CURRENCY

Committee on Financial Services

Michael G. Oxley, Chairman

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Oxley, Baker to Introduce Corporate and Auditing Accountability, Responsibility, and Transparency Act

Today, House Financial Services Committee Chairman Michael G. Oxley (OH), along with Capital Markets Subcommittee Chairman Richard H. Baker (LA) will introduce legislation to restore investor confidence in the accounting profession and capital markets in response to the Enron collapse.

"We have before us a challenge to move meaningful reforms, but the scope of the bill and the scope of our work are greater than any one company," Oxley said. "Our approach is both responsible and responsive. It will help to prevent future Enrons without crushing the entire business sector with endless government. All businesses are not to blame for the excesses of one."

In brief, the bill – the Corporate and Auditing Accountability, Responsibility, and Transparency Act (CARTA) -- would ensure auditor independence through new firewalls and a public oversight board for accounting of publicly traded companies. Companies would have to provide more public information about their financial health in real time. The legislation would beef up the Securities and Exchange Commission's (SEC) budget by almost half to enable it to perform more oversight, and it would be directed to step up audit reviews of large companies.

"This bill represents a great first step towards increasing auditor accountability and improving corporate financial reporting, both of which are essential for restoring confidence in the capital markets," said Baker. "As we move forward, we may need to consider additional measures, but it is crucial that we move quickly with the substantial measures included in this bill."

Restoring Confidence in Accounting

America needs a strong, vibrant, and healthy accounting industry to keep companies financially sound and to provide investors with solid information. New firewalls and increased oversight will ensure independent reviews of company books.

- **Auditor Independence.** The bill would prohibit firms from offering certain controversial consulting services to companies they're also auditing.

- **New Oversight Body.** The legislation would establish a new, public regulatory board with strong oversight authority. "Public regulatory organizations" (PROs), which would be under the direct authority of the SEC, would be made up of two-thirds public members (those not associated with the accounting industry).

- **PRO Powers.** A PRO would have to certify any accountant wishing to audit the financial statements required from public issuers of stock. Additionally, publicly traded companies would be responsible for ensuring that their accounting firms were in good standing and for having their financial statements certified by the PRO. An accountant or accounting firm disqualified by a PRO could be prohibited from certifying financial statements. The PRO would have the statutory authority to punish accountants who violate securities laws, standards of ethics, competency, or independence.

Increasing Corporate Disclosure and Responsibility

Because investors of all types rely on information to make their financial decisions, the bill would increase the amount of real-time information made available to American investors, employees, and the public in general.

- **Off-Balance Sheet Disclosure.** Off-balance sheet transactions, such as the special-purpose entities made famous by Enron, would have to be fully disclosed. Corporate insiders would be required to immediately inform the SEC (next business day) and the public (second business day) when they sell their own company stock, rather than waiting up to 40 days as allowed under today's regulations.

- **Real-Time Public Information.** Companies would be required to disclose information about their financial health more quickly and in plain English making it more useful and relevant for investors. Currently such disclosures can take days to become public.

- **No Interference With Audits.** It would be made unlawful for anyone associated with a company to interfere with the auditing process.

Protecting 401(k) Plans

- **No Insider Sales During Blackouts.** Corporate executives would be prohibited from buying or selling company stock during any period where 401(k) plan participants are unable to buy or sell securities, for example during administrative blackout periods.

Strengthening the SEC

- **Budget Increase.** The SEC's budget would be boosted by almost half, increased from $480 million to $700 million, to enable it to perform the additional tasks and oversight required by the bill.

- **More Audit Reviews.** The SEC would be required to conduct regular and thorough reviews of the largest and most widely traded companies. The Commission would also be required to analyze its enforcement actions over the past five years looking for areas of reporting which may be susceptible to fraud or manipulation.

Reducing Analyst Conflicts of Interest

- **SEC Oversight of New Rules.** In two hearings held last summer, Baker's subcommittee questioned market participants, academics, consumer groups, media and industry representatives on analyst independence. The hearings confirmed that Wall Street research practices were in need of reform and that investors were not receiving the unbiased research needed to make responsible investment decisions.

- Following last week's announcement by the NASD and NYSE to require additional disclosures and crack down on conflicts of interest in Wall Street research, the SEC would be required to study the new regulations and report to Congress on the effectiveness of the rules and annually update such review.

Additional Studies

- **Corporate Information Disclosure.** The SEC would study whether additional corporate information disclosures are necessary. The agency would specifically examine where conflicts of interest may exist, which accounting principles are most vital to a company's financial state, and how fair value accounting forecasts are used in complex derivatives transactions.

- **Credit Rating Agencies.** The role of credit rating agencies in the securities markets and whether there are impediments to accurate analysis or conflicts of interest would also to be studied by the SEC.

- **Corporate Governance.** The President's Working Group on Financial Markets would study current corporate governance standards and whether they are sufficiently serving and protecting investors.

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Chairman Michael G. Oxley
February 13, 2002 CARTA News Conference Talking Points

- Our bill introduction today is the product of months of work by the Financial Services Committee. We already have had three hearings on the Enron collapse. Our committee was the first to have Enron hearings, last December. Dean Powers unveiled his report to the Enron board before us last week.

- We also have taken great care not to interfere with the comprehensive investigations being conducted by the Department of Justice and the SEC. Wrongdoing is determined in the courts, and that's what will happen in the Enron case.

- Our duty in Congress is to fix the problems raised in the cases of Enron, Global Crossing and others.

- Our overall goal is to improve the public's confidence in the capital markets and strengthen the overall financial system. The free market system must emerge stronger from the actions we take. That's what President Bush was talking about in the State of the Union address when he talked about corporate responsibility. And, that's what we're doing today in this bill.

- The legislation we introduce today is a crucial part of our work. But, legislating will not be our only way of addressing these problems. We also need to work directly with the private sector, just as we did last week to help eliminate financial analysts' conflicts of interest.

- We are addressing the core issues that will prevent future Enrons. But, we're not going to crush the entire business sector by putting government in the boardroom. Those who think legislation is the answer to every problem would only gum up the works and make it impossible for the markets to function properly.

- This legislation meets our responsibility to shareholders and employees of publicly traded companies, who deserve to know more---and know it in real time---about a companies' financial health. Let's make solid information available in real time, and everyone can make his own financial decisions from there.

- Our legislation would provide the SEC and a new, public body with direct oversight of the accounting industry, taking care to construct appropriate firewalls to prevent conflicting interests. Let's not forget that we need a strong, healthy, and vibrant accounting industry to provide us with accurate and independent information.

- It's time we get to practical and constructive solutions that will help.

Section-by-Section Analysis

Section 1. Short Title

Designates this title as the "Corporate and Auditing Accountability, Responsibility and Transparency Act of 2002."

Section 2. Auditor Oversight.

The federal securities laws, and the rules and regulations thereunder, require that certain financial statements of public companies be certified by an independent public or certified public accountant and filed with the Securities and Exchange Commission (the "Commission"). Section 2 amends the Securities Exchange Act by inserting after Section 10A (15 U.S.C. 78j-1) a new section, 10B, that requires the establishment of a public regulatory organization ("PRO") to perform certain review and disciplinary functions with respect to accountants who certify those financial statements. Section 2 provides that the Commission shall not accept any such financial statement unless the certifying accountant (1) is subject to a system of review by a PRO established in accordance with the Section and (2) has not been determined in the most recent such review to be not qualified to certify the statements.

Section 2 requires the Commission to adopt rules establishing criteria by which an organization may become a "recognized PRO." Section 2 specifies certain criteria that must be included. The board of any PRO must include members of the accounting profession and "public members" who are not members of the accounting profession. At least two-thirds of the board members must be public members. A PRO must also be organized, and have the capacity, to enforce compliance by accountants, and persons associated with accountants, with the provisions of the Exchange Act, the rules and regulations thereunder, and the PRO's own rules. A PRO must also be organized, and have the capacity, to review accountants' work product and to review potential conflicts of interest involving accountants.

A PRO must have in place procedures to minimize, deter, and resolve conflicts of interest involving its board members. A PRO must also publicly disclose, and make available for public comment, its proposed review procedures and methods. A PRO must consult with State boards of accountancy and must have in place procedures for notifying those boards and the Commission of the results and findings of the PRO's reviews. Finally, a PRO must have in place a mechanism that will allow the PRO to function on a self-funded basis, but that mechanism must not rely principally on the receipt of fees from members of the accounting profession.

An organization that satisfies the criteria to be a recognized PRO is granted the authority to impose sanctions against the accountants it reviews. Those sanctions may include a determination that an accountant is not qualified to certify a financial statement, or certain categories of financial statements, or that a particular person associated with an accountant is not qualified to participate in the certification of a financial statement or certain categories of financial statements. These sanctions may be imposed only after the PRO has conducted a review and provided an opportunity for a hearing and has made any of the following findings: that the accountant or associated person (1) violated professional standards of independence, ethics, or competency; (2) violated the federal securities laws or a rule or regulation thereunder; (3) conducted an audit under circumstances in which independence standards were violated, (including new independence standards which Section 2 requires the Commission to adopt, as discussed below); or (4) impeded, obstructed, or failed to cooperate with the PRO's review.

Section 2 requires the Commission to revise its regulations to provide that, for financial statements required to be certified by an independent public or certified public accountant, an accountant

will not be considered independent of its audit client if it provides that client with financial information system design or implementation services or internal audit services. The Commission is required to make such revisions within 180 days of the enactment of Section 2.

Section 2 sets out certain procedures to govern the PRO review and hearing process, and procedures for Commission review of PRO proceedings. A PRO's review proceedings and findings are protected from discovery or use in any federal or state court civil proceeding and are also exempt from disclosure under the Freedom of Information Act before the completion of any Commission review of the findings or the conclusion of the period in which to seek such review. The Commission is authorized to review PRO findings and sanctions and is authorized to affirm, modify, or set aside the sanctions. Commission review shall include an opportunity for a hearing, though the Commission may limit the hearing solely to consideration of the record before the PRO and the opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction.

A recognized PRO is required to file with the Commission any proposed rule or rule change. The Commission shall publish notice of the proposed rule and give interested persons an opportunity to comment. The Commission shall approve any such proposed rule if the Commission finds that the proposal is consistent with the requirements of the Securities Exchange Act and the relevant rules and regulations thereunder. Certain categories of rules may be given effect immediately upon being filed with the Commission, although the Commission has the authority to summarily abrogate any such rule and require that it be filed as a proposed rule for notice and comment. The Commission is also authorized to abrogate, add to, or delete from the rules of a PRO on the Commission's own initiative after publishing notice and giving interested persons an opportunity to submit data, views, and arguments on the proposal.

Section 3. Improper Influence on Conduct of Audits

Section 3 makes it unlawful for any officer, director, or affiliated person of an issuer to take any action, in contravention of rules adopted by the Commission, to unduly or improperly influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in auditing that issuer's financial statements.

Section 4. Real-Time Disclosure of Financial Information.

Section 4 amends Section 13 of the Securities Exchange Act (15 U.S.C. 78m), to require the Commission to adopt rules requiring issuers of securities registered under Section 12 of that Act to make public disclosure, on a rapid and essentially contemporaneous basis, of information concerning the issuer's financial condition and operations. Section 4 provides, however, that any failure to make any such required disclosure shall not, standing alone, constitute a violation of Rule 10b-5 under the Act.

Section 4 also provides that the Commission shall adopt rules providing that any disclosure required by the Federal securities laws, or rules or regulations thereunder, concerning any sale of securities by an officer, director, or other affiliated person of the issuer of the securities shall be made electronically to the Commission before the end of the business day following the day of the transaction, and shall be made available electronically by the Commission before the end of the business day following the day received by the Commission. Any issuer that maintains a corporate web site is also required to publish such disclosure, by any of its officers, directors, or affiliated persons, on its web site by the end of the day following the day the disclosure is received by the Commission. The Commission shall revise its forms and schedules as necessary to facilitate compliance with these requirements.

Section 5. Insider Trades During Pension Fund Blackout Periods Prohibited

Section 5 makes it unlawful for the directors, officers or principal stockholders of an issuer of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) to purchase or sell any equity securities of the company during a blackout period. A principal stockholder is one who holds, directly or indirectly, beneficial ownership of more than 10% of any class of equity securities registered pursuant to Section 12.

A blackout period is a period during which the employees of the issuer are not permitted to trade equity securities of the issuer held in an individual account plan of the issuer, as such a plan is defined in Section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34)). A blackout period does not include periods of restricted trading where express restrictions are incorporated into the individual account plan, and are disclosed in a timely manner to employees before joining the plan, or as a subsequent amendment to the plan.

Section 5 also provides for recovery, by the issuer, of any profit resulting from a trade made in violation of this provision, and permits the Commission to issue rules implementing the section.

Section 6. Improved Transparency of Corporate Disclosures

Section 6 requires the Commission to revise its regulations under Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), within 180 days, to expand the disclosure requirements for the financial reports and registration statements of public companies, so that they provide adequate and appropriate disclosure of certain of an issuer's off-balance sheet transactions and relationships. Section 6 requires these new disclosures to the extent that the transactions or relationships are not otherwise disclosed in the issuer's financial statements, and are reasonably likely to materially affect the issuer's liquidity or capital resources, or otherwise expose the issuer to material current or possible future liability, obligations, expenses or changes in cash flow, or affect revenue recognition, carrying value, credit ratings, earnings, stock price, or cash flows, or potentially impair assets. Issuers must also disclose relationships and material transactions with related or other persons that involve terms materially different from those that would likely be negotiated with a third party.

The disclosures must include a description of the elements of the transactions necessary to understand their business purpose, economic substance, effect on the financial statements and any special risks or contingencies arising from them.

Section 6 also requires the Commission to conduct an analysis of the extent to which disclosure of additional or reorganized information may be required to improve the transparency, completeness or usefulness of financial statements and other disclosures. In its analysis, the Commission must consider requiring the identification of the key accounting principles that are most important to the issuer's reported financial condition or results of operation, and that require the most difficult, complex or subjective judgments by management. The Commission must also consider requiring an explanation, when material, of how different available accounting principles applied, along with the judgments made in their application and the likelihood of materially different reported results if different assumptions were to prevail. In addition, the Commission must consider requiring an explanation of trading activities were an issuer engages in the business of trading non-exchange traded contracts, accounted for at fair value, but where a lack of market price quotations necessitates the use of fair value estimation techniques. Finally, the Commission must consider establishing requirements relating to the presentation of information in plain language, and requiring any other disclosures in financial statements or other disclosure documents that would improve transparency.

Section 7. Study of Rules Relating to Analyst Conflicts of Interest

Section 7 requires the Commission to conduct a study and review of any final rules by any self-regulatory organization registered with the Commission, related to matters involving equity research analyst conflicts of interest. The study must include a review of the effectiveness of the final rules in addressing matters of objectivity and integrity of equity research analyst reports and recommendations. Section 7 also requires the Commission to submit a report on its study and review to Congress within 180 days of the delivery of the final rules to the Commission, with annual updates thereafter. The report to Congress must include recommendations, including any recommendations for additional self-regulatory organization rulemakings regarding equity research analysts.

Section 8. Oversight of Financial Disclosures

Section 8 requires the Commission to set minimum periodic review requirements to ensure that issuers with the most actively traded or widely held securities, or the largest market-capitalization, will be regularly and thoroughly reviewed by the Commission. Such reviews may include substantive comments, when appropriate, on the issuer's financial statements and other disclosures. The Commission must report annually to Congress on its compliance.

Section 9. Review of Corporate Governance Practices

Section 9 requires the President's Working Group on Financial Markets to conduct a study and review of corporate governance standards and practices, to determine whether they serve the best interests of shareholders. In conducting the study, the Working Group must seek the views of and consult with State securities and corporate regulators, and must report on its analysis to Congress within 180 days of enactment.

The Working Group's study must include an analysis of (1) whether current standards and practices promote full disclosure to shareholders of relevant information; (2) whether corporate codes of ethics are adequate for shareholder protection; (3) the extent to which conflicts of interest are aggressively reviewed; (4) the extent to which sufficient legal protection exists to ensure that any manager who attempts to manipulate or unduly influence an audit is subject to appropriate sanctions and liability; (5) whether the rules, standards and practices relating to determining whether independent directors are in fact independent are adequate; (6) whether rules relating to the independence of directors serving on audit committees are adequate to protect investors and are uniformly applied; (7) whether the duties and responsibilities of audit committees should be established by the Commission; (8) and what further or additional practices or standards might best protect investors and promote the interests of shareholders.

Section 10. Study of Enforcement Actions

Section 10 requires the Commission to review and analyze all of its enforcement actions involving violations of securities law reporting requirements and all restatements of financial statements over the past five years. The purpose of the review is to identify the areas of reporting most susceptible to fraud, inappropriate manipulation or inappropriate earnings management, such as revenue recognition and the accounting treatment of off-balance sheet special purpose entities. The Commission must report its findings to Congress within 180 days of enactment, and use its findings to revise rules and regulations as necessary.

Section 11. Study of Credit Rating Agencies

Section 11 requires the Commission to conduct a study of the role and function of credit rating agencies in the operation of the securities markets, and report on the analysis to the President and Congress within 180 days of enactment. In conducting the study, the Commission must examine (1) the role of credit rating agencies in the evaluation of securities issuers, and the importance of that role to investors and the functioning of the securities markets; (2) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers; (3) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; (4) any barriers to entry into the business of acting as a credit rating agency and measures needed to remove such barriers; (5) and any conflicts of interests in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate their consequences.

Section 12. Reauthorization of Appropriations of the Securities and Exchange Commission

Section 12 aims to increase the Commission's budget in FY 2003 by nearly 50%, authorizing $700,000,000, of which not less than $134,000,000 shall be available for the Division of Corporation Finance and not less than $326,000,000 for the Division of Enforcement.

Section 13. Definition of Securities Laws

Section 13 defines "securities laws" under this Act to mean the Securities Act of 1933 (15 U.S.C. 77a et. seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et. seq.), the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et. seq.), the Investment Company Act of 1940 (15 U.S.C. 80a-1 et. seq.), the Investment Advisers Act of 1940 (15 U.S.C. 80b et. seq.), and the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et. seq.).