**Note**: Two "hardcopy files" are maintained, one at the ISB offices in New York City, and one at the AICPA Library, Harborside Financial Center, 201 Plaza Three, Jersey City, New Jersey. Copies of the hardcopy file documents may be obtained upon request at a cost of $ .15 per page.

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**FRIED, FRANK, HARRIS, SHRIVER & JACOBSON**
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

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September 10, 1998

Writer's Direct Line
202-639-7019

**<u>By Facsimile and U.S. Mail</u>**

Richard H. Towers
Technical Director
Independence Standards Board
1211 Avenue of the Americas
6th Floor
New York, New York 10036-8775

Dear Rick:

We wish to inform you that PricewaterhouseCoopers ("PwC") in Australia has completed the sale of its share registry services entity to an independent party. The sale does not involve any “earn-out,” guarantee of future revenue by PwC or other such contingency.

Prior to the publication of your interpretive letter and our submissions to the Independence Standards Board regarding Coopers & Lybrand's share registry business in Australia, we would like to redact certain privileged or confidential information from the submissions. Please contact us at your earliest convenience to discuss this matter.

Sincerely,

David E. Birenbuam

deb:paj:141045

NEW YORK - WASHINGTON - LOS ANGELES - LONDON

June 8, 1998

WRITER'S DIRECT LINE

202-639-7019

**CONFIDENTIAL**

**BY FACSIMILE**

Richard H. Towers
Technical Director
Independence Standards Board
1211 Avenue of the Americas
6th Floor
New York, New York 10036-8775

Dear Rick:

This letter contains responses to questions you have raised subsequent to our submission of a request for interpretive guidance on behalf of our client, Coopers & Lybrand of Australia ("C&L Australia").

**1. Telstra**

- Telstra Corporation Limited currently is the largest corporation in Australia.

(Redacted)

**2. Dividend Payments**

- C&L Australia does not exercise custody over Telstra's assets in connection with dividend payments.

## 3. Telstra Audit Plan

- For the year ending June 30, 1999, the audit plan for the Telstra audit is as follows:

| | |
|---|---|
| November 1998 | Completion of audit plan |
| March – April 1999 | Internal controls testing (review of key control systems; detailed testing of transactions that generate entries to Telstra's ledgers) |
| June 1999 | Pre-final audit |
| Mid-July – August 1999 | Final audit |

- In addition to these dates, Price Waterhouse of Australia will conduct a half-year review for Australian purposes during mid-January and February 1999.

- If the Commonwealth of Australia conducts a further privatization of Telstra, additional audit work will be required.

## 4. Computershare

- Computershare is independent of C&L Australia.

## 5. Sale of the Share Registry Practice

- The sale of the share registry practice could involve either of two contingencies, although the likelihood of a contingency has not yet been determined.

- First, the purchaser may require a guarantee that the share registry practice will not suffer a significant decline in the year following the sale. Second, the parties may wish to structure a portion of the payment as an "earn-out," under which C&L Australia would be entitled to a share of the profits of the share registry practice for a number of years following the sale.

- With respect to the first potential contingency, the share registry practice's most significant client, Telstra, likely would provide the purchaser with a comfort letter as to its

commitment as a client. Such a letter should obviate the need for a guarantee.

- With respect to the earn-out, none is currently planned, and we propose that the request for interpretive guidance be considered on that basis. Should circumstances change in this respect, C&L Australia will undertake to inform the ISB and seek concurrence that the specific payment arrangement would not impair independence.

**6. Effect of Sale on Proposed Merger**

- The proposed sale of the share registry practice will not have any effect on the terms of the proposed merger of the Australian Price Waterhouse and Coopers & Lybrand firms. The terms do not reflect any assumptions as to the going-concern value of that practice.

Please contact us if you have any further questions.

Sincerely,

David E. Birenbaum

*DC02:134579*

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May 21, 1998

(Appendices not included herein)

202-639-7019

**CONFIDENTIAL**

**BY HAND**

Mr. Richard H. Towers
Technical Director
Independence Standards Board
1211 Avenue of the Americas
6th Floor
New York, New York 10036-8775

Dear Mr. Towers:

This letter confirms and supplements the information presented in the Request For Interpretation/Advice (the "Request") submitted on behalf of our client, Coopers & Lybrand of Australia ("C&L Australia"), on May 8, 1998 and at our meeting of May 13, 1998. As noted in the Request, C&L Australia has concluded that the continued provision of certain share registry services by a partnership owned by partners of C&L Australia (the "SRS Entity") to Telstra Corporation Limited ("Telstra"), for a limited and reasonable time not to extend beyond Telstra's fiscal year-end on June 30, 1999, would not impair the independence of Telstra's auditor in the United States, Price Waterhouse of Australia ("PW Australia"), were PW Australia to merge with C&L Australia. PW Australia has reviewed this matter and concurs with C&L Australia's conclusion. We request your confirmation that, under the facts and circumstances detailed below, the merged firm of C&L Australia and PW Australia (the "Merged Firm"), should it be established, would be independent with respect to audit work performed subsequent to the merger relating to financial statements included in registration statements, forms and reports filed by Telstra with the Securities and Exchange Commission (the "SEC" or "Commission") under the Securities Act of 1933, 15 U.S.C. § 77a *et seq*. (the "Securities Act") and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq*. (the "Exchange Act"). The basis for C&L Australia's conclusion is set forth below.

## 1. Introduction and Executive Summary

1.1 The potential independence issue which is addressed herein arises out of the proposed merger of the member

firms of the Coopers & Lybrand and Price Waterhouse worldwide organizations, including C&L Australia and PW Australia (the "Merger"). If the Merger is approved by government regulators and, subsequently, by the various member firms of the two organizations, it will likely take place in July 1998 (the "Merger Date").

1.2 Telstra is an Australian telecommunications company registered with the SEC and two-thirds owned by the Commonwealth of Australia (the "Commonwealth"). C&L Australia is providing certain share registry services in Australia to three entities relevant here: Telstra; Telstra Instalment Receipt Trustee Limited ("TIRT"), a trustee established by the Commonwealth to facilitate the partial privatization of Telstra; and Telstra ESOP Trustee Pty Limited, a trustee established by Telstra to administer its employee share ownership plan (the "ESOP Trustee"). The auditor of Telstra, TIRT and the ESOP Trustee is the Auditor General of the Commonwealth. PW Australia performs audit services solely for Telstra under contract with the Auditor General and serves as Telstra's auditor in connection with its filings with the SEC. PW Australia does not perform audit services for TIRT or the ESOP Trustee either directly or indirectly under contract with the Auditor General.

1.3 In the partial privatization of Telstra in November 1997, the Commonwealth offered one-third of its shares in Telstra to the public, with payment to be made in two instalments. The first instalment was payable in November 1997. The second instalment is payable on November 17, 1998. Upon payment of the first instalment, the Commonwealth transferred one-third of its shares to TIRT, which then issued to share applicants one Instalment Receipt ("IR") for each allocated share.

Each Instalment Receipt represents a beneficial interest in the underlying share held by TIRT, and Instalment Receipt holders are entitled to dividend and voting rights. If the share applicants pay the second instalment on November 17, 1998, TIRT will transfer the shares to them. As a practical matter, the transfer of shares to the Instalment Receipt holders likely will not occur until early December 1998 (the "Share Transfer"). Further information regarding these arrangements is set out in Telstra's Amendment No. 3 to Form F-1 (filed with the SEC on November 10, 1997), in particular the sections entitled "Description of Shares," "Description of the Instalment Receipts and Trust Deed" and "Description of Interim American Depository Receipts and American Depository Receipts," as well as the Memorandum of Understanding among the Commonwealth, Telstra, TIRT and the ESOP Trustee, which are appended hereto (Appendixes A1 - 4, respectively).

1.4 The Australian Securities Commission has stated that the provision of shareholder registry services to audit clients in Australia does not impair independence. The SEC Staff, however, required C&L Australia several years ago to cease providing share registry services (within a period no shorter than eight months) to an audit client in Australia, Western Mining Corporation.

1.5 While C&L Australia considers the Telstra situation clearly distinguishable from *Western Mining*, the firm is pursuing a plan to divest its share registry practice to unrelated third parties within a reasonable period after the Merger Date and prior to the end of Telstra's fiscal year on June 30, 1999. In this regard, C&L Australia has retained an adviser, prepared an information memorandum, and initiated contact with a number of potential purchasers.

1.6 Telstra, TIRT, the ESOP Trustee and C&L Australia seek to avoid any precipitous disruption of service in connection with the divestment, particularly during a period in which TIRT will transfer shares to the Instalment Receipt holders and the Commonwealth may conduct a further offering of Telstra shares (possibly before the end of 1998). In connection with such an offering, Telstra would file a Form F-1 or F-2 with the Commission. Telstra will also file a Form 20-F annual report with the Commission in September or October 1998 and may conduct a registered debt offering late this year or early next year.

1.7 C&L Australia believes that a period of 12 months constitutes a reasonable time frame within which to divest the share registry practice. The proposed period of 12 months is reasonable and necessary in light of (i) the requirements of Telstra and TIRT with respect to the Share Transfer, and of Telstra with respect to the prospective further privatization (which would be, by far, the largest ever in Australia), (ii) the commercial impracticability (because of the extensive preparation required to perform these services, including the implementation of state-of-the-art technology) of retaining a suitable replacement service provider within a shorter time frame, if C&L Australia were to resign, (iii) the time required to accomplish a divestiture, (iv) the hardship to Telstra that would result if PW Australia were to resign as auditor in connection with its filings with the SEC and (v) the numerous safeguards which mitigate any potential threat to the independence of the Merged Firm during the period of divestiture. Finally, a 12-month period is within the range of transition periods allowed in analogous circumstances by the SEC and other regulatory agencies.

## 2. Share Registry Services Provided to Telstra, TIRT and the ESOP Trustee by C&L Australia

2.1 It is common practice in Australia for accounting firms to maintain the records of share ownership of publicly-listed companies. Share registrars in Australia perform more limited functions than transfer agents in the United States, which typically sign stock certificates and dividend checks and exercise control over dividend bank accounts. Thus, C&L Australia, like other Australian registrars, maintains a register of shareholder names, addresses and number of shares owned, attends to shareholder inquiries, calculates dividend check amounts, and performs a number of other ministerial functions, such as providing information to third parties to facilitate the distribution by such third parties of written materials and dividends to shareholders.[1] C&L Australia has implemented procedures to ensure that Telstra exercises managerial responsibility for the payment of dividends. The client retains responsibility for its shareholder register as well. C&L Australia has agreed also to administer any dividend reinvestment plan or bonus share issue plan approved by Telstra. However, no such plan presently exists, and Telstra is not expected to approve any such plan (which requires authorization of the Parliament) prior to the divestment of the share registry business. A comprehensive summary of the share registry services C&L Australia has agreed to provide to Telstra, TIRT and the ESOP Trustee is presented in Appendix B.

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[1] C&L Australia has contracted with Computershare Pty Ltd ("Computershare"), a major provider of share registry computer services in Australia, to perform certain of these services for TIRT, the ESOP Trustee and Telstra. Computershare operates and maintains the computer system on which the registers for these entities are maintained. C&L Australia has on-line access to the Computershare system.

2.2 Since 1994 (and subsequent to the issuance of the *Western Mining* letter), the Australian Stock Exchange ("ASX") has assumed legal responsibility for recording the holdings of participants in the Clearing House Electronic Sub-Register System, or "CHESS," the ASX's electronic settlement system. This section of the register, which is called the "CHESS Sub-Register," is deemed by law to be part of the legal and principal register of the company. Also since 1994, the ASX has been required to advise share registrars electronically of all share transfers arising from trades on the ASX.

2.3 The ASX retains independent auditors (KPMG) to review the reliability and integrity of the CHESS Sub-Register and share transfers advised electronically by the ASX.

2.4 C&L Australia does not provide share registry services to Telstra in the United States. Rather, these services are provided by the Bank of New York, Telstra's U.S. transfer agent. The Bank of New York maintains a register of American Depository Receipts ("ADRs"), which are listed on the New York Stock Exchange. Telstra shares underlying such ADRs are deposited with a custodian bank in Australia and transferred, in the name of the custodian bank, on the share register in Australia. Telstra shares also were registered and sold to U.S. investors in the partial privatization and are now held by U.S. investors. Transfers of such shares typically take place through CHESS, although off-market transfers can also occur.

## 3. Relevant Independence Principles

3.1 Regulation S-X sets forth the form and content of, and requirements for, financial statements required to be filed by public companies with the Commission under

various provisions of the federal securities laws.[2] Article 2 of Regulation S-X contains certain rules relating to the "Qualifications and Reports of Accountants." Rule 2-01, which is part of Article 2, sets forth the Commission's only substantive rule addressing the independence of public accountants.[3] Rule 2-01 was adopted in 1940, replacing earlier independence standards that were promulgated under the Securities Act.[4]

3.2 Rule 2-01(c) provides that:

> In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in

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2 *See* Rule 1-01(a) of Regulation S-X, 17 C.F.R. § 210.1-01(a) (1997).

3 *See, e.g.*, Qualifications and Reports of Accountants; Proposed Amendment of Rules Regarding Independence of Accountants, 47 Fed. Reg. 47,265 (Oct. 25, 1982) (noting proposal by the Commission "to amend *its rule* regarding the independence of accountants * * * 2-01") (emphasis supplied).

4 *See* Article 14, Rules and Regulations under the Securities Act of 1933, Federal Trade Commission (July 6, 1933), *subsequently adopted as* Article 14, Rules, Regulations and Opinions under the Securities Act of 1933, Securities and Exchange Commission (Apr. 29, 1935). *See also* Rule 650, General Rules and Regulations under the Securities Act of 1933 (Jan. 21, 1936).

connection with the filings of reports with the Commission.[5]

The SEC has stated that Rule 2-01(c) is intended to allow the Commission to take into consideration "the existence of particular relationships [that] might be relevant to its determination whether the accountant was in fact independent."[6] Moreover, the Commission has stated that "[n]o set of rules or compilation of representative situations can embrace all the circumstances which could affect such a determination"[7] and that "situations arise which require judgment in determining whether the Commission's standards of independence have been met . . ."[8]

3.3 More recently, the SEC issued a "Statement of Policy on the Establishment and Improvement of Standards Related to Auditor Independence,"[9] a portion of which is described as setting forth the Commission's independence standard. The Commission stated that the basic test for auditor independence is "whether a reasonable investor, knowing all relevant facts and circumstances, would perceive an auditor as having neither mutual nor conflicting interests with its audit

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5 17 C.F.R. § 201.2-01(c) (1997).

6 Accounting Series Release ("ASR") No. 44 [1937-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) 72,062 at 62,134 (May 24, 1943). A former SEC Chairman has observed that Rule 2-01(c) was intended to underscore that "independence was a question of fact, to be determined after examining all the evidence that might bear upon the existence or non-existence of that fact." Purcell, "Cooperation Between SEC and Public Accountants," J. OF ACCT., 155-56 (August, 1943).

7 Section 602.02a of the Codification, 7 Fed. Sec. L. Rep. (CCH) ¶ 93,257 at 62,885.

8 *Id.*

9 Exchange Act Release No. 39,676 (Feb. 18, 1998).

client and as exercising objective and impartial judgment on all issues brought to the auditor's attention."[10] The Commission noted further that in determining whether an auditor is independent, it "considers all relevant facts and circumstances, and its consideration is not confined to relationships existing in connection with the filing of reports with the Commission."[11]

3.4 In addition to Rule 2-01, Section 600 of the Codification of Financial Reporting Policies and SEC policy statements, the SEC's independence requirements are reflected in no-action letters issued by the OCA. In several letters, the OCA has stated that, absent an SEC rule or interpretation to the contrary, it looks to AICPA standards for guidance.[12] Rule 101 of the AICPA's Code of Professional Conduct provides that "[a] member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by [the AICPA's Council]."[13] Pursuant to Rule 101, the AICPA has issued a series of interpretations and ethics rulings on auditor independence.

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10 *Id.*

11 *Id.* (citing Rule 2-01(c)).

12 *See, e.g., Deloitte, Haskins & Sells*, SEC No-Action Letter [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,398 at 78,455 (Jan. 14, 1983).

13 *See* AICPA Professional Standards, Code of Professional Conduct ("ET") § 101.01. In addition, the AICPA's professional standards state that "[i]ndependent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence." *See* AICPA Professional Standards, Statements on Auditing Standards ("AU") § 220.03.

3.5 While the SEC has declined to adopt rules limiting the performance of specific types of non-audit services by accounting firms for audit clients, the Commission has asserted in other pronouncements that it will not consider accountants independent, if they assume managerial or decision-making responsibilities on behalf of clients while performing non-attest services. Specifically, while acknowledging that "independent public accountants often advise management and offer professional advice on matters dealing with financial operations," Section 602.02.c.i of the Codification provides that "managerial and decision-making functions are the responsibility of the client and not of the independent accountant."[14] Section 602.02.c.i further states that:

> Managerial responsibility begins when the accountant becomes, or appears to become, so identified with the client's management as to be indistinguishable from it. In making a determination of whether this degree of identification has been reached, the basic consideration is whether, to a third party, the client appears to be (i) substantially dependent upon the accountant's skill and judgment in its financial operations, or (ii) reliant only to the extent of the customary type of consultation or advice.[15]

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14 7 Fed. Sec. L. Rep. (CCH) ¶ 73,263 at 62,890.

15 *Id.*

This restriction is based on the Commission's view that "[i]f the independent accountant were to perform functions of this nature, he would develop, or appear to develop, a mutuality of interest with his client which would differ only in degree, but not in kind, from that of an employee," in which case "it may be logically inferred that the accountant's professional judgment toward the particular client might be prejudiced in that he would, in effect, be auditing the results of his own work."[16]

3.6 In light of the Commission's concern with "self-review," Section 602.02.c.i also sets forth the SEC's position that "an accounting firm cannot be deemed independent with regard to auditing financial statements of a client if it has participated closely, either manually or through its computer systems, in maintenance of the basic accounting records and preparation of the financial statements, or if the firm performs other accounting services through which it participates with management in operational decisions."[17]

## 4. A Reasonable Transition Period is Required to Divest the Share Registry Practice

4.1 As noted above in section 1.1, any independence issue that arises with respect to the SRS Entity's performance of share registry services for Telstra will arise solely as a result of the Merger. In anticipation of the Merger, C&L Australia has actively developed and pursued a plan to divest its share registry practice. Divestment, however, cannot be accomplished immediately as of the

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16 *Id.*

17 *Id.*

Merger Date. A reasonable transition period is required to avoid serious disruption to Telstra, TIRT and the ESOP Trustee.

4.2 C&L Australia believes that a period of 12 months constitutes a reasonable and necessary time frame within which to accomplish divestiture of the share registry practice. A number of factors support this view. First, TIRT, the ESOP Trustee, Telstra and C&L Australia wish to minimize disruption during a period in which two major undertakings regarding the registers will be implemented. Second, resignation from the share registry engagements or the audit engagement is not commercially practicable. Third, a number of safeguards mitigate substantially whatever perceived threat to independence may arise from the Merger during the period of divestiture. Finally, the proposed 12-month period is required by the particular facts and circumstances of the TIRT, ESOP Trustee and Telstra engagements and is consistent with guidance provided by the SEC and its Staff and other regulatory agencies, which have granted appropriate transitional relief in analogous situations.

## 5. The Need to Avoid Serious Disruption

5.1 C&L Australia's request for a reasonable transition period must be viewed in light of the particular facts and circumstances presented by its engagements with TIRT, the ESOP Trustee and Telstra. Specifically, TIRT must transfer shares of Telstra to over 1.5 million Instalment Receipt holders in early December 1998, following payment of the second instalment on November 17, 1998. The logistical requirements associated with assisting TIRT to process these payments and transfer the shares to the Instalment Receipt holders are of extraordinary size and complexity. TIRT and C&L

Australia have made substantial investments in preparing for these tasks.

5.2 A second major undertaking affecting TIRT, the ESOP Trustee and Telstra is the Commonwealth's planned sale of its remaining holdings in Telstra. The Australian government has announced that it will sell the final two-thirds of its shares in Telstra if it is re-elected in the election anticipated to occur late in 1998 or early in 1999. Preliminary planning for a second public offering of Telstra shares currently is underway.

5.3 Preparation for these major undertakings, which has been substantial, cannot readily be duplicated by an alternative service provider. The Commonwealth tentatively appointed C&L Australia registrar for its sale of Telstra shares in June 1997, following an exhaustive tender process commenced two months earlier. Prior to that time, C&L Australia spent over 12 months researching and identifying improved technological methods for handling the Telstra assignment. Although C&L Australia had administered the registers associated with the five largest offerings in Australia's history, public announcements indicated that the Telstra offering could be up to ten times larger than any preceding it. The industry acknowledged that new and innovative processes, involving state-of-the-art technology, would be essential to meet the volume and complexity of the Telstra assignment. After lengthy negotiations, the Commonwealth in September 1997 officially appointed C&L Australia registrar for its sale of Telstra shares, and, in October 1997, the Commonwealth appointed C&L Australia registrar for a two-year term for the ongoing TIRT and Telstra registers.

5.4 The Commonwealth's offering of one-third of its shares in Telstra in November 1997 was the largest public

offering in Australia's history. The offering generated approximately 1.9 million share applicants, six times more than any previous offering in Australia. Implementation of the TIRT register was a substantial logistical task. (Redacted)

5.5 C&L Australia's request for a reasonable transition period is designed to reassure its clients that divestiture will take place in an orderly process that will not jeopardize either the planning or implementation of the Share Transfer or second public offering.

## 6. Resignation from the Registry Engagements is Not Commercially Practicable in a Term Shorter than that Required for Divestiture

6.1 The SRS Entity's resignation from the TIRT, ESOP Trustee and Telstra engagements would impose significant inconvenience and hardship on its clients. Given the approaching date of the Share Transfer and the possibility of a second public offering shortly thereafter, and considering the knowledge gained to date by personnel of C&L Australia and the infrastructure developed (as described above) to meet the requirements of TIRT, the ESOP Trustee and Telstra, resignation would seriously jeopardize satisfactory completion of the Share Transfer and implementation of the second public offering (if the Commonwealth decides to proceed with it).

6.2 Moreover, it is highly unlikely that an alternative service provider could assume the registry engagements in a time frame shorter than the one C&L Australia proposes for divestment. Only one other registrar in Australia currently is large enough to contemplate the second instalment and second public offering of Telstra shares. That registrar is preparing for two other large public

offerings, one involving the demutualization of AMP Society and the other involving the sale by the New South Wales Government of all of its shares in TAB Limited (a state-owned wagering operator). The AMP Society demutualization will create a register of up to 1.5 million shareholders (equal in size to the present TIRT register), while the TAB Limited offering is expected to generate from 500,000 to 1 million shareholders. Already facing significant challenges to meet its obligations under existing engagements, this registrar will not be prepared to replace the SRS Entity in the short term as registrar for TIRT, the ESOP Trustee and Telstra. Notably, C&L Australia declined to tender for the AMP Society demutualization, recognizing that it did not have sufficient resources to perform both assignments satisfactorily. Under these circumstances, transfer of the TIRT, ESOP Trustee and Telstra registers to a different service provider is not commercially practicable in the short term. The period realistically required to replace the SRS Entity as registrar is explained in section 9.2.

## 7. Resignation from the Telstra Audit Would Cause Significant Hardship to Telstra

7.1 PW is obligated under contract with the Auditor General to perform audit services for Telstra for the fiscal years ending June 30, 1998 and June 30, 1999.

7.2 PW's resignation from the Telstra audit as of the Merger Date would jeopardize Telstra's filing of financial statements in Australia and the United States for the fiscal year ending June 30, 1998.

7.3 PW's resignation from the Telstra audit prior to completion of the June 30, 1999 audit would be

impractical and highly disruptive to Telstra for the following reasons:

7.3.1 Significant physical disruption to multiple Telstra divisions and senior management during start up phase of new auditor;

7.3.2 Potential impact on Telstra's ability to file on a timely basis six-month and yearly financial statements in Australia and the United States;

7.3.3 Potential impact on the Commonwealth's timetable for conducting second tranche of the Telstra privatization;

7.3.4 Disruption to other associated audit activities, including regulatory accounts, Japanese Securities Registration, and filing requirements.

7.4 The appointment of an additional auditor by Telstra for U.S. purposes (and retention of PW for Australian purposes) would be impractical and highly disruptive to Telstra for the same reasons. The appointment of an additional auditor also would impose duplicate costs on Telstra.

**8. No Independence Issue Arises Prior to December 1998, and, Thereafter, a Number of Safeguards Mitigate Substantially Any Perceived Threat to Independence During the Period of Divestiture**

8.1 Until the Share Transfer in early December 1998, the SRS Entity will provide registry services primarily to TIRT and the ESOP Trustee, and these services will not impair the Merged Firm's independence in relation to Telstra.

8.1.1 The provision of registry services to TIRT and the ESOP Trustee will not give rise to any potential for self-review.

(a) Neither TIRT nor the ESOP Trustee is an audit client of PW Australia or C&L Australia or will be an audit client of the Merged Firm. Rather, the Auditor General serves as the auditor of both entities. It should be noted in this connection that the SEC accepts foreign governmental auditing agencies, such as the Auditor General, as auditor of government agencies in connection with registration statements, forms and reports filed with the Commission. *See*, *e.g*., Rule 2-03 of Regulation S-X.

(b) The financial accounts of TIRT and the ESOP Trustee will not be consolidated with those of Telstra.

(c) The records the SRS Entity will maintain in relation to registry services provided to TIRT and the ESOP Trustee:

- do not form the basis for the preparation or review of accounting entries or financial records of Telstra,
- have no bearing on the financial statements of Telstra, and
- are not accounting records.

(d) PW Australia does not examine any aspect of the instalment receipt register of

TIRT in connection with its audit of Telstra. Nor does PW Australia examine in that regard TIRT's or Telstra's performance of its responsibilities to holders of instalment receipts.

8.1.2 The services provided to TIRT and the ESOP Trustee do not involve the assumption of managerial responsibilities on behalf of Telstra.

(a) TIRT and the ESOP Trustee, entities separate and distinct from Telstra, are managed independently of Telstra. Telstra neither supervises nor controls TIRT or the ESOP Trustee. The SRS Entity's performance of services for TIRT and the ESOP Trustee, therefore, will not relieve Telstra of managerial responsibilities.

(b) Both TIRT and the ESOP Trustee owe fiduciary obligations to trust beneficiaries, not to Telstra. TIRT owes its fiduciary obligations to Instalment Receipt holders. The ESOP Trustee owes its fiduciary obligations to participants in Telstra's employee share ownership plan (prior to the Share Transfer, to participating employees holding instalment receipts and, thereafter, to employee shareholders to the extent of payment of the second instalment).

8.2 The potential independence issue relating to Telstra does not arise until early December 1998, when TIRT transfers the Telstra shares to the Instalment Receipt holders. Maintenance of the Telstra share register will be merely a formality prior to that time, because the register will contain only two shareholders: the Commonwealth and TIRT. The principal services the SRS Entity will provide to Telstra before the Share Transfer relate to the holding of Telstra's Annual General Meeting on November 6, 1998. These services, involving such tasks as the distribution of meeting notices and collection and counting of ballots, will be essentially ministerial and unrelated to maintenance of Telstra's share register.[18] Accordingly, we see no basis for concluding that the provision of share registry services by the SRS Entity to Telstra would give rise to any potential impairment of independence prior to the Share Transfer.

8.3 No partner of the Merged Firm other than present partners of C&L Australia will derive any financial benefit from the provision of share registry services to Telstra. This is because C&L Australia will transfer the share registry line of business to the SRS Entity prior to the Merger. The SRS Entity will be owned by the present partners of C&L Australia. Further, the present C&L Australia partners will be walled off from any audit services performed for Telstra. Such services will be the sole responsibility of the former PW partners. Thus, the partners who provide audit services to Telstra will not derive any benefit from the share registry engagement.

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18 The SRS Entity also will perform certain tasks in relation to the dividend Telstra will pay in October 1998, principally with respect to the distribution of the dividend by TIRT to the Instalment Receipt holders.

8.4 Based upon current processing volumes for TIRT, the SRS Entity is expected to perform data entry for Telstra with respect to only 0.3% of the changes in volume on the Telstra share register. These changes in volume reflect share transfers not executed on the ASX. Share transfers executed on the ASX, which are expected to account for 99.7% of the changes in volume on the Telstra register, will be advised electronically to the SRS Entity.

8.5 The audit team (*i.e.*, the former PW personnel) will rely on the opinion of the Auditor General, which in turn relies on the opinion of KPMG, an unrelated third-party auditor, with respect to share transfers advised electronically to the SRS Entity. Furthermore, the Auditor General, not the Merged Firm, retains final authority over the audit of Telstra's financial statements.

8.6 The Merged Firm intends to place reliance on the independent audit work of the Auditor General with respect to the audit of Telstra's U.S. financial statements. Under Australian Corporation Law, the Auditor General as part of its audit must consider whether Telstra has kept proper accounting records (including registers). In satisfying this requirement and forming an audit opinion on the financial statements, the Auditor General will perform the following tasks:

8.6.1 Until the time the second instalment is paid, the Auditor General will review the share register maintained by Telstra's Company Secretary, which includes only two shareholders (the Commonwealth and TIRT).

8.6.2 Subsequent to instalment receipt conversion, the Auditor General will adopt the following procedures for the December 31, 1998 half-

year review/audit and June 30, 1999 annual audit:

(a) request confirmation from the share registrar of the total issued shares and their paid-up value on the share register;

(b) request confirmation from the share registrar that the register has been properly maintained in accordance with the Corporation Law; and

(c) audit the confirmations received under (a) and (b) above via the conduct of independent audit testing on the share register. It is important to note that the Auditor General will conduct this independent audit testing directly using his staff and not rely on sub-contracted staff from the Merged Firm.

8.7 The Merged Firm's reliance on the independent audit work of the Auditor General will accord with the practice and procedures outlined under U.S. Generally Accepted Auditing Standards ("GAAS"), in particular Statement of Auditing Standard 65, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements." The Merged Firm will consider the planning and findings of the work of the Auditor General in forming an opinion on the U.S. financial statements.

8.8 The facts and circumstances stated herein distinguish the present situation from existing SEC and AICPA guidance relating to share registry services.

8.8.1 The Telstra situation differs significantly from *Western Mining*, where C&L Australia provided share registry and audit services to Western Mining Corporation, an SEC registrant, for a number of years, not as a consequence of a merger but in the ordinary course of business, and without the benefit of the numerous safeguards listed above in sections 8.3 through 8.7.

8.8.2 Given C&L Australia's decision to divest the share registry practice, the present situation also is distinguishable from *Levitz, Zacks & Ciceric*.[19] There, the SEC Staff concluded that an accounting firm's maintenance of a database of information on behalf of an audit client could adversely affect the firm's independence, because the arrangement did not appear to be of a short-term nature.

8.8.3 The services the SRS Entity will provide to Telstra are distinguishable from those addressed in Example 3 of Section 602.02.c.ii of the Codification of Financial Reporting Policies.

(a) The services do not involve a "complete restatement" of Telstra's shareholder register, as that term is used in Example 3.

(b) Instead, the services will be ministerial in nature. Moreover, as indicated above, the SRS Entity will perform data entry with

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19 SEC No-Action Letter, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,925, at 78,666 (Dec. 17, 1992).

respect to only a *de minimis* percentage (0.3%) of the changes in volume on the Telstra share register.

(c) Other share registry services provided to Telstra, such as the input of data regarding address changes or the calculation of dividend check amounts, similarly will be clerical in nature.

8.8.4 The services do not impair independence under Interpretation 101-3 of the AICPA's independence rules.

(a) Telstra will remain responsible for all of its basic accounting records and resulting financial statements, and no member of the SRS Entity, or of the Merged Firm, will exercise influence over Telstra's operating, financial, or accounting policies in connection with the share registry business.

(b) Moreover, the SRS Entity will not consummate transactions in Telstra stock, possess custody of Telstra assets, or exercise authority on behalf of Telstra.

(c) All source documents used in the compilation of the share registry will be prepared independently of the SRS Entity, and the SRS Entity will not make any changes to the source data without instruction.

8.8.5 The services do not impair independence under AICPA Ethics Ruling 39, which specifically states that if an auditor is not an "officially appointed stock transfer agent or registrar," it may assist clients in accordance with Interpretation 101-3.

(a) The SRS Entity will not act as an officially appointed stock transfer agent or registrar with respect to Telstra's U.S. listed securities. Rather, the Bank of New York, which currently acts as Telstra's transfer agent with respect to its U.S. listed securities, will retain that role. AICPA Ethics Ruling 39 does not prohibit the SRS Entity or its employees (who will not be members of the AICPA) from serving as an officially appointed registrar in Australia with respect to securities not listed on U.S. exchanges.

8.9 The services will not impair the appearance of the Merged Firm's independence in relation to Telstra The Commission has stated that the appearance of independence is to be judged from the perspective of a reasonable investor, knowing all relevant facts and circumstances. We believe that the facts and circumstances described herein mitigate any perceived threat to the independence of the Merged Firm, and that a reasonable investor would not perceive any impairment. In this regard, we note particularly that the Australian Securities Commission sanctions the provision of share registry services to audit clients, and that the Bank of New York, not the SRS Entity, will serve as Telstra's transfer agent with respect to Telstra securities traded in the United States. In light of these

and the other mitigating facts and circumstances described herein, we believe that a reasonable investor would perceive the Merged Firm as having neither mutual nor conflicting interests with Telstra, and as exercising objective and impartial judgment on all issues brought to its attention.

**9. The Proposed 12-Month Period Reflects the Particular Facts and Circumstances Presented Here and is Consistent with Analogous Guidance**

9.1 The proposed 12-month period is necessary to assure C&L Australia sufficient time to divest the share registry practice. The primary divestment option is to conduct a trade sale, in which the share registry practice would remain intact under new ownership not affiliated with the Merged Firm. C&L Australia hopes to approve a trade sale by mid-August 1998. The second divestment option, to be pursued if a trade sale is not achieved, is to conduct a public offering of the share registry business. If such an offering becomes necessary, C&L Australia would expect to conduct it by mid-April 1999. The proposed divestiture period would grant C&L Australia an additional ten weeks beyond mid-April 1999, a modest extension intended to account for possible delays in the divestiture process A timetable reflecting these two divestment options is attached as Appendix C1.

9.2 The timetable outlining the two divestment options reflects a schedule shorter than the one required to resign the registry engagements. Specifically, C&L Australia believes that, while it could notify TIRT, the ESOP Trustee and Telstra as of the Merger Date of its intent to resign the share registry engagements, it could not responsibly resign until mid-May 1999. That is because any plan of resignation must recognize the

absence of viable alternative service providers in the short term, and the clients' imperative that the Share Transfer in early December 1998 and a dividend payment in March or April 1999 not be disrupted. In this regard, it should be noted that (i) Telstra could face exposure to substantial liability if the Share Transfer is not executed properly, (ii) a successful Share Transfer is in the interests of the Commonwealth, as well as TIRT and Telstra, and (iii) as noted in section 8.2, the potential threat to the independence of the Merged Firm does not arise prior to the Share Transfer. Accordingly, C&L Australia's resignation plan provides for finalization of the resignation process after issues related to the Share Transfer and dividend payment have been resolved. A timetable reflecting the resignation option is attached as Appendix C2.

9.3 The proposed 12-month period is within a range of transition periods allowed in similar situations by the SEC and other regulatory agencies.

9.3.1 The Commission's independence requirements do not specifically discuss transitional arrangements designed to address issues that arise as the result of a merger of two accounting firms, and no controlling precedent exists as to what constitutes a reasonable approach to such issues. However, both Rule 2-01 and other Commission pronouncements stress the need to consider all the facts and circumstances bearing on a particular independence question. In addition, the Office of the Chief Accountant ("OCA") has indicated in a series of no-action letters that it would not question the independence of an accounting firm with respect to an audit client

for which the firm had performed, on a temporary or emergency basis, certain services that might otherwise raise independence concerns.

(a) For example, in *William I. Minoletti & Co., P.C.*,[20] the OCA expressed the view that it would not consider a firm's independence impaired where, as a result of a change in an audit client's ownership and location, the firm assisted the client for a period of approximately *one year* in the preparation of monthly financial statements and the computation of financial data. An auditor's preparation of a client's financial statements poses a more obvious independence problem than does the maintenance of shareholder registers, which does not involve the preparation or review of accounting records. Nevertheless, the OCA permitted the firm to prepare its client's financial statements for twelve months.

(b) Similarly, in *Adler Blanchard & Co.*,[21] the OCA indicated that it would not question the independence of a firm that provided "limited and mechanical" bookkeeping services to an audit client over an eight-month period. The firm had provided the services as a "temporary

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20 SEC No-Action Letter [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,632 at 78,922 (Mar. 27, 1984).

21 SEC No-Action Letter [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,929 at 78,669 (Mar. 11, 1991).

solution" in anticipation of the client's establishment of an in-house bookkeeping function.[22]

(c) In a third no-action letter, *Stanton, Magedanz, Edens & Co.*,[23] the SEC Staff declined to question a firm's independence where, in response to an emergency created by the resignation of an audit client's chief financial officer and the illness of an accounting clerk, the firm assisted the client for a two-month period in the preparation of monthly financial statements and performed additional consulting services.[24]

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22 *Id.* at 78,670.

23 SEC No-Action Letter [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,114 at 76,552 (June 17, 1985).

24 *See also Caldwell, Becker, Dervin, Petrick & Co.*, 1995 SEC No-Act LEXIS 909 (May 10, 1995) (Staff would not question the independence of a firm that provided general bookkeeping and record keeping services for a two-month period to an audit client whose bookkeeper had taken a sudden leave of absence for medical reasons).

While the OCA has indicated in this series of no-action letters that accounting firms may provide certain otherwise prohibited services on a temporary basis, it has not defined the parameters of a "temporary" period of time. In adopting, and then maintaining in place, "temporary rules" under the federal securities laws in other contexts, however, the Commission has affirmatively demonstrated that the concept of "temporary" is relative and flexible. Examples include the "temporary" rules and regulations adopted by the Commission under the Williams Act in 1968. *See* EXCHANGE ACT REL. No. 8370 (July 30, 1968), *as amended by* EXCHANGE ACT REL. No. 8392 (Aug. 30, 1968), *and further amended by* EXCHANGE ACT REL. No. 9060 (Jan. 18, 1971). These temporary rules and regulations were not replaced with "final" rules until *14* years later. *See* EXCHANGE ACT REL. No. 18524 (March 3, 1982). *See also* INVESTMENT COMPANY ACT REL. No. 18158 (May 20, 1991) (proposal to rescind two "temporary" rules adopted *11* years earlier which exempted certain money market funds from registration); SECURITIES ACT REL. No. 6873 (Aug. 14, 1990) (adoption of two-year extension of "temporary" rule adopted six years earlier which permitted various filing fees to be remitted to a U.S. Treasury lockbox located in Pennsylvania); INVESTMENT COMPANY ACT RULE 3a-2, 17 C.F.R. § 270.3a-

(d) In addition, the Codification includes two examples of circumstances under which an accounting firm may temporarily perform services considered inappropriate in other circumstances. Example 6 under Section 602.02.c.ii of the Codification states that an accounting firm's independence would not be impaired where the firm assisted an audit client with its year-end bookkeeping after the unexpected resignation of the client's comptroller, provided that the firm did not assume managerial responsibilities for the client.[25] Similarly, Example 12 under Section 602.02.g of the Codification indicates that, in an emergency or temporary situation, an accounting firm could rent time on the firm's computer to an audit client without adversely affecting the firm's independence.[26]

(e) While these examples and no-action letters do not specifically address independence issues that arise as a result of a merger between two accounting firms, they are consistent with the Commission's position, as stated

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2 (1998) (exempting "transient" investment companies from the requirements of the Investment Company Act of 1940 and the rules and regulations promulgated thereunder for a period of one year).

25 *See* 7 Fed. Sec. L. Rep. (CCH) ¶ 73,264 at 62,891.

26 *See* 7 Fed. Sec. L. Rep. (CCH) ¶ 73,272 at 62,906.

elsewhere in the Codification, that determinations as to an accountant's independence must be made "in the light of all the pertinent circumstances in the particular case." Moreover, these no-action letters broadly illustrate that the Commission and its Staff have distinguished between independence issues that arise in the ordinary course of an accounting firm's activities and those which arise in unusual circumstances, and they recognize that restrictions which may normally be considered necessary are not warranted in extraordinary circumstances, where independence policies tailored to the exigencies of the specific situation are more appropriate.

9.3.2 In assessing the reasonableness of C&L Australia's approach to independence issues arising with respect to Telstra solely as a result of the Merger, analogies also can be made to other situations involving business combinations or other exceptional events in which courts and regulatory agencies have recognized that entities may employ transitional arrangements to address unusual circumstances, while ensuring compliance with the fundamental policies underlying applicable laws and regulations. Several of these analogies, drawn principally from other areas of securities and banking regulation, are discussed in Appendix D.

9.3.3 In assessing the reasonableness of the requested period for divestiture, it should be

noted that, in *Western Mining*, the SEC Staff retroactively accepted *five years'* worth of filings made by Western Mining Corporation while its auditor served (not as a consequence of a merger but in the ordinary course of business) as share registrar. In addition, the SEC Staff granted the auditor a period of at least eight months to resign the share registry engagement, which we understand involved a stable register of only 100,000 shareholders.[27] Here, the potential independence issue arises solely as a result of the anticipated Merger. Furthermore, the issue centers upon a register undergoing major changes and containing over 1.5 million Instalment Receipt holders. Under these circumstances, we believe that a 12-month divestiture period is entirely reasonable.

## 10. Reliance on Guidance from the ISB Staff

10.1 We understand that parties directly affected by an interpretation issued by the Staff of the Independence Standards Board may rely upon the interpretation.

10.2 Financial Reporting Release ("FRR") No. 50 provides that, "[p]ositions issued by the ISB staff to a particular party . . . *may be relied upon by that party* in accordance with the ISB Operating Policies."[28]

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27 The letter summarizing the Staff's position is dated November 1, 1993. The Staff required the auditor to resign the share registry engagement "no later than the time of the commencement of the year-end audit phase for the year ended June 30 1994." We understand that the year-end audit phase would have commenced no sooner than July 1, 1994, thus permitting the auditor at least eight months to resign the share registry engagement.

28 FRR No. 50, 7 Fed. Sec. L. Rep. (CCH) ¶ 72,450 at 62,309 n.11 (Mar. 26, 1998) (emphasis supplied).

10.3 The ISB Operating Policies, in turn, provide that, "[a]bsent express ratification by the Board, ISB staff interpretations will be considered as applying only to the particular parties directly affected by the interpretation, *who may rely on such interpretation*."[29]

10.4 In sum, an ISB Staff interpretation may be relied upon by the parties directly affected by it. In addition to C&L Australia, the parties directly affected by the ISB Staff interpretation in this matter are PW Australia, TIRT, the ESOP Trustee, Telstra and the Commonwealth. These parties intend to rely on the Staff's interpretation.[30]

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29 ISB Operating Policies, Art. 3, § IV (emphasis supplied).

30 FRR No. 50 provides that "[t]he Commission also retains ultimate authority to not accept, or to modify or supplement, ISB independence standards and interpretations in the same manner that the Commission can modify or supplement accounting standards and interpretations issued by the FASB." FRR No. 50, 7 Fed. Sec. L. Rep. (CCH) ¶ 72,450 at 62,308 (Mar. 26, 1998). Given the statements in FRR No. 50 and the ISB Operating Policies regarding reliance on ISB Staff interpretations, we understand that a decision by the Commission not to accept an interpretation would affect only the reliance of third parties, not that of the parties directly affected by the interpretation.

## 11. Conclusion

11.1 C&L Australia has concluded (and PW Australia has concurred) that the Merged Firm's independence in relation to audit work in connection with Telstra's financial statements performed before and after the Merger will not be impaired (i) as a result of the provision of share registry services by the SRS Entity to TIRT and the ESOP Trustee, or (ii) as a result of the provision of share registry services by the SRS Entity to Telstra prior to the close of its fiscal year ending June 30, 1999. In particular, C&L Australia has concluded (and PW Australia has concurred) that the Merged Firm's independence will not be impaired with respect to registration statements, forms and reports filed by Telstra with the SEC during this period. We seek your concurrence with these conclusions and our understanding of the reliance that may be placed by parties directly affected by an ISB Staff interpretation on such interpretation.

Sincerely,

David E. Birenbaum

DC02:131959.08

**DRAFT REQUEST FOR INTERPRETATION / ADVICE**

## 1. Person seeking advice


| | | |
|---|---|---|
| 1.1 | Name of person seeking advice: | Tony Harrington |
| 1.2 | Position: | Deputy Chairman |
| 1.3 | If not partner, was a partner consulted: | N/A |
| 1.4 | Firm/Employer: | Coopers & Lybrand |
| 1.5 | Address: | 333 Collins Street |
| 1.6 | City: | Melbourne |
| 1.7 | State/Province: | Victoria |
| 1.8 | Zip/Postal Code: | 3000 |
| 1.9 | Country: | Australia |
| 1.10 | Daytime Phone: | (61 3) 9633-3311 |
| 1.11 | Fax: | (61 3) 9633-3275 |


## 2. Summary description of inquiry

2.1 Would the continued provision of share registry services by Coopers & Lybrand ("C&L Australia") to an Australian audit client of Price Waterhouse ("PW Australia") for a limited period subsequent to the merger of the two firms (creating the "Merged Firm") impair the Merged Firm's independence with respect to that client?

## 3. Facts

3.1 C&L Australia provides certain share registry services in Australia to Telstra Corporation Limited, an Australian company registered with the Securities and Exchange Commission (the "SEC" or "Commission") and owned two-thirds by the Commonwealth of Australia (the "Commonwealth"). The Commonwealth commenced the privatization of one-third of Telstra in November, 1997 and may conduct a further offering of Telstra shares (possibly before the end of the year). In connection with such an offering, Telstra would file a Form F-1 or F-2 with the Commission. Telstra will also file a Form 20-F annual report with the Commission in September or October this year and may conduct a

registered debt offering late this year or early next year.

3.2 C&L provides certain registry services to Telstra Instalment Receipt Trustee Limited ("TIRT"), a trustee established by the Commonwealth to facilitate the partial privatization of Telstra. TIRT presently holds one-third of Telstra's shares in trust for holders of Telstra Instalment Receipts, which are traded on the Australian Stock Exchange (the "ASX") (American Depositary Receipts ("ADRs") are traded on the New York Stock Exchange). Instalment Receipt holders will make the second of two scheduled payments for Telstra shares on November 17, 1998. Thereafter, likely in early December, 1998, TIRT will transfer the Telstra shares to the Instalment Receipt holders (the "Share Transfer").

3.3 C&L provides certain registry services to Telstra ESOP Trustee Pty Limited, a trustee established by Telstra to administer its employee share ownership plan (the "ESOP Trustee").

3.4 PW Australia performs audit services for Telstra under contract with Telstra's auditor in Australia, the Auditor General of Australia, and serves as Telstra's auditor in connection with its filing with the SEC of registration statements, forms and reports under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). PW does not serve as the auditor of TIRT or the ESOP Trustee. The Auditor General serves as auditor of those entities, as well as Telstra.

3.5 C&L will transfer the share registry line of business to a new entity (the "SRS Entity") prior to the Merger. The SRS Entity will be owned by the present partners of C&L but will not be included in the Merged Firm. The present partners of C&L will play no role with respect to audit services performed for Telstra. PW partners will retain sole responsibility for those services.

3.6 C&L presently is pursuing a plan to divest its share registry business within a reasonable and limited period not to extend beyond the end of Telstra's fiscal year on June 30, 1999. Telstra and C&L seek to avoid any precipitous disruption of service in connection with the divestment, particularly during a period when the Commonwealth may conduct a

further offering of Telstra securities.

## 4. Relevant literature

4.1 Auditor Independence Generally

4.1.1 Rule 2-01 of Regulation S-X

4.1.2 Section 600 of the Codification of Financial Reporting Policies (the "Codification")

4.1.3 Rule 101 of the AICPA's Code of Professional Conduct

4.2 Share Registry Services

4.2.1 Levitz, Zacks & Ciceric, SEC No-Action Letter, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,925, at 78,666 (Dec. 17, 1992)

4.2.2 Section 602.02.c.ii of the Codification, Example 3

4.2.3 AICPA Interpretation 101-3

4.2.4 AICPA Ethics Ruling 39

4.2.5 Western Mining correspondence

4.3 Temporary" or "Emergency" Arrangements under SEC Independence Requirements

4.3.1 William I. Minoletti & Co., P.C., SEC No-Action Letter, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,632 at 78,922 (Mar. 27, 1984).

4.3.2 Adler Blanchard & Co., SEC No-Action Letter, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,929, at 78,669 (Mar. 11, 1991).

4.3.3 Stanton, Magedanz, Edens & Co., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,114, at 76,552 (June 17, 1985).

4.3.4 Caldwell, Becker, Dervin, Petrick & Co., 1995 SEC No-Act LEXIS 909 (May 10, 1995).

4.3.5 Section 602.02.c.ii of the Codification, Example 6

4.3.6 Section 602.02.g of the Codification, Example 12

## 5. Proposed response

5.1 The provision of share registry services by the Merged Firm to Telstra, TIRT and the ESOP Trustee for a limited period of time not to extend beyond June 30, 1999 would not impair the Merged Firm's independence with respect to audit work performed subsequent to the merger related to financial statements included in registration statements, forms and reports filed with the SEC under the Securities Act or the Exchange Act.

## 6. Supporting rationale

- TIRT and the ESOP Trustee

6.1 The provision of share registry services to TIRT and the ESOP Trustee would not give rise to any potential for self-review.

6.1.1 Neither TIRT, nor the ESOP Trustee, is an audit client of PW or C&L or will be an audit client of the Merged Firm. Rather, the Auditor General serves as the auditor of both entities.

6.1.2 The financial accounts of TIRT and the ESOP Trustee will not be consolidated with those of Telstra.

6.1.3 The records maintained by C&L in relation to registry services provided to TIRT and the ESOP Trustee (i) do not form the basis for the preparation or review of accounting entries or financial

records of Telstra, (ii) have no bearing on the financial statements of Telstra, and (iii) are not accounting records.

6.2 The services provided to TIRT and the ESOP Trustee do not involve the assumption of managerial responsibilities of Telstra, because Telstra does not manage either entity. Both entities are managed independently of Telstra. The fiduciary obligations of TIRT and the ESOP Trustee are owed to trust beneficiaries, not to Telstra. TIRT owes its fiduciary obligations to Instalment Receipt holders, who possess rights similar to those of shareholders (e.g., voting rights, rights to distributions). The ESOP Trustee owes its fiduciary obligations to participants in Telstra's employee share ownership plan (prior to the Share Transfer, to participating employees holding instalment receipts and, thereafter, to employee shareholders to the extent of payment of the second instalment).

- Telstra

6.3 Potential independence issues relating to Telstra would not arise until early December, 1998, when TIRT transfers the Telstra shares to the Instalment Receipt holders. Maintenance of the Telstra share register will be merely a formality prior to that time, because the register will list only two shareholders: the Commonwealth and TIRT.

6.4 Independence is not impaired after the Share Transfer, because:

6.4.1 C&L Australia partners are currently pursuing a plan to divest the share registry practice within a reasonable and limited period not to extend beyond the end of Telstra's fiscal year on June 30, 1999. In this regard, C&L Australia has retained an adviser, prepared an information memorandum, and initiated contact with a number of potential purchasers.

6.4.2 No partner of the Merged Firm other than present partners of C&L Australia will derive any benefit from the provision of share registry services to Telstra. This is because C&L Australia will transfer the share registry line of business to the SRS Entity prior to the Merger. The SRS Entity will be owned by the present

partners of C&L Australia. Further, the present C&L Australia partners will be walled off from any audit services performed for Telstra. Such services will be the sole responsibility of the former PW partners. Thus, the partners who provide audit services to Telstra will not derive any benefit from the share registry engagement. The segregation of audit and share registry partners, together with the other factors we have outlined, mitigates any potential threat to independence.

6.4.3 The ASX advises registrars electronically of share transfers arising from market trades. Such transfers are expected to account for 99.7% of the changes in volume on the Telstra share register. The ASX also retains independent auditors (KPMG) to review the reliability and integrity of its electronic settlement system and share transfers arising from market trades. The audit team (i.e., the former PW personnel) will rely on the opinion of the Auditor General, which in turn relies on the opinion of KPMG, with respect to these transfers.

6.4.4 The SRS Entity will perform data entry with respect to non-market transfers only, which will account for a de minimis percentage (0.3%) of the changes in volume on the Telstra share register.

6.4.5 If divestiture has not occurred prior to the Share Transfer, the SRS Entity will provide share registry services to Telstra for only a limited period which will not extend beyond June 30, 1999, so that the divestiture may be completed in an orderly fashion.

6.4.6 The SEC Staff advised C&L Australia to cease providing share registry services to an audit client, Western Mining Corporation, in 1993. As will be evident from a review of the correspondence in *Western Mining*, the facts and circumstances considered there are clearly distinguishable from those presented in paragraphs 6.3 through 6.4.5. It should be noted further that, C&L Australia had provided both share registry and audit services to Western Mining Corporation for an extended period of time, as contrasted with the situation here where the issue arises only as result of a merger and

a limited transitional period is contemplated during which the shareholder registry services practice will be divested.

- The Appearance of Independence

6.5 The Commission has stated that the appearance of independence is to be judged from the perspective of a reasonable investor, knowing all relevant facts and circumstances. We believe that the facts and circumstances described herein mitigate any potential threat to independence, and that a reasonable investor would not perceive any impairment. In this regard, we note particularly that the Australian Securities Commission sanctions the provision of share registry services to audit clients, and that the Bank of New York, not C&L Australia, serves as Telstra's transfer agent with respect to ADRs traded on the New York Stock Exchange. In light of these and the other mitigating facts and circumstances described herein, we believe that a reasonable investor would perceive the Merged Firm as having neither mutual nor conflicting interests with Telstra and as exercising objective and impartial judgment on all issues brought to its attention.

**7. Alternatives considered and why rejected**

7.1 C&L and PW considered continuing both share registry services and audit services on a long-term basis. The firms rejected this option for a number of business reasons.

**8. If confidential treatment requested, explain why it should be granted**

8.1 We request confidential treatment of this matter because (i) C&L's discussions with the ISB Staff, (ii) C&L's plans to divest the share registry business, and (iii) Telstra's plans with respect to further securities offerings, constitute confidential commercial or financial information, the public disclosure of which could cause harm to C&L and Telstra and interfere with the orderly divestiture of the share registry business.

## 9. Expedited Consideration

9.1 We request expedited consideration of this Request for Interpretation/Advice. As indicated, the issue will arise when the merger takes effect in July, 1998. Telstra wishes to be assured as to the Merged Firm's independence well in advance of that date. Accordingly, favorable action is sought by the end of May, 1998.

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